based on Hixon's improper actions with respect to her dealings with Halferty.

On June 6, 1994, Hixon sued Halferty, alleging breach of contract and other causes of action related to Halferty's disclosure of the information regarding the investments in violation of the confidentiality clause of the Forbearance Agreement. In a curious twist of events, Hixon was shot to death on March 2, 1997 while this case was pending. The trustee of her estate, Tom Cariveau, was substituted as plaintiff. The Sonoma County Superior Court ruled that the forbearance agreement was void as against public policy. Cariveau appealed.

The First District Court of Appeal affirmed the lower court's ruling that the nondisclosure clause is unenforceable as a public policy violation of the NASD's rules and the Securities Exchange Act of 1934. Justice James Marchiano wrote: "The only interest appellant identifies in support of the contract term is the general public policy in favor of promoting the settlement of disputes....Refusing to enforce the confidentiality clause does not affect the settlement of the dispute between Hixon and Halferty, but merely declines assistance to Hixon's concealment of her wrongdoing....The inclusion of a restrictive confidentiality clause in the Forbearance Agreement is not only directly connected to Hixon's misconduct, but is an instance of misconduct in itself....To permit Hixon's violations of rules and shield them from administrative review in an agreement to silence wrongdoing would undermine the public's confidence in the integrity of securities oversight. This type of secret settlement should not be left in some dark oubliette, leaving investors unprotected. To countenance this agreement would encourage future NASD violators to hide their misdeeds in a secret agreement free from the light of regulatory scrutiny."

As part of a settlement agreement in six-year-long litigation against it, DOC agreed in October 2000 to improve its Web site so as to assist investors who believe they are victims of securities fraud in filing complaints with the Department. In ***Farrar v. Department of Corporations***, No. BC137842 (Los Angeles County Superior Court), DOC was sued by investors of First Pension Corporation; the plaintiffs alleged that DOC had been given information regarding First Pension's long-running unlawful activities but failed to take action until the fraud scheme was detected by federal authorities. *Farrar* was later transferred to Orange County and consolidated with other civil fraud proceedings pending against First Pension, most of which settled after a jury found that First Pension's auditor, Coopers & Lybrand (now PricewaterhouseCoopers), was liable for misrepresenting First Pension's financial condition, concealing material information, and abetting the company's managers in the fraud; in related criminal action, three of the company's managers who admitted swindling 8,000 investors out of their savings are in federal prison. Under the settlement (in which DOC admitted to no wrongdoing), DOC agreed to inform the public on how to file complaints about suspected securities fraud and to maintain information on its Web site to help investors detect and report fraudulent investment schemes. Pursuant to the settlement, DOC has added links enabling consumers to download its complaint forms (thereafter, those forms must be completed and mailed to DOC); further, DOC's Web site links to the databases of national organizations, enabling investors to attempt to check out the disciplinary histories of their brokers, investment advisers, financial planners, and other money managers.

# Department of Insurance

*Commissioner: Harry W. Low ♦ (415) 538-4500 ♦ (916) 492-3500 ♦ (213) 897-8921 ♦ Toll-Free Consumer Hotline: 1-800-927-4357 ♦ Internet: www.insurance.ca.gov*

Insurance is the only interstate business wholly regulated by the several states rather than the federal government. In California, this responsibility rests with the Department of Insurance (DOI), organized in 1868 and headed (as of 1988) by an elected Insurance Commissioner. Insurance Code sections 12919 through 12938 set forth the Commissioner's powers and duties. Authorization for DOI is found in section 12906 of the 800-page Insurance Code; the Department's regulations are codified in Chapter 5, Title 10 of the California Code of Regulations (CCR).

The Department's designated purpose is to regulate the insurance industry in order to protect policyholders. Such regulation includes the licensing of agents and brokers, and the admission of companies to sell insurance products in the state. In California, the Insurance Commissioner licenses approximately 1,500 insurance companies that carry premiums of approximately $65 billion annually. Of these, 600 specialize in writing life and/or accident and health policies.

In addition to its licensing function, DOI is the principal agency involved in the collection of annual taxes paid by the insurance industry. The Department also collects more than 175 different fees levied against insurance producers and companies.

The Department also performs the following functions:

(1) it regulates insurance companies for solvency by triannually auditing all domestic insurance companies and by selectively participating in the auditing of other companies licensed in California but organized in another state or foreign country;

(2) it grants or denies security permits and other types of formal authorizations to applying insurance and title companies;

(3) it reviews formally and approves or disapproves tens of thousands of insurance policies and related forms annu-

ally as required by statute, principally related to accident and health, workers' compensation, and group life insurance;

(4) it establishes rates and rules for workers' compensation insurance;

(5) it preapproves rates in certain lines of insurance under Proposition 103, and regulates compliance with the general rating law in others; and

(6) it becomes the receiver of an insurance company in financial or other significant difficulties.

The Insurance Code empowers the Commissioner to hold hearings to determine whether brokers or carriers are complying with state law, and to order an insurer to stop doing business within the state. However, the Commissioner may not force an insurer to pay a claim; that power is reserved to the courts.

DOI has over 1,200 employees and is headquartered in San Francisco. Branch offices are located in Los Angeles, Sacramento, and San Diego. The Commissioner directs 21 functional divisions and bureaus, including the Consumer Services Division and the Fraud Division.

DOI's Consumer Services Division operates the Department's toll-free complaint line. Through its bureaus, the Division responds to requests for general information; receives, investigates, and resolves individual consumer complaints against insurance companies, agents, and brokers that involve violations of statute, regulations, or contractual provisions; initiates legislative and regulatory reforms in areas impacting consumers; and tracks trends in code violations and cooperates with law enforcement to bring deterrent compliance actions. Cases which cannot be resolved by the Consumer Services Division are transferred to the Compliance Bureau within the Legal Division, which is authorized to file formal charges against a licensee and take disciplinary action as appropriate, including cease and desist orders, fines, and license revocation.

**On June 28, 2000, Insurance Commissioner Chuck Quackenbush—facing certain impeachment—resigned rather than testify under oath about his involvement in the diversion of Northridge earthquake settlement funds to private foundations that spent the money to promote his political agenda rather than on victim relief.**

The Department's Fraud Division (originally the Bureau of Fraudulent Claims) was established in 1979 to protect the public from economic loss and distress by actively investigating and arresting those who commit insurance fraud. The Fraud Division is currently composed of three separate fraud programs: automobile, workers' compensation, and special operations (which includes property, health, life, and disability insurance fraud).

# MAJOR PROJECTS

## Quackenbush Resigns Amid Scandal Surrounding Misuse of Northridge Settlement Funds

On June 28, 2000, Insurance Commissioner Chuck Quackenbush—facing certain impeachment—resigned rather than testify under oath about his involvement in the diversion of Northridge earthquake settlement funds to private foundations that spent the money to promote his political agenda rather than on victim relief.

◆ ***Scandal Overview.*** The 1994 Northridge earthquake was the most costly natural disaster in California history, devastating businesses, homes, and lives, and causing $27 billion in commercial and residential destruction. Following the quake, over 600,000 insured homeowners and businesses filed claims with their insurers. Thereafter, thousands of quake victims were forced to file complaints with DOI, complaining of unfair claims settlement practices by their insurance companies. Among other things, the complaints alleged "low-balling" of damage estimates, incompetent insurance company adjusters, excessive delays in settlements, and refusal to pay based on overly restrictive applications of statute of limitations rules. In January and February of 1999, DOI auditors completed extensive surveys, called "market conduct examinations," of four insurance companies' claims handling practices in connection with the Northridge earthquake. In the market conduct examinations, DOI attorneys identified numerous alleged violations of Insurance Code section 790.03(h), which prohibits insurers from engaging in unfair claims settlement practices, and recommended that the Department levy stiff fines against the companies—including $2.5 billion in fines against State Farm, $866 million against 21st Century, $538 million against Farmers Home Group, and $250 million against Allstate—plus an additional $200 million for victim repayments. On March 2, 1999, DOI officials subpoenaed insurance executives of six major insurance companies to its offices, and told them they collectively faced more than $3 billion in potential fines as a result of the violations uncovered by DOI—violations that the companies disputed.

Following these meetings, Commissioner Quackenbush issued press releases announcing that he had reached "final settlements" with several large insurers over their handling of approximately 3,000 claims resulting from the 1994 Northridge earthquake. The actual settlement agreements were not released to the public. The funds from these "final settlements" were transferred to several nonprofit foundations created by the Department and intended to educate Californians about earthquake safety and repair. In particular, six earthquake insurers agreed to donate over $12 million to the California Research and Assistance Fund (CRAF), a nonprofit corporation formed in April 1999 by DOI Chief of Staff William W. Palmer (who resigned from the Department in July 1999 amid allegations that he ran a private law practice on the side) and run by Deputy Insurance Commissioner George Grays. *[17:1 CRLR 153–59]* At the same time he approved the settlements, Quackenbush also collected large campaign contributions from some of the companies involved.

In early 2000, copies of the confidential market conduct examinations revealing alleged insurer misconduct were given to a staffer of the Assembly Insurance Committee, and later to staff of a subcommittee of the Senate Judiciary Committee. Simultaneously, staff of the Senate Insurance Committee began investigating a complaint from a constituent about the source of funding for television ads featuring Quackenbush; during this investigation, Committee staff learned of the existence of CRAF. On January 27, 2000, Senator Jackie Speier, Chair of the Senate Insurance Committee, asked Attorney General Bill Lockyer to commence an investigation into the Department and CRAF.

In March and April 2000, *Los Angeles Times* journalist Virginia Ellis wrote a series of articles which ultimately revealed that the six insurers were allowed to settle for a combined total of less than $13 million instead of the $3.2 billion-plus in proposed penalties they faced for violations of Insurance Code section 790.03(h) and DOI's regulations banning unfair claims settlement practices related to the Northridge earthquake. Ellis' reports further revealed that the funds were deposited into CRAF's coffers (instead of the general fund), and that they were used to further the Commissioner's political goals rather than on consumer education or victim restitution. Between July and December 1999, CRAF spent $3 million in settlement funds on television ads featuring Quackenbush, and donated $1.4 million to groups with no connection to earthquake issues (including a $500,000 contribution to the Greater Sacramento Urban League and a $263,000 donation to a Sacramento football camp attended by two of Quackenbush's sons). None of the settlement money collected was ever used for earthquake relief.

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From April through June 2000, the Assembly and Senate Insurance Committees held hearings on the matter, receiving extensive testimony from Northridge earthquake victims, insurers, DOI employees involved in the market conduct examinations, and senior DOI officials involved in negotiating the Northridge settlements, as well as the named officers and directors of the various nonprofit foundations. Disclosures showed that Deputy Insurance Commissioner George Grays—who resigned over his role in the scandal on April 13, 2000—actually ran CRAF from within the Department and authorized payments from the foundation from inside the Department, even though the Commissioner and his top staff insisted that CRAF was independent from the Department.

Quackenbush appeared before the Assembly Insurance Committee on April 27, 2000, defending the nonprofit foundations as an "effective, innovative" approach to victim restitution and contending that CRAF had "earmarked $6 million for relief for Northridge victims." Although he denied having any direct involvement in the decisionmaking of the foundations, he noted that he had "written to CRAF and urged them to speed approval of the distribution plan to be implemented through a third-party administrator to make this money available as quickly as possible for Northridge earthquake victims." Quackenbush asked the Committee to chalk up the controversy to "mistakes in judgment, timing, and prioritization."

The Legislative Counsel disagreed with Quackenbush's assessment of the problem. On April 26 and again on May 1, 2000, the Legislative Counsel issued opinions concluding that the Commissioner lacked legal authority to create nonprofit foundations to receive insurance settlement funds. The opinion stated that the Commissioner's enforcement authority is limited to assessing fines and penalties authorized by the Insurance Code, and concluded that the "contributions" made by insurers in settlement of the alleged violations did not constitute "sanctions" as defined in state law governing administrative proceedings.

As May 2000 unfolded, Sacramento County Superior Court Judge John R. Lewis froze the assets remaining in CRAF's account (approximately $6 million) at the request of Attorney General Lockyer. Most major newspapers began to call for Quackenbush's resignation. The Senate Insurance Committee requested the Commissioner's presence at a hearing on May 23, but Quackenbush accused the Committee of a "political ambush," refused to answer questions upon the advice of his defense counsel, and walked out of the hearing. The next day, the Senate subpoenaed Quackenbush, forcing him to return. On June 5, Quackenbush was defiant, accusing Committee Chair Speier of "wasting taxpayer money on this endless witch hunt." He told the Committee that he knew little about the operations of the foundations or how public money from insurance settlements was ultimately directed to private vendors used by his political team for ads featuring his photo and for polling on his performance in office and his political future.

As June 2000 wore on, the "i" word (impeachment) began to surface. Even Republicans on the Assembly Insurance Committee, which resumed its hearings on June 6–8, expressed disbelief at the extent of the misconduct being methodically presented to them, and the Commissioner's inability to recognize it, remember it, or take responsibility for it. At one point, Republican Assemblymember Rico Oller stated: "There has been an incredible amount of memory loss here."

On June 12, 2000, Senate Judiciary Committee Chair Martha Escutia released DOI's market conduct examinations of State Farm, Farmers Home Group, Allstate, and 21st Century, posting the documents on the Committee's Web site; the Foundation for Taxpayer and Consumer Rights (FTCR) did the same several days later. The documents, called "damning" by Senate President pro Tempore John Burton, temporarily refocused the spotlight on the conduct of the insurance

industry in handling Northridge claims. According to Senator Burton, "it indicates that there was a pattern and practice of bad faith and deception on the part of major insurance carriers who may or may not have been patrons of his reelection." FTCR alleged that DOI's investigation revealed that State Farm did not properly explain policyholders' benefits, misled policyholders, or misrepresented settlements in 37% of the 825 files reviewed; 21st Century offered unacceptably low settlements in 32% of the 431 files reviewed; and Allstate reduced settlements based on unnecessary or excessive depreciation of property value in 16% of the 808 files reviewed (DOI's market conduct examination of Farmers was incomplete). Overall, the documents revealed 2,500 instances in which DOI examiners found that claims had been mishandled. The insurers protested the release of the information, and Quackenbush filed suit against the Senate to compel it to return the confidential documents.

Meanwhile, the Assembly Insurance Committee resumed its hearings in late June 2000. On June 26, senior DOI attorney Cindy Ossias—testifying under a grant of immunity from prosecution—confirmed that she was the whistleblower who had leaked copies of the market conduct examinations to the Assembly and Senate committees because she had been ordered to shred documents containing DOI legal staff recommendations regarding fines for the Northridge insurers. Ossias, who was part of the team that conducted the market conduct examinations, testified that she was "appalled" when she learned that Quackenbush had settled with the companies for $1–$2 million each. In other testimony on June 26, DOI attorney Robert Hagedorn linked Quackenbush directly to the scheme when he testified that DOI's chief counsel, Brian Soublet, informed Hagedorn that Quackenbush directed Soublet, in November 1999, to reach settlements in pending disciplinary matters with title insurance companies (see LITIGATION) because Quackenbush needed $4 million for a "media buy" for television commercials. Committee members immediately recognized the discrepancy between Hagedorn's testimony and Quackenbush's repeated insistence that he had no direct involvement in the use of public funds by his staff or the nonprofit foundations to further his political agenda. Also on June 26, four DOI officials invoked their fifth amendment rights rather than testify before the Committee.

**Although consumer advocates hoped for a stinging indictment of the insurance industry's practices, the Assembly Insurance Committee made a number of recommendations aimed primarily at improving Departmental practices and legislative access to DOI information.**

With Quackenbush scheduled to testify on June 29, Sacramento was at fever pitch. On June 28, after numerous meetings with Republican leadership, Quackenbush resigned effective July 10 in a letter delivered to the Secretary of State's office. Although the Committee canceled its June 29 hearing, both the Committee and Attorney General Lockyer insisted that their probes into the matter would continue. On July 5, and under prodding by Lockyer, Quackenbush named McGeorge School of Law Professor J. Clark Kelso as Chief Deputy Commissioner; Kelso then became Acting Commissioner upon Quackenbush's resignation. Kelso immediately requested and accepted the resignations of six senior DOI officials.

On July 17, Acting Commissioner Kelso announced his decision to close an ongoing investigation into unauthorized disclosure of confidential information by Ossias, and dismiss the pending suit against the Senate for wrongfully disclosing DOI information. Kelso explained that continuing these legal actions would "serve no purpose." Ossias was reinstated as a DOI attorney in August 2000.

On July 31, Governor Davis named retired First District Court of Appeal Justice Harry W. Low as Insurance Commissioner; after being confirmed by both houses of the legislature, Low took over on September 18, 2000. At this writing, Low is expected to serve out the two remaining years of Quackenbush's term.

◆ ***Scandal Aftermath***. On August 21, 2000, the Assembly Insurance Committee released its final report on its investigation into DOI's use of settlement funds. The Committee's report found that the Department "abrogated its statutory duty and broke faith with the public." The report detailed five days of testimony by 42 witnesses, and highlighted the inconsistencies between the evidence gathered and the explanations offered by Quackenbush and other senior DOI officials. The report concluded that "Mr. Quackenbush and his senior aides used that money [settlement funds paid into nonprofit foundations or directly to vendors] to benefit the Commissioner and his associates, not the public. The evidence suggests DOI, starting in 1999, used its enforcement powers to force insurers to contribute to slush funds disguised as nonprofit foundations. The DOI, working with a group of longtime associates and consultants, then used the foundations to serve the Commissioner's political agenda and financially benefit personal friends of top DOI officials. In the pursuit of these objectives, the needs of California consumers and representations made in agreements with insurers largely were ignored. And as Mr. Quackenbush and DOI officials evaded proper governmental oversight, the interests of some Northridge earthquake victims may have been abandoned."

Although consumer advocates hoped for a stinging indictment of the insurance industry's practices, the Assembly Insurance Committee made a number of recommendations aimed primarily at improving Departmental practices and legislative access to DOI information. Among other things, the Committee recommended that (1) DOI's regulatory and enforcement processes should be insulated from political influences; (2) the use of public education or "outreach" funds obtained through regulatory powers by elected officials should be banned or restricted; (3) DOI's market conduct examination process should be reviewed to ensure accountability to

consumers; (4) all money obtained from insurers through enforcement actions should be deposited into the general fund or other account overseen by the legislature and the Governor; (5) the use of settlement funds should be statutorily limited; (6) the public should have access to final settlement documents; and (7) the state's protections for whistleblower employees who lawfully report corruption, misconduct, and malfeasance in state government should be reviewed and strengthened. The Committee also recommended that "the legislature, in consultation with the Insurance Commissioner, should consider enacting a law to ensure relief for Northridge earthquake policyholders who may be entitled to additional claims payment."

On August 28, 2000, the Senate Insurance Committee released its final report entitled *The Department of Insurance: In Rubble After Northridge*. The report offers a comprehensive review of DOI settlement practices dating back to 1997 (and involving companies other than the Northridge earthquake carriers—including life, title, and health insurance carriers), as well as evidence and testimony gathered by the Committee during its hearings. The Senate Insurance Committee found that over $19 million was paid to three nonprofit foundations by 26 insurers as "settlements" of DOI enforcement actions between August 1, 1997 and May 2, 2000. According to the Committee, "from February 1997 to May 2000, the DOI's method of settling with insurers evolved from a process with legislative scrutiny to an intricate scheme designed to raise the most money possible without any oversight from the Legislature." The report concludes: "While self-promotion by elected officials often poses a problem for the public interest, the unique characteristics of the job of...[the Insurance Commissioner], a regulator with jurisdiction over an $80 billion industry, led to abuses of power unprecedented in modern California history. By 1999, settlements were no longer based upon the rule of law, but rather upon the rule of expedience with the law serving as a cover story."

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The Senate Insurance Committee's report—apparently authored by the staff of the committee, approved by Committee Chair Jackie Speier, and acknowledging that "the recommendations in this report do not necessarily reflect the viewpoints of all members of the committee"—offered more pointed suggestions for reform than did the Assembly's report. Among other things, the Senate's report recommended that the legislature (1) establish a fund from which to pay claims made by victims of the Northridge earthquake; (2) authorize the rescission of the settlement agreements with the insurers involved and require DOI to complete the market conduct examinations, levy fines if appropriate, and appoint a special master to oversee the process; (3) reform DOI's settlement practices to ensure that settlement funds are deposited into the general fund, restrict the Commissioner's authority to direct insurers to make contributions to nonprofit foundations, require the Commissioner to approve all settlements, and prevent the Commissioner from using settlement funds to finance promotions featuring the Commissioner; (4) make final market conduct examinations and settlements public documents; (5) expand DOI's review of consumer complaints (including complaints by consumers who are represented by attorneys); (6) prohibit or limit campaign contributions to the Commissioner by insurers when they have business before the Commissioner; (7) improve the education and training of DOI attorneys to ensure that political opinions do not cloud legal reasoning, and create an independent ethics office within DOI; and (8) waive the statute of limitations for legitimate Northridge claims that are now time-barred. The Senate Committee also urged the legislature to substantially increase the fines for violations of the Insurance Code, because "current penalties...[are] not enough to dissuade insurers from unfair and prohibited acts related to claims settlements and, thus, the fines should be higher to create greater deterrence."

In October 2000, the Bureau of State Audits (BSA) released a sharply critical report finding that Commissioner Quackenbush "abused his authority when he required insurers to pay $12.3 million in settlement outreach payments directly to nonprofit organizations and vendors for purposes not specifically related to his regulatory responsibilities." The report went on to criticize as "imprudent" other settlements totaling $16.5 million that, while apparently legal in the sense that they were made for purposes related to the Department's regulatory authority, were paid directly to nonprofits and were thus outside the reach of state purchasing and expenditure controls. According to BSA, "this practice...usurps the authority of the Legislature to oversee and direct expenditure of the funds through the budget process."

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Further, BSA noted that many of the settlements with insurers "failed to include any monetary penalties against insurance companies found to have violated certain provisions of the Insurance Code and the Unfair Practices Act, such as handling claims in bad faith or receiving illegal monetary benefits on amounts deposited in escrow accounts. The department also omitted critical enforcement provisions from settlement agreements, thereby further eroding the department's ability to effectively regulate insurers." The report noted that by not including

cease and desist provisions and by failing to impose fines, DOI's settlements apparently "absolved...[the insurers] of misconduct." Additionally, by concealing the amount and nature of the settlement payments, and by structuring the settlements so that the violations were not reported to the National Association of Insurance Commissioners (NAIC), DOI limited the amount of information available to other state regulators and consumers and increased the risk of continued violations.

BSA also found that DOI does not manage its enforcement activities effectively, allowing violations of the law to go unpunished. The auditors found that DOI's legal division does not promptly resolve complaints referred to it by other DOI bureaus and that DOI is unable to track enforcement cases because of a lack of an integrated monitoring system between the different branches of DOI. The report also found that poor controls over fine payments, cost reimbursements, and outreach activities inhibit the Department's ability to manage these payments and ensure that funds are used to further legitimate regulatory purposes.

BSA recommended that DOI require insurers to remit all settlement payments directly to the Department in order to maintain direct control over expenditures for outreach and education. The report also recommended that the legislature consider amending the Insurance Code to prohibit the payment of settlement funds directly to nonprofit organizations, foundations, or vendors. BSA also recommended that where egregious violations are identified, the insurer should be required to pay an appropriate penalty; DOI should clearly state the amount of such penalty, the date each penalty is due, and all other settlement terms in a public settlement agreement that includes an order to cease and desist the activities.

Finally, the report concluded that DOI should improve its enforcement program by developing an integrated case tracking system, reviewing open cases periodically, assigning and resolving the existing backlog of open cases in the legal division, requiring insurers to remit payment of fines, penalties, and settlements to DOI directly (and setting up a standardized system for receiving such payments), and strengthening accounting controls within the Department.

In February 2001, BSA released a follow-up report detailing actions taken by DOI to implement its recommendations. BSA noted that—in addition to the enactment of SB 2107 (Speier), which prohibits the Commissioner from ordering settlement payments to a nonprofit or directing funds outside the treasury (see below)—the Department has implemented a policy requiring standardized language to be included in settlement agreements. The language is to include the terms of the settlement, including monetary payments to be made and payment due dates, the specific code or regulatory section(s) that were found to have been violated, and—where applicable—cease and desist orders. The Department also stated that it has implemented a policy to report all penalties assessed against insurers to the NAIC.

BSA's report also noted that the Department had taken action to address the questionable purposes for which outreach payments had been used. According to DOI, settlements with insurers and other regulated entities will no longer include provisions for "outreach payments." Rather, all monies received from settlements, other than those to paid to victims as restitution, will be deposited into the general fund or DOI's account.

The report noted that DOI had taken partial corrective action to address its lack of effective management over its enforcement activities. DOI stated that it plans to reinitiate its case tracking project and follow prescribed guidelines to develop a feasibility study report and budget change proposals. The Department will also standardize its data input fields to improve case management and timekeeping systems. DOI has reinstituted combined enforcement meetings among its branches in order to review, prioritize, and assign enforcement matters. Additionally, DOI has implemented new collection and accounting procedures for settlement proceeds and provided for increased communications protocols between the legal and accounting departments.

◆ ***But What About the Earthquake Victims?*** As noted above, most of the recommendations emanating from legislative and other oversight entities focused on internal and procedural reform within DOI. However, some legislators and public officials were concerned that legitimate earthquake victims would go under- or uncompensated. Senator Speier asked Attorney General Lockyer for an opinion about the legality of the settlement agreements, in hopes that a negative ruling might prompt the legislature or a court to invalidate them—which would theoretically reinstate DOI jurisdiction over the disputed claims and the insurers' conduct. In July 2000, Lockyer issued a written opinion stating that Quackenbush had acted without legal authority in reaching settlement agreements with insurers following the Northridge earthquake that required the insurers to contribute to foundations whose activities were not related to the disaster. The opinion stated that although the Commissioner has broad authority to reach settlements with insurers accused of mishandling claims, and although the Commissioner may include in a settlement a requirement that an insurer contribute funds to a nonprofit foundation, the foundation must support activities associated with the responsibilities undertaken by DOI in the proceeding. Quackenbush exceeded his authority by creating foundations that financed political polling, minority outreach, and grants to charities. According to the Attorney General, "the commissioner may not...[require] payment of funds to a private charitable foundation for the purpose of supporting activities unrelated to the regulatory enforcement responsibilities of the Department of Insurance in the proceeding."

When he took office, Acting Commissioner Kelso initiated talks seeking a mutual rescission of the settlement agreements between DOI and the Northridge insurers. At a Senate Insurance Committee hearing on August 10, 2000, Kelso told legislators that a mutual rescission would "avoid many years of protracted and expensive court actions," and expressed fear that the pendency of several bills in the legislature that would

reopen the claims period for Northridge victims would jeopardize his negotiations.

Nevertheless, the legislature passed—and the Governor signed—SB 1899 (Burton) (Chapter 1090, Statutes of 2000), which revives claims for damages arising out of the earthquake that are barred solely because the statute of limitations has run, and permits them to be filed until January 1, 2002 (see 2000 LEGISLATION). The insurance industry has filed a wide-ranging and thus-far-unsuccessful challenge to the validity of SB 1899 (see below for details).

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Additionally, on November 20, 2000, Attorney General Lockyer filed a lawsuit in Sacramento County Superior Court seeking to void the insurer settlements negotiated by Quackenbush. Based on his earlier legal opinion, Lockyer argued that Quackenbush lacked the legal authority to enter into settlements that provided for the creation of a nonprofit corporation and diversion of settlement funds to that corporation to support activities unrelated to the regulatory enforcement responsibilities of the Department. The Attorney General was joined in his petition by Commissioner Low. At this writing, the insurers are actively contesting the action, arguing that they complied "in good faith" with the Commissioner's demands.

Finally, several earthquake victims have filed civil suits against both former Commissioner Quackenbush and against the companies. For example, on April 27, 2000, Northridge earthquake victim Ronald Gallimore filed *Gallimore v. State Farm*, No. BC 229003, in Los Angeles County Superior Court. Plaintiff filed suit under the Unfair Competition Act, Business and Professions Code section 17200 *et seq.*, seeking injunctive relief and restitution. The suit alleges that State Farm engaged in unfair business practices in the context of the adjustment of property loss claims including those arising out of the Northridge earthquake. State Farm responded on August 7, 2000 by filing a special motion to strike plaintiff's complaint under Code of Civil Procedure section 425.16, the state's "anti-SLAPP" (Strategic Litigation Against Public Participation) statute. Incredibly, State Farm argued that plaintiff and his attorneys had gained access to confidential information contained in DOI's investigative inquiries and confidential market conduct examinations, and that to allow the suit to go forward would interfere with State Farm's ability to respond to an official DOI proceeding and chill State Farm's first amendment right to communicate with its regulator in response to an official inquiry. Even more incredibly, the trial court granted State Farm's motion to strike on December 11, 2000; Gallimore filed a notice of appeal on February 7, 2001 in the Second District Court of Appeal, where the case is pending at this writing.

◆ ***Legislative Response to "Insurancegate."*** Throughout the summer of 2000, the legislature responded to the unfolding scandal with a flurry of reform bills aimed primarily at the Department and the office of the Insurance Commissioner (see 2000 LEGISLATION).

In addition to SB 1899's attempt to directly assist victims of insurer bad faith, legislative efforts were also aimed at closing legal loopholes that Quackenbush and his staff exploited. SB 2107 (Speier) (Chapter 1090, Statutes of 2000) prohibits the Commissioner from entering into settlement agreements that allow an insurer, agent, or broker to contribute to a nonprofit entity (or that otherwise direct funds outside the state treasury system) or that direct funds to another person or entity; it also prohibits the use of settlement proceeds to produce materials using the Commissioner's name, voice, or likeness. SB 2107 further requires that all settlements be approved by the Commissioner; permits settlement payments only to those due payment as a result of the wrongdoer's violations; and requires all fines, penalties, costs and assessments to be deposited in the state treasury. SB 1524 (Figueroa) (Chapter 1089, Statutes of 2000) similarly requires that fines and penalties resulting from DOI enforcement actions be deposited into an appropriate state fund, and further provides that any such funds allocated for outreach purposes may not use the Commissioner's name, voice, or likeness without court approval. SB 1805 (Escutia) (Chapter 997, Statutes of 2000) makes final DOI market conduct examination reports of unfair or deceptive business practices, and all executed stipulations and settlements resolving market conduct examinations, public records that must be posted on DOI's Web site; it also requires the Bureau of State Audits to audit examinations of claims practices that are terminated or suspended by the Department.

The legislature declined to enact other more far-reaching reform measures. SCA 19 (Speier), which would have placed a proposal on the ballot to convert the Insurance Commissioner's position from elective to appointive, failed in the Senate Constitutional Amendments Committee. SB 953 (Speier) would have placed restrictions on the amount insurers with matters pending before the Department may contribute to candidates for commissioner, and limited the contributions a candidate for Insurance Commissioner could accept from the insurance industry. Despite a unanimous 37–0 Senate vote, the measure failed in the Assembly on a 27–34 vote on August 28, 2000. SB 1738 (Hayden) would have created a statewide citizens' utility board to stimulate consumer representation and advocacy before DOI. Heavily opposed by the insurance industry, SB 1738 was allowed to die in the Senate Appropriations Committee's suspense file. And AB 481 (Scott), which would have required the Commissioner to give policyholder concerns first priority in settlement agreements and allowed the Commissioner to require remediation or payment to policyholders in order to ensure compliance with all laws applicable to insurance transactions, was vetoed by the Governor.

◆ ***Grays Pleads Guilty; More Allegations Surface in 2001.*** On January 16, 2001, former Deputy Commissioner George Grays pleaded guilty to federal charges of mail fraud and money laundering in connection with the theft of $263,000 from the Department. According to the written plea agreement, Grays—who was neither an officer or director of CRAF—maintained CRAF's checkbook and "virtually single-handedly decided which entities received monetary grants from CRAF." Grays admitted to siphoning money from CRAF via fraudulent payments to Skillz Athletics Foundation, a nonprofit foundation run by Brian Thompson, a friend of Grays. Quackenbush's children attended sports camps run by Skillz. Grays paid Skillz $263,000 from CRAF; Thompson "kicked back" $170,900 to Grays and spent the remaining $92,100 for personal expenses rather than charitable purposes. At this writing, Grays is awaiting sentencing; prosecutors have said they will recommend leniency to U.S. District Court Judge David F. Levi in return for Grays' cooperation.

In February 2001, the *Los Angeles Times* revealed other questionable conduct by Quackenbush. While in office, Quackenbush took frequent, lavish trips abroad, paid for by the insurance companies he was regulating and often arranged by the managing partner of LeBoeuf, Lamb, Greene & McRae, a San Francisco law firm that represents numerous insurance companies and that receives considerable legal business from the Department. The *Times* also reported that DOI, while Quackenbush was Commissioner, concealed a $400,000 payment from Lloyd's of London to DOI to reimburse it for expenses racked up by Quackenbush in marshaling support for the insurer in a securities fraud suit filed by the Department of Corporations against Lloyd's. According to the *Times*, DOI staff produced a phony invoice to hide the money, billing the payment as "educational briefings."

These accounts led legislators to introduce more reforms designed to limit the discretion of the Insurance Commissioner and to remove the outside influence of regulated insurers on DOI decisionmaking. At this writing, several new bills spawned by the continuing Quackenbush scandal are pending. SB 708 (Speier) is intended to implement recommendations contained in the Senate Insurance Committee's report on the Quackenbush scandal that were not addressed by previous legislation. SB 798 (Speier) would prohibit regulated entities from either directly or indirectly making campaign contributions or gifts of any kind to the Insurance Commissioner, to any candidate for that office, or to any committee that is formed primarily to elect an individual to the office of Insurance Commissioner. And AB 931 (Frommer) would prohibit the Commissioner from accepting in any calendar year travel reimbursements or payments exceeding $1,000 from an entity subject to regulation by the Commissioner (see 2001 LEGISLATION).

### SB 1899 Gives Northridge Quake Victims Second Chance to File Claims

SB 1899 (Burton) (Chapter 1090, Statutes of 2000) offers potential relief to thrice-victimized Northridge earthquake claimants (first by the quake, then by their insurance companies, then by Commissioner Quackenbush) by adding section 340.9 to the Code of Civil Procedure. Section 340.9 provides: "Notwithstanding any other provision of law or contract, any insurance claim for damages arising out of the Northridge earthquake of 1994 which is barred as of the effective date of this section solely because the applicable statute of limitations has or had expired is hereby revived and a cause of action thereon may be commenced provided that the action is commenced within one year of the effective date of this section." The "applicable statute of limitations" is Insurance Code section 2071, which requires insureds to file claims against their policies within twelve months of the "inception of the loss" (the enforceability of section 2071 is being litigated at this writing—see LITIGATION).

The availability of section 340.9 is subject to three limitations: (1) it applies only to cases in which the insured contacted the insurer prior to January 1, 2000, regarding potential Northridge earthquake damage; (2) it does not apply to any claim that has been "litigated to finality" in any court of competent jurisdiction; and (3) it does not apply to any claim that has been resolved by a written settlement agreement, provided that the insured was represented by an attorney admitted to practice in California at the time of the settlement, and the attorney signed the agreement.

SB 1899 appears to address several problems—widespread allegations by thousands of homeowners of insurer misconduct in handling timely claims that went absolutely unaddressed by Commissioner Quackenbush's administration; the fact that some quake-related damage simply was not discovered until after the one-year limitations period had run; and the California Supreme Court's delay in deciding *Vu v. Prudential*, in which a ruling favorable to homeowners could estop insurers from relying on the statute of limitations in cases where their own adjusters and inspectors failed to discover all quake-related damage within the one-year limitations period (see LITIGATION).

As expected, Century National Insurance Company and three of the largest insurance industry associations filed *Century National Insurance Co. v. Los Angeles County Superior Court (People)*, No. S093127, in the California Supreme Court on November 22, 2000, asking the court to enjoin the operation of section 340.9 until it can rule on the validity of SB 1899. Among other things, the insurers allege that SB 1899 is unconstitutional because it abrogates the contracts clause of both the United States and California constitutions, and destroys vested contract rights in violation of due process. On November 29, 2000, the court declined to hear the case, giving no reason for its refusal.

SB 1899 took effect on January 1, 2001, and permits eligible claims to be filed until January 1, 2002.

### State Auditor Reviews California Earthquake Authority

After the 1994 Northridge earthquake caused $12.5 billion in insured losses, most homeowners insurance compa-

nies—which were then required by Insurance Code section 10081 to offer earthquake protection along with homeowners policies—withdrew from the homeowners insurance market or reduced the amount of earthquake insurance they offered to avoid the risk of another costly disaster. In 1995, Commissioner Quackenbush proposed the creation of the California Earthquake Authority (CEA), a publicly managed, privately funded entity that would provide earthquake insurance to consumers and encourage insurance companies to reenter the homeowners insurance market. In 1995, the legislature passed AB 13 (McDonald) (Chapter 944, Statutes of 1995), which created the CEA, and AB 1366 (Knowles) (Chapter 939, Statutes of 1995), which permitted insurers to pare back section 10081's required earthquake coverage to "barebones" levels. *[16:1 CRLR 150; 15:4 CRLR 222; 15:2&3 CRLR 186]*

According to DOI and CEA supporters, the program helps spread the risk associated with earthquake losses by establishing a pool of $7.5 billion, financed largely by participating insurance companies and premiums from CEA policies, plus commitments from reinsurance companies and private investors. Under the program, customers submit their claims to the company that handles their policy, but CEA actually pays the claim and assumes much of the risk. If an earthquake exhausts CEA's resources, claims will be paid on a *pro rata* basis and policyholders could be assessed an additional 20% on top of their regular premiums.

A standard CEA "mini-policy" carries a 15% deductible, caps payments for personal property damages at $5,000, and allows $1,500 for emergency housing expenses. In 1999, DOI implemented regulatory changes which provide for a new "supplemental" residential earthquake insurance policy, in addition to CEA's current "mini-policy." Under the supplemental policy (which CEA participant insurers are not required to offer), homeowners may choose a 10% deductible (rather than the standard 15% deductible) and boost contents coverage to $100,000 (from the currently-authorized $5,000) and emergency housing coverage to $15,000 (up from the current $1,500). The lower deductible costs the average policyholder about 80 cents more per $1,000 of coverage (or about $155 annually for the average home); the increased coverage for contents and emergency housing will add about 50 cents more per $1,000 covered. *[17:1 CRLR 157; 16:2 CRLR 133; 16:1 CRLR 151]*

With the departure of Commissioner Quackenbush in 2000, and the simultaneous release of an outside financial review of CEA, questions surfaced as to whether CEA would have sufficient funds to pay claims in the event of a serious earthquake. Specifically, State Treasurer Phil Angelides and several legislators questioned the amount of money spent by CEA on reinsurance (up to 90% of premiums paid, according to some estimates). Reinsurance helps pay claims in the event of a catastrophic earthquake, but its high cost limits CEA's ability to build up cash reserves. In August 2000, the Joint Legislative Audit Committee granted Senator Martha Escutia's request that the Bureau of State Audits (BSA) evaluate CEA's reinsurance expenses and other aspects of the program.

In February 2001, BSA released its report entitled *California Earthquake Authority: It Has Taken Steps to Control High Reinsurance Costs, but As Yet Its Mitigation Program Has Had Limited Success.* The report noted that the CEA, through its 18 member companies, insures more than 830,000 homes against earthquake damage, accounting for almost two-thirds of the residential earthquake insurance market in California.

BSA found that while CEA's reinsurance costs are high, they are not unreasonable. Reinsurance coverage is expensive due to the significant losses that could be expected in the event of a catastrophic earthquake; but without such reinsurance, CEA might not have the resources to pay for losses resulting from a major earthquake. The report noted that CEA maintains roughly $2.5 billion in reinsurance coverage, accounting for about one-third of its capacity to pay policyholders. Catastrophe reinsurance is more expensive than other types of reinsurance. Further, by law CEA must offer coverage statewide, so it cannot reduce its exposure to loss by limiting coverage in earthquake-prone areas (as can private insurers); therefore, its reinsurance costs are higher than those of other companies.

However, BSA said that CEA has acted to reduce reinsurance costs while maintaining coverage, and that the Authority's rate-on-line (the amount of compensation the Authority pays to reinsurance companies to assume part of the risk) is not unreasonable compared to what other insurers are paying. The report also found that CEA has taken steps to reduce its reliance on reinsurance. The audit found, however, that CEA faces challenges ahead in maintaining its capacity to pay claims because its reinsurance contracts will expire within the next two years and its authority to assess its member companies up to $2.2 billion if losses exceed capital will expire in December 2008. The report recommended that CEA continue to monitor the reinsurance market and research alternative financing to reduce its dependence on reinsurance.

BSA also examined CEA's earthquake mitigation pilot program, called State Assistance for Earthquake Retrofitting (SAFER). Under the SAFER program, which is designed to reduce earthquake-related losses, CEA uses some interest earned on premiums to fund seismic assessments for homeowners in pilot counties whose homes meet eligibility criteria. Between October and December 1999, SAFER received nearly 17,000 calls from interested consumers. Of these, 8,304 qualified homeowners were interested in receiving a seismic assessment of their homes. By December 2000, CEA completed roughly 68% of the assessments and sent 86% of those reports to the homeowners. According to BSA, CEA expects to complete the remaining inspections and reports by May 2001.

BSA concluded, however, that CEA has not found the right mix of incentives to encourage homeowners to actually retrofit their homes, and that the number of retrofitted homes is low. Although SAFER spent about $3.5 million on the assessments, it could not demonstrate that it had achieved its

goal of reducing the state's risk of loss from earthquakes. As of December 2000, only 31—or 0.9%—of 3,576 homeowners whose homes need structural retrofit improvements had completed those improvements through the SAFER program. BSA recommended that CEA establish a system for determining how many homeowners who participate in the SAFER program complete the recommended retrofit improvements, and also establish a target number of homes to be made seismically secure before expanding the program.

### Propositions 30 and 31 Defeated; Third Party Bad Faith Legislation Nullified

On March 7, 2000, the insurance industry succeeded in prolonging its insulation from third party bad faith claims when California voters rejected ballot measures that would have reinstated the third party right of action to enforce Insurance Code section 790.03(h).

On October 7, 1999, Governor Davis signed SB 1237 (Escutia) (Chapter 720, Statutes of 1999), the "Fair Insurance Responsibility Act of 2000," which authorized a consumer to sue another person's insurance company in tort for violation of Insurance Code section 790.03(h), which prohibits companies from engaging in unfair claims settlement practices. At the same time, the Governor also signed AB 1309 (Scott) (Chapter 721, Statutes of 1999), which limited these third party actions to specific types of unfair claims settlement practices and to causes of action involving bodily injury, wrongful death, or property damage. These bills were to go into effect January 1, 2000. *[17:1 CRLR 151–52]* Within days after the bills were signed, however, a number of insurance companies—including State Farm, Farmers, Allstate, USAA, and Fireman's Fund—announced their intent to place a referendum measure repealing the new laws on the March 2000 ballot. Within weeks of the bills' approval by the Governor, the insurance industry—thinly disguised as "Consumers Against Fraud and Higher Insurance Costs"—had qualified two referenda (Propositions 30 and 31) for the ballot and raised over $40 million to defeat them.

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A "third-party bad faith action" against a company with which the plaintiff has no contractual relationship was permitted under *Royal Globe Insurance Co. v. Superior Court*, 23 Cal. 3d 880 (1979), a landmark decision of the California Supreme Court. Subsequently, the same court—but with a markedly different composition—reversed *Royal Globe* in *Moradi-Shalal v. Fireman's Fund Insurance Co.*, 46 Cal. 3d 287 (1988). *[8:4 CRLR 87]* In essence, *Moradi-Shalal* stripped the courts of authority to fully enforce the provisions of the Insurance Code that ban bad faith claims settlement practices by insurance companies, and placed that responsibility squarely and solely on the shoulders of the Insurance Commissioner. Since the *Moradi-Shalal* decision, however, consumers and plaintiffs' attorneys have consistently complained about the Department's failure to aggressively police bad faith practices by insurance companies. *[16:2 CRLR 131–32]* Consumer Attorneys of California (CAOC), sponsor of SB 1237, asserted that—in the aftermath of *Moradi-Shalal*—insurance companies have no incentive to settle third party claims in a fair, reasonable, and prompt manner, and argued that insurer profits have increased tenfold since *Moradi-Shalal* at the expense of injured claimants. Thus, the proponents of SB 1237 contended that DOI's poor enforcement record leaves consumers without an effective remedy and at the mercy of insurer bad faith claims settlement practices.

Proposition 30 contained most of the same provisions as SB 1237; Proposition 31 asked voters to affirm the provisions of AB 1309. Immediately after placing these provisions on the ballot, the insurance industry began an intense and expensive campaign to defeat its own measures in order to nullify the new third party bad faith legislation. With the insurance companies (and, undoubtedly, policyholders) footing the bill, Proposition 30 and 31 opponents carried out a massive television, print, and direct mail campaign directing voters to vote against the two ballot measures. The industry's ads suggested that voting yes on Propositions 30 and 31 would result in insurance premium hikes of $200–$300 per year and that the third party actions are not necessary because consumers can take disputes to DOI. Some ads even suggested that the new laws would allow drunk drivers to sue insurers. The industry characterized this issue as an effort by trial lawyers to create litigation and collect larger fees.

CAOC focused its efforts on seeking a yes vote on Proposition 30. Supporters contended that insurance companies routinely engage in unfair claims practices and that the only way to hold insurers accountable is to allow them to be sued for violating state law. The proponents of the two propositions also pointed out that the laws explicitly prohibit drunk drivers from bringing suits under the new provisions, and rejected the industry's projections of the impact of the provisions on premiums.

On January 27, 2000, Attorney General Bill Lockyer released a written opinion, in response to a request from Senate President pro Tem John Burton, concluding that Propositions 30 and 31 would not allow drunk drivers to sue insurers. Nonetheless, the California chapter of Mothers Against Drunk Drivers (MADD) cited the drunk driving issue as one of its main reasons for joining the campaign to defeat the measures. Proposition 30 and 31 supporters questioned whether the group was under pressure from the insurance industry, which contributes millions of dollars annually to MADD's national headquarters. And although Governor Davis supported and signed SB 1237 and AB 1309 in 1999, he declined to formally lend his support to the third party bad faith propositions, much to the dismay of CAOC.

On March 7, 2000, Propositions 30 and 31 were defeated by a nearly two-to-one ratio, effectively nullifying SB 1237 and AB 1309 and reinstating the *Moradi-Shalal* rule.

### Department Implements Low-Cost Auto Insurance Pilot Program

SB 171 (Escutia) (Chapter 884, Statutes of 1999) and SB 527 (Speier) (Chapter 794, Statutes of 1999) require DOI to establish pilot programs to provide low-cost, liability-only auto insurance policies for "good driver" residents of Los Angeles and San Francisco counties whose household income is at or below 150% of the federal poverty level. The low-cost auto insurance program, also known as the "Lifeline" program, is administered by the California Automobile Assigned Risk Plan (CAARP). *[17:1 CRLR 160]*

To implement the low-cost automobile insurance pilot program, Commissioner Quackenbush adopted new section 2498.6, Title 10 of the CCR, on an emergency basis and submitted it to the Office of Administrative Law (OAL) on February 18, 2000. The regulation incorporates by reference a separate plan designated the "California Automobile Insurance Low-Cost Program Plan of Operations," which is the plan for the equitable apportionment among insurers required to participate in CAARP of persons residing in the County of Los Angeles and the City and County of San Francisco who are eligible to purchase a low-cost policy through the pilot programs. The plan also sets forth procedures which insurers and applicants must follow to obtain a low-cost auto policy. OAL disapproved DOI's proposed regulation on February 28, 2000. In its decision, OAL stated that the regulation failed to comply with the necessity, clarity, and consistency standards of Government Code section 11349.1. The Commissioner corrected the deficiencies identified by OAL and resubmitted the emergency regulation to OAL on March 17, 2000; OAL approved the regulation on March 27, 2000. Emergency regulations are valid for 120 days.

Section 2498.6 and the incorporated-by-reference "Plan of Operations" establish the "Lifeline" low-cost automobile insurance program as authorized by SB 171 and SB 527, effective July 1, 2000. The policies provide less coverage than the minimum otherwise required by law—a maximum liability coverage of $10,000 per injury, $20,000 per accident, and $3,000 for vehicle damage. In contrast, the minimum standard liability requirements are $15,000 per injury, $30,000 per accident, and $5,000 vehicle damage. The policies cost about $450 for Los Angeles and $410 for San Francisco annually, more for male drivers age 19–24. CAARP, the administrator of the program, reported receiving 3,300 inquiries and selling 102 policies during the first two weeks of availability. Early reports also indicated that some agents refused to sell the new policies and some consumers had difficulty locating an agent willing to work with them to purchase a low-cost policy.

On July 25, 2000, OAL approved DOI's readoption of section 2498.6 on an emergency basis for another 120-day period. On August 11, 2000, DOI published notice of its intent to permanently adopt section 2498.6 and the "Plan of Operations," and scheduled a public hearing for October 2, 2000. Thereafter, on November 21, 2000, DOI submitted a certificate of compliance on the proposed regulation to OAL, but OAL disapproved it on January 8, 2001 for failure to comply with Government Code section 11349.1's necessity standard and for incorrect procedure. In order to keep existing section 2498.6 and the incorporated-by-reference Plan of Operations in effect while DOI resolves this issue, DOI readopted section 2498.6 as an emergency regulation effective January 8, 2001. At this writing, DOI staff is working to correct the rulemaking file for resubmission to OAL.

### Other DOI Rulemaking

The following is a summary of other DOI rulemaking proceedings, some of which were discussed in more detail in Volume 17, No. 1 (Winter 2000) of the *California Regulatory Law Reporter*.

◆ ***Public Inspection and Publication of Examinations.*** On February 13, 2001, OAL approved DOI's adoption of section 2695.30, Title 10 of the CCR, on an emergency basis. This regulation implements SB 1805 (Escutia) (Chapter 997, Statutes of 2000), which requires DOI to make its reports on market conduct examinations of insurer claims handling practices available for public inspection (including by publication on its Web site) (see 2000 LEGISLATION). SB 1805 also provides that a report of a market conduct examination must be transmitted to the examined insurer upon its adoption by the Commissioner; that the insurer then has ten business days in which to submit comments to the Commissioner relating to the adopted report; and that, within ten business days after transmittal of the adopted report, the Commissioner must publish on DOI's Web site both the adopted report and any comments received thereon. Section 2695.30 includes standards for the presentation and length of comments that an insurance company may submit for publication concerning the Insurance Commissioner's report on his examination of alleged unfair or deceptive practices of the insurance company.

At this writing, the Commissioner has yet to publish notice of his intent to permanently adopt section 2695.30, and the emergency regulation is valid until June 13, 2001.

◆ ***Slavery Era Insurance Policies.*** On January 26, 2001, DOI published notice of its intent to hold public hearings and adopt regulations to implement SB 2199 (Hayden) (Chapter 934, Statutes of 2000), which requires the Commissioner to request and obtain information from insurers doing business in California regarding any records of slaveholder insurance policies issued by any predecessor corporation during the slavery era, which policies provided coverage to slaveholders for damage or death to their slaves (see 2000 LEGISLATION).

DOI proposes to adopt new sections 2393–2398, Title 10 of the CCR, to implement SB 2199. Section 2393 would state the purpose of the legislation and the regulations, which is to require insurers to make slavery era insurance informa-

tion available to DOI, and to require DOI to make that information available to the public and to the legislature. Section 2394 would define terms used throughout the regulations. Section 2395 would require every insurer to report to the Commissioner regarding slaveholder insurance policies ("policies issued to or for the benefit of slaveholders to insure them against the death of, or injury to, human property") that it wrote either directly or indirectly through a predecessor corporation during the slavery era (prior to 1865). Section 2396 would set forth the format and required contents of the insurer reports, including the names of all slaves and slaveholders, policy information, and a description of the methodology employed by the insurer to identify and compile the records and information that are responsive to these regulations and to SB 2199. Section 2397 would require insurers to submit their reports to the Commissioner by October 15, 2001; authorize the Commissioner to require additional reports if a report is determined to be incomplete; and require insurers that do not file by October 15, 2001 to submit progress reports on the first day of every month thereafter until the required information has been submitted. Section 2398 would require the Department to establish a Slavery Era Insurance Policy Registry, consisting of all of the information submitted by the insurers, and make it available to the public and to the legislature.

DOI held public hearings on these proposed regulations on March 13, 2001 in Los Angeles and on March 16, 2001 in San Francisco; at this writing, the Department is compiling the comments received and preparing to adopt the proposed regulations.

◆ ***Rental Car Agents.*** AB 62 (Papan) (Chapter 618, Statutes of 1999) creates and establishes fees for a new type of production agency license, called a rental car agent license, which authorizes a rental car company or the franchisee of a rental car company to offer to its customers insurance if the insurance is sold as part of a vehicle rental transaction. The bill requires a rental car agent to provide informational brochures to customers relating to insurance offered, and specifies both required and prohibited conduct on the part of a rental car agent. These provisions became operative on January 1, 2001. *[17:1 CRLR 161]*

On December 6, 2000, OAL approved DOI's adoption of emergency regulations, sections 2130–2130.8, Title 10 of the CCR, which implement the requirements of AB 62. Among other things, the regulations require that a separate license be obtained by each natural person or organization that intends to act as a rental car agent; establish a $340 application fee and a $340 license renewal fee; set forth the contents of the required brochures that rental car agents must provide to consumers; require licensees to provide to the Commissioner the training materials they use in training employees or endorsees to sell insurance; impose recordkeeping requirements on rental car agents; and set forth procedures the Commissioner must follow in considering applications for licensure. On and after January 1, 2001, no rental car company may sell or offer insurance without complying with Insurance Code section 1758.8 *et seq.* and these regulations.

On March 9, 2001, DOI published notice of its intent to permanently adopt its emergency regulations, and set a hearing for April 24, 2001. In the meantime, OAL approved DOI's readoption of the regulations on an emergency basis on April 30, 2001; this action ensures that the regulations are valid for another 120 days.

◆ ***Credit Insurance Rates.*** DOI has commenced two rulemaking proceedings to implement AB 1456 (Scott) (Chapter 413, Statutes of 1999), regarding credit insurance rates.

**DOI has commenced two rulemaking proceedings to implement AB 1456 (Scott) (Chapter 413, Statutes of 1999), regarding credit insurance rates.**

Credit insurance is sold in conjunction with a loan or credit agreement by credit card companies, finance companies, auto dealers, department stores, or wherever loans are made or credit extended for personal property purchases. Credit property insurance policies make payments for the consumers to the lender for a specific loan or credit agreement in the event the property is lost or becomes damaged. Credit unemployment policies make payments on behalf of the consumer to the creditor in the event the borrower becomes unemployed. Credit life and credit disability insurance make payments to the lender in the event the consumer dies or becomes disabled.

AB 1456 (Scott) permits the Insurance Commissioner to set credit insurance rates based on a target 60% loss ratio for all lines of credit insurance, including those for life, disability, involuntary unemployment, and property, by January 1, 2001. AB 1456 also requires the Insurance Commissioner to make available to the public actual loss ratios for all lines of credit insurance on an annual basis. According to the legislative analyses of AB 1456, "credit insurance has been long recognized to be overpriced." The author introduced this bill to stem losses experienced by consumers as a result of excessive credit insurance rates. This measure is designed to clarify the standard for credit insurance rates and to ensure that the standard is applied to all lines of credit insurance. *[17:1 CRLR 165]*

On August 4, 2000, DOI published notice of its intent to amend sections 2248.30–2248.48, Title 10 of the CCR, governing the prima facie maximum premium rates for "short term" credit life and credit disability insurance. Under Insurance Code section 779.36(a), the "Commissioner shall adopt regulations that become effective no later than January 1, 2001, specifying prima facie premium rates based upon presumptive loss ratios, with rates which would be expected to result in a target loss ratio of 60 per cent, or any other loss ratio as may be dictated after applying the factors contained in this subdivision, for each class of credit disability...and credit life insurance." The Department's proposed amendments to sections 2248.30–2248.48, Title 10 of the CCR would (1) change the presumptive loss ratio ("target loss ratio") for credit life insurance from

55% to 60% (the credit disability presumptive loss ration would remain 60%); (2) recalculate the prima facie premium rates for life and disability insurance based upon the 60% presumptive loss ratio and the loss experience generated since the existing regulations were promulgated; (3) repeal the existing mechanism for computing and using deviated life insurance rates and (4) extend the disability deviated rate mechanism to life insurance. At this writing, the Department is still considering the proposed amendments.

On November 17, 2000, DOI published notice of its intent to adopt new sections 2670.1–2670.27, Title 10 of the CCR, which would specify prima facie rates for credit property insurance and credit unemployment insurance. DOI's proposed regulations were modeled on the largest premium volume credit property and credit insurance programs in California. Each prima facie rate uses the statutory target loss ratio of 60%. The proposed regulations would allow companies to request rates different from the benchmark rates if the companies have data to support a different rate. The proposed regulations would require rate reductions of approximately 75%. On January 10, 2001, the Department held a public hearing on the proposed regulations. Insurance industry representatives opposed the regulations, saying that DOI had failed to consider all the required factors under Insurance Code section 779.36, such as acquisition costs (including commissions and other forms of compensation), expenses, profits, loss ratios, reserves, and other reasonable actuarial considerations. Industry comments suggested that if DOI asked the industry to provide data on these ratemaking factors, then the proposed prima facie rates would have to be much higher than those proposed by the Department. Consumers Union disagreed, contending that the proposed prima facie benchmark rates are not low enough. At this writing, the proposed credit property and credit unemployment rate regulations are still under consideration by DOI.

◆ ***Organized Automobile Insurance Fraud Interdiction Program.*** DOI is adopting two sets of regulations to implement AB 1050 (Wright) (Chapter 885, Statutes of 1999), the Organized Crime Prevention and Victim Protection Act of 1999. AB 1050 and a companion bill, SB 940 (Speier) (Chapter 884, Statutes of 1999), combine to increase auto insurance anti-fraud funding, target fraud control activities, and make other reforms related to auto insurance fraud. *[17:1 CRLR 160–61]*

On July 7, 2000, OAL approved DOI's emergency adoption of section 2698.70–2698.77, Title 10 of the CCR, to implement Insurance Code sections 1874.8 and 1874.81 added by AB 1050. These laws require the Commissioner to assess insurers up to fifty cents per vehicle annually, and to distribute these funds to California district attorneys for use in prosecuting organized automobile insurance fraud cases. The regulations specify that insurers must pay twenty-five cents per vehicle insured in 2000, and fifty cents per vehicle insured in years thereafter, to fund the Organized Automobile Insurance Fraud Interdiction Program; set forth the procedure whereby district attorneys may apply for grant funding; specify the criteria and process by which the Commissioner reviews applications and awards grants; and set forth the standards for reporting and auditing the grantee's use of funds and performance under the grant program. These regulations were subsequently adopted on a permanent basis by DOI and approved by OAL on November 21, 2000.

On October 27, 2000, DOI published notice of its intent to amend sections 2698.61, 2698.62, 2698.65, 2698.66, and 2698.67, Title 10 of the CCR, which govern its preexisting Program for Investigation and Prosecution of Automobile Insurance Fraud. These amendments are intended to conform the existing assessment procedures to those established for the Organized Automobile Insurance Fraud Interdiction Program (see above), and to establish a uniform auditing process. DOI held a public hearing on these proposed regulatory amendments on December 15, 2000; at this writing, the Department is preparing the rulemaking file for submission to OAL.

◆ ***Broker Fees.*** On April 14, 2000, DOI republished notice of its intent to adopt new sections 2189.1–2189.8, Title 10 of the CCR, to establish standards governing broker fees. While existing law prohibits insurance agents from charging customers a fee for an insurance transaction, no such prohibition applies to brokers. DOI originally published notice of this proposal in August 1999, and held a hearing on it in October 1999 *[17:1 CRLR 155]*; based on the written and oral comments received, DOI republished the proposal for a new 45-day comment period and held a public hearing on the amended proposal on June 6, 2000.

The regulations define the term "broker fee" to mean "any fee, however labeled, charged by an insurance broker to provide services that constitute or arise out of the transaction of insurance, as defined in Insurance Code section 35, but excluding fees charged for services not constituting or arising out of the transaction of insurance," and establish preconditions for the charging of a broker fee. For example, the regulations require that a broker disclose to a consumer all material facts surrounding the fee, provide a consumer with a standard disclosure form prescribed by the regulations, and sign and have the consumer sign an agreement which contains certain language mandated by the regulations. In particular, the broker must disclose (if true) that an insurer may pay to the broker a commission in addition to the broker fee. Both the disclosure and the agreement must be in English and in any other language principally used by the broker to advertise, solicit, or negotiate the sale and purchase of insurance.

The regulations also recite certain acts that are deemed unfair or deceptive. Among others, these include failure to provide a consumer with the standard disclosure, failure to complete all relevant portions of the broker fee agreement before giving the agreement to the consumer for review, failure to provide a consumer with a fully completed copy of the broker fee agreement as soon as reasonably practicable, and failure to promptly refund an entire broker fee if the broker

acts incompetently or dishonestly resulting in financial loss to the consumer (or, regardless of financial loss, if the broker commits certain listed acts of misfeasance or nonfeasance).

As adopted by DOI, the regulations apply to all transactions and services performed by fire and casualty broker-agents acting in the capacity of an insurance broker for applicants, policyholders, or other consumers of an insurance coverage described in Insurance Code sections 660 or 675; under section 2189.1(b), certain provisions of the new regulations do not apply to a wholesale intermediary (a broker-agent that negotiates an insurance contract with a retail broker-agent, but not with a consumer), provided that the wholesale intermediary discloses its fees in writing to the retail broker-agent. OAL approved these regulations on August 25, 2000.

◆ ***Viatical Settlements***. On March 24, 2000, the Department published notice of its intent to adopt new sections 2698.90–2698.98, Title 10 of the CCR, regarding viatical settlements. A viatical settlement is a financial service for the terminally ill which enables individuals to receive immediate cash from all or part of their life insurance policies. Viatical settlement companies purchase life insurance policies owned by and/or insuring individuals diagnosed with a terminal illness. Insurance Code sections 10113.1 and 10113.2 set forth the requirements for persons entering into and soliciting viatical settlement agreements, and DOI proposed regulations to implement these statutes. However, on September 27, 2000, Governor Davis signed SB 1837 (Figueroa) (Chapter 705, Statutes of 2000). Sponsored by the Department of Corporations (DOC), SB 1837's main purpose is to clarify that viatical settlement contracts are securities and are thus within DOC's jurisdiction (see agency report on DOC for related discussion). Accordingly, DOI abandoned this rulemaking proceeding.

◆ ***Title Insurance/Escrow Regulations***. On February 16, 2000, Commissioner Quackenbush announced his adoption of emergency regulations governing the conduct of California title insurers and escrow companies under DOI jurisdiction. According to the Commissioner, the new regulations were needed to implement and clarify laws governing escrow accounts that had resulted in confusion and litigation. The new regulations—sections 2557–2557.16, Title 10 of the CCR—would have required escrow companies to provide customers with a choice of whether to establish interest-bearing accounts for their escrows, or to select a direct benefit of reduced rates resulting from escrow company banking relationships (banks often give escrow companies "earnings credits" in the form of payments, services in lieu of payments, or discounts that are based upon the amount of client funds deposited by an escrow company or title insurer in the bank). Escrow companies would also have been required to charge a single, all-inclusive rate for all escrow services, except for certain charges that are required by law to be itemized separately. This rulemaking action was announced in conjunction with settlement agreements reached between DOI and title insurers with respect to a suit filed by the Attorney General on behalf of DOI and the state Controller's Office (see LITIGATION).

On March 27, 2000, OAL disapproved the proposed regulations because DOI's finding of emergency was not sufficient to show that the immediate adoption of the regulations was necessary for the immediate preservation of the public health and safety, or general welfare, and because of the omission of a required form from the rulemaking record.

On April 7, 2000, DOI published notice of its intent to adopt sections 2557–2557.16, Title 10 of the CCR, in the normal course, and set a public hearing for June 20, 2000. However, this rulemaking proceeding was subsequently dropped due to the ongoing legislative hearings into the scandal surrounding the Northridge earthquake settlements.

◆ ***Appeals of Workers' Compensation Disputes***. On February 10, 2000, OAL approved DOI's adoption of new section 2509.40 *et seq.*, Title 10 of the CCR, regulations that govern appeals to the Commissioner of various decisions regarding workers' compensation issues. These regulations, which are required by AB 877 (Solis) (Chapter 517, Statutes of 1997), have been in effect since June 1999 as emergency regulations. *[17:1 CRLR 156–57]*

◆ ***FAIR Plan Amendments***. On November 24, 1999, OAL approved DOI's adoption of sections 2590 and 2590.1, Title 10 of the CCR, related to the California FAIR Plan Association. FAIR, an association of all property insurers in the state of California, is intended to assure stability in the California property insurance market and to provide basic property insurance to eligible property owners in high-risk areas who are unable to obtain it in the normal market. All insurers participate according to the amount of business they write in the state. However, Insurance Code section 10094.2 requires the FAIR Plan Association, pursuant to regulations adopted by the Commissioner, to provide for a method to proportionately relieve an insurer from participation in the FAIR Plan if the insurer voluntarily writes (a) basic property insurance on risks located in brush hazard areas, (b) basic property insurance in designated inner city areas, or (c) business owners package insurance on risks located in designated inner city areas. Section 2590 defines several terms used in the statute and regulations; section 2590.1 requires the FAIR Plan Association to adopt a fair and reasonable method that allows insurers whole or partial relief from participation in the Association. *[17:1 CRLR 154]* The regulations became effective on December 24, 1999.

◆ ***Fair Claims Settlement Practices Regulations***. In August 1999, DOI published notice of its intent to reorganize, clarify, and make some substantive revisions to sections 2695.1–14, Title 10 of the CCR, the regulations adopted by former Commissioner John Garamendi to implement and interpret the sixteen unfair claims settlement practices barred by Insurance Code section 790.03(h). *[17:1 CRLR 155–56]* During 2000, DOI abandoned this rulemaking proceeding.

◆ ***CAARP Plan of Operations***. In August 1999, DOI published notice of its intent to adopt a new CAARP Plan of Operations that will supersede section 2400 *et seq.*, Title 10 of the CCR, but will be incorporated by reference into that

section. *[17:1 CRLR 154–44]* DOI failed to complete this rulemaking proceeding within the one-year period provided by Government Code section 11346.4(b); thus, the Department must republish this regulatory change.

## Department Continues Effort to Secure Claims Payment for Holocaust Survivors

The Department continues to participate in wide-ranging efforts to secure payment of insurance claims on behalf of Holocaust survivors and heirs. During World War II, many Jewish families in Europe purchased life insurance policies as financial protection for loved ones who would survive them. However, Nazi Germany did not preserve insurance policy documents, nor did it issue death certificates for Jews and others murdered in concentration camps during the Holocaust. As a result, many Holocaust survivors and their heirs have been unable to collect on policies purchased over 50 years ago. Several nationwide class action lawsuits have been filed against large European insurance companies on behalf of Holocaust survivors to ensure that they receive payment on legitimate claims; DOI has joined such an action pending in federal court in New York. Some of the companies that are refusing to pay claims of Holocaust victims are licensed in California. Along with the National Association of Insurance Commissioners (NAIC) and the International Commission for Holocaust-Era Insurance Claims (ICHEIC), DOI has been working to bring these companies "to the table" and persuade them to honor their contractual commitments. An estimated 20,000 California residents are Holocaust survivors or the children of individuals who were among the six million killed by the Nazis during World War II. *[17:1 CRLR 157–58; 16:2 CRLR 134–35; 16:1 CRLR 152–53]*

**The Department continues to participate in wide-ranging efforts to secure payment of insurance claims on behalf of Holocaust survivors and heirs.**

This effort on behalf of Holocaust survivors involves proceedings in all branches of government, including the following:

◆ ***State Legislation***. During 1998, 1999, and 2000, the California legislature was active in enacting bills to assist Holocaust survivors (see 2000 LEGISLATION; see also *17:1 CRLR 157–58*). Of particular import, AB 600 (Knox) (Chapter 827, Statutes of 1999) enacted the Holocaust Victim Insurance Relief Act of 1999 (HVIRA) at Insurance Code section 13800 *et seq*. The HVIRA requires the Insurance Commissioner to establish and maintain the public Holocaust Era Insurance Registry, which contains records and information relating to insurance policies issued by insurers in the state, either directly or through a related company, to persons in Europe which were in effect between 1920 and 1945. AB 600 requires insurers to file that information on Holocaust-era policies issued and claims made with the Commissioner for inclusion in the Registry. Failure to comply or falsification of records is grounds for license suspension. *[17:1 CRLR 157–58]* Disclosure of the lists by the insurance companies is deemed critical, because many survivors and their heirs otherwise have no knowledge as to whether their relatives purchased any insurance.

◆ ***State Investigatory Hearings***. In November 1999, Commissioner Quackenbush announced his intent to subpoena eight insurance companies to appear at investigatory hearings in December 1999, to enable DOI to investigate the companies' readiness to comply with the HVIRA. Quackenbush said that the Department would revoke the licenses of those companies that did not provide a list of unpaid World War II-era claims by April 6, 2000. The following companies were subpoenaed to hearings on December 1–2, 1999: Assicurazioni Generali S.p.A (U.S. Branch) (Generali); American Re-Insurance Company (Munich Re); Fireman's Fund Insurance Company (Allianz); Fortis Insurance; Gerling American Insurance Company (Gerling); Peerless Insurance Company (ING); Providence Washington Insurance Company (Basler-Lebens); and Winterthur International American Insurance Company (Winterthur).

Just prior to the December 1999 hearings, Quackenbush announced that the Department had reached "landmark agreements" with three Dutch insurance carriers. The three companies—Aegon, ING, and Fortis—agreed to provide lists of Holocaust-era beneficiaries and to begin paying on claims related to these policies. In the agreements, Quackenbush also announced the Department's establishment of a "humanitarian fund" to benefit California Holocaust survivors, and the three carriers agreed to make a combined contribution of $4.2 million to the fund.

Nine other insurers appeared (some under subpoena, some voluntarily) at the December 1999 hearings in Los Angeles and San Francisco. "You're gonna comply with this law or I'm going to kick you out of the state," Quackenbush reportedly told the insurers at the Los Angeles hearing. The Commissioner's threats drew criticism from the Clinton administration, which was trying to resolve Holocaust-era disputes through international diplomacy and the ICHEIC. Counsel for Generali complained that the company was required to appear at DOI's hearings even though it had already provided a list of 98,000 names to Yad Vashem, the Jewish Holocaust memorial in Jerusalem, and—along with four other companies—had provided $90 million in to the ICHEIC to pay claims and administrative costs. Quackenbush responded that Generali was obliged to produce over 300,000 names and reiterated that he would seek revocation of the company's license to operate in California if it does not comply with the HVIRA.

◆ ***State Administrative Rulemaking***. On January 13, 2000, OAL approved DOI's emergency adoption of section 2278–2278.5, Title 10 of the CCR, regulations that establish standards for reporting by insurance companies doing business in California to the Holocaust Era Insurance Registry consistent with the requirements of the HVIRA. On February

8, 2000, OAL approved DOI's emergency amendments to those regulations. The regulations define terms that are used throughout the HVIRA and its implementing regulations; clarify who is required to file a report; set forth the report format and its required contents, including number of policies sold to persons in Europe which were in effect between 1920 and 1945, information on each policy sold (including name and address of policyholder, name and address of insured, beneficiary name, current status of the policy (*e.g.*, whether any heirs have been located and/or claims paid), and name of the insurance company that issued the policy), and several required certifications on each listed policyholder and insured. The regulations further specify that all reports must be received by DOI no later than April 7, 2000, and require DOI to establish the Registry and make it accessible to the public.

As emergency regulations are valid for only 120 days, DOI readopted them on May 30, 2000, September 20, 2000, and again on January 16, 2001. In the meantime, however, the federal courts enjoined DOI from enforcing its regulations (see below). At this writing, the published version of the regulations includes a notation that, although DOI is prohibited from enforcing them, OAL has approved the readoption of these emergency regulations in order to maintain the status quo pending the outcome of the litigation.

◆ ***State Court Litigation***. Following the passage of AB 1334 (Knox) (Chapter 43, Statutes of 1998), which permits Holocaust survivors and heirs to file claims against World War II-era policies until 2010 and gives California courts jurisdiction to hear them, a number of lawsuits were filed against European companies (particularly Generali) in Los Angeles County Superior Court. *[17:1 CRLR 157–58]* In November 1999, the parties to *Stern v. Generali,* No. BC 185376, the first California suit brought under AB 1334, reached a settlement for an undisclosed amount. The confidential settlement was reportedly far less than the $135 million originally sought; however, the agreement was regarded as a crucial breakthrough for survivors and their beneficiaries. In February 2000, four other plaintiffs followed suit and settled their claims against Generali in Los Angeles County Superior Court, including *Babos v. Generali*, No. BC 188680; *Friedman v. Generali*, No. BC 193182; and *Fischbein and Feldman v. Generali*, No. BC 214191.

◆ ***Federal Court Litigation***. The most important federal litigation on the Holocaust-era insurance claims issue is *Gerling Global Reinsurance Corporation, et al. v. Low*, in which three insurance companies and one trade association of insurance companies who do business in California are attempting to invalidate the HVIRA and DOI's implementing regulations (sections 2278–2278.5, Title 10 of the CCR) on grounds that the state statute violates the federal government's "foreign affairs" power and the commerce, due process, and equal protection clauses of the U.S. Constitution. On June 9, 2000, Judge William B. Shubb of the U.S. District Court for the Eastern District of California issued a preliminary injunction prohibiting the Department from enforcing either the HVIRA or its Registry regulations on grounds that plaintiffs established probability of success on the merits of their claims under the foreign affairs doctrine and the commerce clause. On February 7, 2001, the U.S. Ninth Circuit Court of Appeals reversed on both counts (240 F.3d 739), but affirmed the issuance of the preliminary injunction because it found that the HVIRA might impinge the insurers' due process rights—an issue which was not considered at length by the district court. Thus, the Ninth Circuit remanded the matter to the district court for consideration of the due process issue; at this writing, the matter is still pending in the district court and DOI is still enjoined from enforcing either the HVIRA or its regulations.

**On June 9, 2000, Judge William B. Shubb of the U.S. District Court for the Eastern District of California issued a preliminary injunction prohibiting the Department from enforcing either the HVIRA or its Registry regulations on grounds that plaintiffs established probability of success on the merits of their claims under the foreign affairs doctrine and the commerce clause.**

In other federal court action, the Ninth Circuit on May 18, 2000 issued an unpublished ruling in *Stahl v. Victoria Holding AG*, 221 F.3d 1349 (2000) (reported in full at 2000 U.S. App. LEXIS 11358), reversing a 1998 Los Angeles federal district court's order denying plaintiffs' motion to conduct jurisdictional discovery and dismissing their claim for lack of personal jurisdiction over the defendant insurance company. Plaintiffs are the heirs of death camp victim Heinrich Stahl, and their bid to conduct discovery to determine whether German insurer Victoria Holding AG has ties to California had been denied by the district court. The Ninth Circuit directed U.S. District Judge William D. Keller to permit plaintiffs to gather and present evidence regarding the insurance companies' personal jurisdiction issues. *Stahl* was subsequently dismissed voluntarily by plaintiffs.

In 2000, most remaining California individual and class action Holocaust-era claims against European insurers or their successor firms were removed to federal court. In December 2000, the federal Judicial Panel on Multidistrict Litigation granted Generali's motion to consolidate and transfer the remaining cases to the Southern District of New York. At this writing, the consolidated cases are pending before U.S. District Court Judge Michael B. Mukasey, No. MDL 1374 (S.D.N.Y.).

◆ ***Holocaust-Era Insurance Claims Dispute Affected by Quackenbush Scandal***. Even DOI's effort to assist California Holocaust survivors was impacted by the scandal that drove Commissioner Quackenbush from office. As noted above, in November 1999 three Dutch insurance companies became the first to commit to voluntary compliance with the HVIRA. In agreements with the companies, then-Commissioner Quackenbush announced the Department's establish-

ment of a "humanitarian fund" to benefit California Holocaust survivors, and the three carriers agreed to make a combined contribution of $4.2 million to the fund. In April 2000, the Dutch Insurance Association, on behalf of its member companies (including Aegon, ING and Fortis) submitted the first list of Holocaust-era insurance policies to the Department for publication in the California Holocaust Insurance Registry.

Although the list of policies has been posted on DOI's Web site, the promised funds were never collected. On May 17, 2000, the *Los Angeles Times* reported that, more than five months after agreements were announced, the Department had yet to collect any money for the fund. A spokesperson for the three insurers said that while the insurers agreed to make the payment, the Department never actually asked for the money. At the time, Commissioner Quackenbush issued a statement saying that, "Because of problems related to the other foundations that were established and the resulting criticisms, this foundation has never been activated...." The Bureau of State Audits' October 20, 2000 report (see above) confirmed that the Holocaust survivor fund payments have yet to be received from the three Dutch insurance companies.

### Auto Body Repair Consumer Bill of Rights

On January 24, 2001, Commissioner Low—pursuant to SB 1988 (Speier) (Chapter 867, Statutes of 2000)—released the Department's *Auto Body Repair Consumer Bill of Rights* and notified all auto insurers that they must provide the document to insureds at the time they apply for a policy or when they file a claim. The standardized form informs consumers that they are entitled to: (1) select the auto body repair shop to repair damage covered by their insurer; (2) receive an itemized written estimate for auto body repairs and, upon completion of repairs, a detailed invoice; both must contain an itemized list of parts (identified as new, used, aftermarket, reconditioned, or rebuilt) and labor, along with the total price for the work performed; (3) be informed about coverage for towing services; (4) be informed about the extent of coverage, if any, for a replacement rental vehicle while the damaged vehicle is being repaired; and (5) be informed of where to report suspected fraud or other complaints and concerns about auto body repairs.

### DOI Releases Consumer Complaint Study

In November 1999, as required by Insurance Code section 12921.1, DOI released its annual consumer complaint study for automobile, homeowners, and life insurance covering complaints closed during calendar years 1996, 1997, and 1998. When DOI receives a complaint from a consumer, it applies the criteria set forth in section 2694, Title 10 of the CCR, to classify the complaint as either "justified," "unjustified," or a "question of fact." *[16:1 CRLR 149–50]* In its consumer complaint study, DOI ranked the 50 largest insurers according to their justified complaint ratio, which is based on the number of justified complaints closed compared to the number of policies or exposures.

Among the fifty largest automobile insurers, the top three insurers were Wawanesa Mutual (with a 0.7 justified complaint ratio), USAA Casualty (with a 1.3 justified complaint ratio), and California State Automobile Association (with a 1.6 justified complaint ratio). The bottom three insurers were American International of California (with a justified complaint ratio of 49.4), Superior (with a justified complaint ratio of 61.6), and Permanent General Insurance (with a justified complaint ratio of 66.6).

Among the fifty largest homeowners insurers, the top three were USAA Casualty, Associated Indemnity, and TIG; each had a 0.0 justified complaint ratio. The bottom three insurers were American Bankers of Florida (with a 15.7 justified complaint ratio), National General (with a 25.4 justified complaint ratio), and Pacific Specialty (with a 31.0 justified complaint ratio).

Among the fifty largest life insurers, the top three were Northwestern Mutual Life, Globe Life and Accident, and First Colony Life; each had a 0.0 justified complaint ratio. The bottom three life insurers were Colonial Life and Accident (with a 5.3 justified complaint ratio), Midland National Life (with a 5.4 justified complaint ratio), and Conseco Life (with a 5.5 justified complaint ratio).

## 2000 LEGISLATION

### DOI Reform Legislation

**SB 1805 (Escutia)**, as amended August 31, 2000, requires the Commissioner to make information concerning the resolution of market conduct examinations and the contents of adopted reports of examinations of unfair or deceptive business practices available for public inspection and on the Department's Web site. The bill also permits insurers to furnish comments regarding adopted reports of examination for publication on the Department's Web site. SB 1805 further requires the Commissioner, if he/she suspends or terminates a market conduct examination of claims practices, to send a copy of the complete file to the Bureau of State Audits, and requires the State Auditor to audit the file pursuant to Government Code section 10527 and make a determination of the propriety of the termination or suspension. The Governor signed SB 1805 on September 30, 2000 (Chapter 997, Statutes of 2000).

**SB 1524 (Figueroa)**, as amended August 24, 2000, adds section 12926.1 to the Insurance Code. Section 12926.1 requires that any fines, penalties, fees, and costs resulting from any matter involving compliance with or enforcement of any provisions of the Insurance Code or other laws involving any entity subject to the jurisdiction of the Commissioner be deposited in the appropriate fund as provided by law.

Section 12926.1 also provides that any funds ordered or allocated by a settlement to be used for public outreach shall be subject to specified limitations: (1) the Commissioner's name, likeness, or voice shall not be used in any printed, audio, or visual material that is released either for general distribution or to specific recipients unless a court finds good

cause to do so; (2) the message shall be limited to information relevant to the enforcement action or compliance issues that generated the funds; (3) the primary focus of any public outreach where the purpose is to advise members of the public of rights affecting pecuniary or property interests shall be to provide specific information needed by the affected persons to obtain or protect those rights; (4) no funds subject to this subdivision shall be used for general education of the public about insurance issues, except to the extent that the education relates to the type of violations that caused the enforcement or compliance action, and otherwise complies with the limitations of this section; and (5) no funds subject to this subdivision shall be spent or otherwise disposed of unless the expenditure or disposal has been approved by a court of competent jurisdiction.

SB 1524 also authorizes certain individuals, a city attorney, a district attorney, or the Attorney General to bring legal action against the Commissioner to enforce these provisions. The bill also authorizes a court to order the Commissioner to pay damages out of nonpublic funds to any prevailing party in any enforcement action arising out of the bill's provisions. Governor Davis signed SB 1524 on September 30, 2000 (Chapter 1089, Statutes of 2000).

**SB 2107 (Speier)**, as amended August 25, 2000, permits the Commissioner to delegate the power to negotiate settlements, but requires the Commissioner to approve all settlements. As to settlements, SB 2107 also prohibits the Commissioner—unless specifically permitted by law—from (1) requiring the respondent to contribute to a nonprofit entity; (2) requiring the respondent to contribute or transfer funds to any fund other than to the State Treasurer for deposit in the Insurance Fund; (3) directing funds to another person or entity; and (4) using settlement moneys to produce printed, audio, or visual materials using the name, likeness, or voice of the Commissioner for general distribution. SB 2107 also provides that the Commissioner may only agree to payment to those persons or entities to whom payment may be due because of the respondent's violation of a provision of the Insurance Code or other law regulating the business of insurance in this state. Further, a settlement may only include the sanctions provided by the Insurance Code or other laws regulating the business of insurance in California (except that the settlement may include attorneys' fees, DOI's costs in bringing the enforcement action, and future DOI costs to ensure compliance with the settlement agreement). Governor Davis signed this bill on September 30, 2000 (Chapter 1091, Statutes of 2000).

**SB 1738 (Hayden)**, as amended May 9, 2000, would have created a statewide organization to represent insurance policyholders and patients to advocate for lower insurance rates and quality health care in California. Sponsored by the Foundation for Taxpayer and Consumer Rights, SB 1738 would have created the Insurance Policyholder and Patient Association, modeled after citizens' utility boards (CUBs) that exist in Illinois, Oregon, and Wisconsin with respect to utility consumers and similar to the San Diego-based Utility Consumers' Action Network. *[11:3 CRLR 1; 11:2 CRLR 1]* According to the committee analysis, the bill was designed to create a consumer-based, nonprofit watchdog to meaningfully participate and facilitate representation of consumer interests in ratemaking and policysetting proceedings of DOI and the Department of Managed Health Care. To fund the CUB, SB 1738 would have required the Department of Motor Vehicles, health plans, and insurers to send membership notices regarding the association in their mailings. Heavily opposed by insurers, the bill died in the Senate Appropriations Committee's suspense file.

**SCA 19 (Speier)**, as amended May 23, 2000, would have placed on the November 2000 ballot a proposal to change the position of Insurance Commissioner from an elective position to a Governor-appointed position, subject to confirmation by the Senate, and limited to no more than eight years. California's Insurance Commissioners were appointed by the Governor until 1988; Proposition 103 converted the position to an elective post.

According to Senator Speier, there is an inherent conflict in the current system, which allows an elected Insurance Commissioner to impose fines on a regulated industry while accepting campaign contributions from that same industry. Although the insurance industry and its agents would still be free to contribute to the Governor, the author argues that direct industry influence would be significantly diluted. Further, the Senate would be able to approve or reject the Governor's appointee. In opposition to the measure, Proposition 103 author Harvey Rosenfield argued that what is needed is not a change in the elected status of the Insurance Commissioner; rather, the insurance industry should be barred from contributing to a candidate for Commissioner. Also in opposition, the Center for Public Interest Law pointed to the "revolving door" problem: "Prior to 1988, the individuals appointed as Insurance Commissioner by all governors—regardless of political party—were former insurance executives, and these individuals generally returned to some sector connected to the insurance industry after serving their term of office. Their allegiance to the insurance industry while in office—and their corresponding indifference (if not antipathy) toward consumer protection—was unmistakable." On May 24, 2000, SCA 19 failed passage in the Senate Committee on Constitutional Amendments.

**SB 953 (Speier)**, as amended August 21, 2000, would have placed limits on the amounts insurers may contribute to the Insurance Commissioner when the insurer has a matter pending before the Department. The bill would also have limited the campaign contributions a candidate for Commissioner may accept from the insurance industry and would have placed campaign contribution and voluntary campaign expenditure limits on the Insurance Commissioner and candidates for the office of the Insurance Commissioner. The industry opposed the bill, arguing that applying certain contribution provisions to insurers alone is unfair and that regulating campaign contributions should not be done in "piecemeal fashion." SB 953 failed passage on the Assembly floor on August 28, 2000.

**AB 481 (Scott)**, as amended and enrolled August 31, 2000, would have provided that in any settlement agreement related to unfair methods of competition and unfair and deceptive acts or practices in the business of insurance, the Insurance Commissioner shall give first priority to policyholders; the settlement agreement may provide for remediation, payment to policyholders, or both of these remedies. The bill would have allowed settlement agreements to include, as a condition of settlement, an order or allocation of funds to be used by the Department for education and research related to any of the alleged violations which were the basis for the action. The bill would have required any funds received for such purposes to be deposited in the Insurance Fund and to be expended for research and education only when authorized pursuant to the Budget Act. Governor Davis vetoed AB 481 on September 30, 2000, stating that while "much of this bill is positive,...[it] confers on the Department of Insurance a power previously reserved to the judiciary, namely to mediate and resolve disputes arising from claims by individual policy holders."

## Auto Insurance

**SB 1988 (Speier)**, as amended August 25, 2000, is the "Anti-Auto Theft and Insurance Fraud Act of 2000," in which the legislature made the following findings: "The legislature finds and declares that auto theft, auto body repair fraud and other forms of auto insurance fraud, including staged accidents, cause great economic harm and personal suffering to the people of California. The cost of this theft and fraud has been estimated to be at least $1 billion annually and may be in excess of $9 billion annually. According to the Bureau of Automotive Repair, 39% of the work it inspects involves fraud, and according to the California Highway Patrol, insurance fraud and auto theft are linked to organized crime. Accordingly, the legislature has determined that it is necessary to increase efforts by state agencies to combat this type of fraud and to require insurers to strengthen their antifraud efforts."

Among other things, SB 1988 requires the Bureau of Automotive Repair to undertake a pilot program to inspect auto bodywork on insured vehicles to determine whether fraud was committed and to recommend measures for the prevention of auto body fraud until June 30, 2003; the results of this pilot program are to be reported to the legislature by September 1, 2003. The bill also requires DOI to develop a standardized Auto Body Repair Consumer Bill of Rights covering specified issues, and requires insurers to present this form to consumers either at the time of applying for insurance or following an accident that is reported to the insurance company (see MAJOR PROJECTS).

SB 1988 also adds new Article 4.5 (commencing with section 1874.85) to Chapter 12 of the Insurance Code, which requires insurers that issue automobile liability or collision policies to inspect vehicles for which they have approved a claim for the cost of auto body repairs, either during the repair process or after the work has been completed; the number of vehicles inspected shall be a statistical sampling sufficient to demonstrate to DOI the insurer's efforts to reduce fraudulent auto body work during a calendar year. Insurers must report specific findings annually to DOI.

SB 1988 also enhances the annual insurer assessment that funds DOI's Fraud Division from $1,000 to $1,300, and increases the fine for auto insurance fraud from $10,000 to $15,000. Under the bill, the professional licenses of doctors and chiropractors who are convicted of multiple counts of certain insurance fraud offenses must be revoked for ten years; the bill also amends the State Bar Act to provide that insurance fraud is grounds for disbarment or suspension of the license of an attorney. The bill also encourages the agencies regulating physicians, chiropractors, and attorneys to commence investigations of alleged insurance fraud before their licensees are criminally convicted (with the permission of the prosecuting district attorney).

The bill also permits the Commissioner to declare a region of the state as an auto insurance fraud crisis area "if the Commissioner determines that organized automobile fraud activity exists in the area and contributes significantly to the cost of automobile insurance in that area." Such a designation will permit the Commissioner to require insurers to report claims to a special DOI unit for tracking; the bill also doubles fines for insurance fraud offenses committed in an auto insurance fraud crisis area. SB 1988 was signed by the Governor on September, 28, 2000 (Chapter 867, Statutes of 2000).

**AB 2594 (Cox)**, as amended June 19, 2000, was joined to SB 1988 (Speier) (see above) and increases the fines and penalties for criminal convictions of all types of insurance fraud. AB 2594 provides for a fine of up to $50,000 for a first conviction of insurance fraud, the possibility of one year in jail or prison, or both the fine and imprisonment. A second or subsequent conviction requires imprisonment in the state prison, a $50,000 fine, or both. Governor Davis signed AB 2594 on September 28, 2000 (Chapter 843, Statutes of 2000).

**SB 1731 (Lewis)**, as amended May 9, 2000, is a DOI-sponsored bill that repeals Insurance Code section 11621, which set forth exclusions from participation in the California Automobile Assigned Risk Plan (CAARP), and establishes clearer and more detailed rules governing insurer participation in CAARP. Among other things, the bill provides that insurer groups under the same ownership may elect to be treated as one insurer for CAARP purposes and receiving assignments and assessments; and requires insurers that discontinue writing automobile liability insurance, but which retain auto insurance authorization, to continue to pay CAARP assessments and receive assignments until prior-established quotas have been filled, unless another insurer is allowed to assume those obligations. The Governor signed SB 1731 on July 21, 2000 (Chapter 175, Statutes of 2000).

**AB 1848 (Maddox)**, as amended June 27, 2000, adds section 11580.17 to the Insurance Code. Section 11580.17 provides that the Department shall not prohibit an insurer from inspecting a motor vehicle prior to issuing collision or comprehensive coverage (at no cost to the insured), but requires insurers conduct-

ers conducting such inspections to inspect every motor vehicle for which coverage is requested except new motor vehicles and motor vehicles previously insured. This bill was signed by the Governor on August 8, 2000 (Chapter 210, Statutes of 2000).

**AB 1778 (Lowenthal)**, as amended August 10, 2000, requires vehicle repair dealers to include on written invoices a notice to consumers of whether crash parts are original equipment manufacturer or non-original equipment manufacturer aftermarket crash parts. This bill was signed by the Governor on September 6, 2000 (Chapter 336, Statutes of 2000).

**SB 1996 (Speier)**, as amended August 11, 2000, allows the DMV Director to approve the use of alternative reporting forms for verifying insurance coverage; increases the types of information that may be used as evidence of proof of insurance; and requires certain licensed vehicle dealers to provide written notification to transferees, in Spanish and in English, that they cannot legally drive without some form of liability insurance. In addition, this bill requires the DMV to make the above-mentioned notification available in any other languages used in the most recent statewide voter pamphlet. SB 1996 was signed by the Governor on September 14, 2000 (Chapter 455, Statutes of 2000).

**AB 2904 (Committee on Insurance)**, as introduced March 14, 2000, facilitates access to the low-cost automobile insurance pilot program (see MAJOR PROJECTS) by allowing driving experience earned outside the United States to count toward the three years of driving experience needed to participate in the program. The Governor signed this bill on September 30, 2000 (Chapter 1033, Statutes of 2000).

**SB 1403 (Committee on Transportation)**, as amended August 29, 2000, provides that until January 1, 2004, the low-cost insurance pilot program provisions meet statutory liability insurance and financial responsibility requirements, and makes other clean-up amendments to these and related provisions. SB 1403 was signed by the Governor on September 30, 2000 (Chapter 1035, Statutes of 2000).

## Earthquake Insurance

**SB 1899 (Burton)**, as amended July 6, 2000, adds section 340.9 to the Code of Civil Procedure. Section 340.9 provides that, notwithstanding any other provision of law or contract, any insurance claim for damages arising out of the 1994 Northridge earthquake which is barred solely because of the statute of limitations may be commenced within one year of the effective date of this bill (see MAJOR PROJECTS). This bill does not apply to claims litigated to finality in any court of competent jurisdiction or to written compromised settlements where an insured was represented by counsel. Governor Davis signed SB 1899 on September 30, 2000 (Chapter 1090, Statutes of 2000).

## Holocaust-Era Claims

**SR 28 (Hayden)**, as introduced May 24, 2000, calls on the U.S. Department of State to support California's legislation in support of World War II-era survivors of slave and forced labor and insurance claims by Holocaust survivors as a crucial catalyst in advancing the cause of survivors; and further calls on the U.S. Department of State to view a just resolution of survivors' claims as a human precedent and moral priority for present and future generations. This resolution was unanimously approved by the Senate on May 25, 2000.

**AB 1728 (Villaraigosa)**, as amended August 7, 2000, adds section 17155.5 to the Revenue and Taxation Code, which excludes from gross income (for purposes of income tax calculation) any amount received as reparation payments paid by the German Foundation known as Remembrance, Responsibility , and the Future, or any other source of humanitarian reparations made for purposes of redressing the injustice done to persons who were required to perform slave or forced labor during World War II. The German Foundation was created in February 1999 with contributions from a dozen prominent German companies; since then, approximately 190 additional German banks and firms have committed to participate, and a number of American firms that did business in Germany during World War II have also indicated they will contribute. More than one million Holocaust survivors worldwide are expected to receive $7,500 each from the Foundation. This bill was signed by the Governor on September 25, 2000 (Chapter 685, Statutes of 2000).

## Slavery Era Insurance Policies

**SB 2199 (Hayden)**, as amended August 28, 2000, makes the following legislative finding: "Insurance policies from the slavery era have been discovered in the archives of several insurance companies, documenting insurance coverage for slaveholders for damage to or death of their slaves, issued by a predecessor insurance firm. These documents provide the first evidence of ill-gotten profits from slavery, which profits in part capitalized insurers whose successors remain in existence today. Legislation has been introduced in Congress for the past ten years demanding an inquiry into slavery and its continuing legacies. The Insurance Commissioner and the Department of Insurance are entitled to seek information from the files of insurers licensed and doing business in this state, including licensed California subsidiaries of international insurance corporations, regarding insurance policies issued to slaveholders by predecessor corporations. The people of California are entitled to significant historical information of this nature."

SB 2199 adds sections 13810–13813 to the Insurance Code, which require the Insurance Commissioner to request and obtain information from insurers doing business in California regarding any records of slaveholder insurance policies issued by any predecessor corporation during the slavery era, which provided coverage to slaveholders for damage or death to their slaves. The bill requires insurers to research and report on these policies, and requires the Commissioner to make the information available to the public and

to the legislature (see MAJOR PROJECTS). The Governor signed SB 2199 on September 29, 2000 (Chapter 934, Statutes of 2000).

**SB 1737 (Hayden)**, as amended June 29, 2000, requests the Regents of the University of California to assemble a colloquium of scholars to draft a research proposal to analyze the economic benefits of slavery that accrued to owners and the businesses, including insurance companies and their subsidiaries, that received those benefits. The bill requests the Regents to make recommendations to the legislature regarding the colloquium's findings by January 1, 2002. This bill was signed by the Governor on September 30, 2000 (Chapter 1038, Statutes of 2000).

### Health/Disability Insurance

**AB 2797 (Papan)**, as amended May 2, 2000, prohibits insurance companies and their affiliates from disclosing individually identifiable information about the health of, or the medical or genetic history of, insureds to any depository institution, or to any third party, for use with regard to the granting of credit. This bill was signed by the Governor on August 31, 2000 (Chapter 278, Statutes of 2000).

**AB 2107 (Scott)**, as amended August 24, 2000, imposes the duty of honesty, good faith, and fair dealing on insurers, brokers, agents, and others engaged in the business of Medicare supplemental insurance and long-term care insurance with respect to prospective policyholders. The bill also provides that, after July 1, 2001, a life insurance agent must provide elders with written disclosures explaining the resource and income requirements of the Medi-Cal program before selling or offering to sell to an elder or his/her agent any financial product on the basis of the product's treatment under Medi-Cal. This bill also amends the definition of financial abuse for the purpose of reporting and investigating elder and dependent abuse, and requires the State Bar to submit an annual report to the legislature on the number of complaints filed against attorneys alleging financial abuse and misrepresentation directed against seniors. The Governor signed AB 2107 on September 13, 2000 (Chapter 442, Statutes of 2000).

**SB 1814 (Speier)**, as amended August 28, 2000, requires the Insurance Commissioner to annually prepare a rate guide which provides information on all Medicare supplement insurance policies and contracts which are sold in California; the guide is to be distributed through the Health Insurance Counseling Advocacy Program offices, upon request by telephone and on DOI's Web site. This bill also makes several changes to existing Medicare supplement insurance policies, including the extension of an open enrollment period to individuals under 65 years of age who are eligible for Medicare due to a disability. SB 1814 was signed by the Governor on September 25, 2000 (Chapter 707, Statutes of 2000).

**SB 265 (Speier)**, as amended August 30, 2000, revises California law to conform to the federal Health Insurance Portability and Accountability Act of 1996 (HIPAA), and requires health plans and disability insurers to issue HIPAA coverage to federally eligible individuals at certain premium rates beginning July 1, 2000. This bill defines a "federally eligible individual" as an individual who (a) has had 18 or more months of prior group coverage; (b) is not otherwise eligible for health coverage; (c) was not terminated from his/her most recent health coverage plan due to nonpayment of premiums or fraud; and (d) has exhausted any Consolidated Omnibus Budget Reconciliation Act (COBRA) or Cal-COBRA continuation coverage. AB 265 was signed by the Governor on September 28, 2000 (Chapter 810, Statutes of 2000).

**AB 2616 (Margett)**, as amended August 25, 2000, prohibits health insurers from requesting information not reasonably necessary to determine liability for the payment of claims. It requires insurers to pay health care providers for the cost of duplicating information requested in connection with contested claims, and extends to January 1, 2002 the sunset date of the exemption from the requirements of the Senior Insurance Law for direct response disability insurance (which is sold through advertisements in newspapers, television, radio, or information attached to other billings, such that insureds must contact the insurer to get more information). The Governor signed the bill on September 28, 2000 (Chapter 844, Statutes of 2000).

**AB 2903 (Committee on Health)**, as amended August 29, 2000, as it relates to DOI, authorizes the Insurance Commissioner to contract with the Department of Managed Health Care to administer the Independent Medical Review System as it applies to disability insurers (see agency article on DMHC for further information). AB 2903 was signed by the Governor on September 28, 2000 (Chapter 857, Statutes of 2000).

**AB 1740 (Ducheny)**, as amended June 22, 2000, the state's 2000–02 budget bill, requires DOI to evaluate the contract transferring the Health Insurance Plan of California (HIPC) to private operation, and to determine whether the contract calls for activities subject to regulation by the Department. DOI must report the result of this evaluation to the Senate and Assembly Insurance Committees. The bill also permits the Commissioner to publish notices relating to Holocaust era insurance claim activities, provided that none of the funds for this purpose may be used for other budget activities, no photographs are used in publication of these notices, and no elected official's name is used in the publications unless required by law. The bill was signed by the Governor on June 30, 2000 (Chapter 52, Statutes of 2000).

**SB 1839 (Speier)**, as amended August 28, 2000, would have required health plans and disability insurers to cover routine patient care costs associated with Phase II and III clinical trials for life-threatening prostate cancer, if the clinical trial is provided in California and the patient's physician certifies that it is likely to be more beneficial than any available standard treatment. On September 30, 2000, the Governor vetoed SB 1839, stating: "I believe that health plans should cover the cost of routine patient care for enrollees participating in clinical trials—in fact, it should not even be controversial....However, under this bill, thousands of Cali-

fornians suffering from breast cancer and other cancers would continue to be denied coverage. I favor a more comprehensive approach, one which would cover other cancer trials in addition to prostate....I intend to sponsor this legislation for introduction on the first day of the next legislative session, and I will be requesting swift passage" (see 2001 LEGISLATION for description of SB 37 (Speier)).

### Other Insurance-Related Legislation

**SB 1915 (Poochigian)**, as amended July 6, 2000, adds section 354.4 to the Code of Civil Procedure, which allows Armenian Genocide victims or their heirs or beneficiaries to bring suit to recover on claims arising from unpaid insurance policies purchased in Europe or Asia between the years of 1875 and 1923. Section 354.4 allows them to file suit against insurance companies holding such policies that do business in California, and extends the statute of limitations on such claims to December 31, 2010. During the years of 1915 to 1923, the Armenian people were subjected to genocide at the hands of the Turks. About 1.5 million Armenians were killed and many more were displaced from their homes, including the maternal grandparents of the author of this bill, Senator Poochigian. The Governor signed this bill on September 20, 2000 (Chapter 543, Statutes of 2000).

**AB 2251 (Cox)**, as amended June 27, 2000, requires any person who is licensed as an insurance agent or broker or an insurer that maintains a certificate of authority to transact insurance in California that advertises for the sale of insurance on the Internet, to disclose their license number or certificate of authority numbers on the Internet. The bill also specifies that a person who advertises on the Internet is deemed to be transacting insurance in California if the person does any of the following: (1) provides an insurance premium quote specifically to a California resident; (2) accepts an application for coverage from a California resident; (3) otherwise communicates with a California resident regarding one or more terms of an agreement to provide insurance or an insurance policy. The bill requires non-admitted insurers that advertise on the Internet to follow the provisions relating to advertising by non-admitted insurers. The bill was approved by the Governor on August 8, 2000 (Chapter 211, Statutes of 2000).

**AB 393 (Scott)**, as amended July 5, 2000, requires insurers to comply with the insurance agent licensing laws with regard to employees or contractors who solicit, negotiate, or effect insurance; and prohibits persons from soliciting, negotiating, or effecting contracts of insurance without a valid license. This bill also requires DOI to investigate and implement a system, and report to the legislature in regard to the system, permitting license fees to be paid electronically by employers on behalf of their employees.

AB 393 also establishes a personal lines broker-agent license for persons who sell automobile insurance, residential property insurance (including earthquake and flood insurance), personal watercraft insurance, and umbrella or excess liability insurance providing coverage when written over one or more underlying automobile or residential property insurance policies. The bill enacts related provisions, including provisions regarding prelicensing and continuing education qualifications and licensure fees for personal lines broker-agent licensees.

AB 393 also establishes a credit insurance agent license for organizations that sell specific types of insurance in connection with, and incidental to, a loan or extension of credit other than a loan in excess of $60,000 relating to or secured by real property where the repayment period does not exceed ten years. The bill was signed by Governor Davis on September 5, 2000 (Chapter 321, Statutes of 2000).

**AB 2069 (Corbett)**, as amended August 18, 2000, requires the State Bar of California to conduct a study regarding the legal and professional responsibility issues that may arise as a result of the relationship between an attorney and an insurer when the attorney is retained by the insurer to represent an insured, and the attorney is subsequently retained to represent a party against another party insured by the insurer. A report on the study, and any recommendations, must be submitted to the legislature and the California Supreme Court on or before July 1, 2001. This bill, sponsored by California Defense Counsel, is designed to address issues raised by the decision in *State Farm Mutual Auto Insurance Company v. Federal Insurance Company*, 72 Cal. App. 4th 1422 (1999), *review denied* Sept. 29, 1999. In this case, the Fifth District Court of Appeal held that a law firm is disqualified from bringing an action against an insurance company while representing a policyholder of that same company in an unrelated insurance defense case. The court said that such representation is inconsistent with an attorney's duty of undivided loyalty under Rule 3-310 of the Bar's Rules of Professional Conduct. Governor Davis signed AB 2069 on September 16, 2000 (Chapter 472, Statutes of 2000).

**SB 1337 (Speier)**, **SB 1372 (Leslie)**, and **AB 1707 (Kuehl)** would have required banks, other financial institutions, and—in the case of AB 1707—insurance companies to obtain customers' permission before sharing or selling private financial information. Federal legislation enacted in 1999 allow banks to share financial information with an affiliated insurance company or brokerage firm or sell it to third parties. The federal law requires financial institutions to give consumers an opportunity to opt out to prevent their data from being sold to third parties, but does not require consent to share information with affiliates. These bills would have required consumer consent before private financial information could be shared or sold with affiliates. Each of the bills died in committee.

The following bills reported in Volume 17, No. 1 (Winter 2000) of the *California Regulatory Law Reporter* died in committee or otherwise failed to be enacted during 2000: **AB 1380 (Villaraigosa)**, which would have adjusted the MICRA cap on noneconomic damages in medical malpractice actions to reflect the cumulative percentage change in the Consumer Price Index; **SB 749 (Hughes)**, relating to rental car agent

licenses; **AB 976 (Cardoza)**, the California Low-Cost Auto Insurance Policy Act; **SB 519 (Lewis)** and **SB 944 (Johnson)**, which would have created an auto "mini-policy" covering only the named insured; **SB 622 (Speier)**, which would have statutorily defined the term "inception of the loss" in earthquake insurance policies; **AB 591 (Wayne)**, which would have required certain disability insurers to provide coverage for routine patient care costs related to treatment of an enrollee or insured in a clinical trial meeting specified requirements; and **AB 374 (Cunneen)**, which would have required the Insurance Commissioner, in consultation with the Chief Information Officer and the Secretary of State, to adopt regulations creating minimal acceptable standards regarding the use in the insurance industry of digital signatures and public-key infrastructures.

# 2001 LEGISLATION

## DOI Reform Legislation

**AB 931 (Frommer)**, as amended April 16, 2001, would add section 12903.1 to the Insurance Code, which would prohibit the Commissioner from accepting in any calendar year travel reimbursements or payments exceeding $1,000 from an entity or a private attorney or law firm with a client subject to regulation by the Commissioner, a private attorney or law firm that is under contract or consideration for a contract to represent either DOI or the Commissioner in his/her official capacity, or a private attorney or law firm seeking advocacy fees under Insurance Code section 1861.10(b). *[A. Ins]*

**SB 708 (Speier)**, as introduced February 23, 2001, is intended to implement recommendations contained in *Department of Insurance: In Rubble After Northridge*, the Senate Insurance Committee's report on the Quackenbush scandal (see MAJOR PROJECTS). SB 708 would (1) provide for a civil penalty for an act by an insurer that is an unfair method of competition or an unfair and deceptive trade practice; (2) establish an unspecified but higher civil penalty for a willful act that is an unfair method of competition or an unfair and deceptive trade practice; (3) remove the discretion of the Insurance Commissioner to define an act for these purposes and define such acts in statute; (4) allow the Commissioner to order an insurer to pay a claim—which the Commissioner is currently not authorized to do; (5) expand the Department's earthquake mediation program to disputes that arise out of residential and automotive coverages; (6) provide that the Commissioner may not decline to investigate a complaint on various grounds, including that the insured is represented by an attorney or that an attorney has filed the complaint; (7) require that information about justified complaints against insurers (including the date a justified consumer complaint was filed, a succinct description of the facts of the justified complaint, and a statement of DOI's rationale for determining that the complaint is justified) be disclosed to the public; (8) require that DOI legal opinions given to insureds be made public, under specified circumstances; (9) prohibit the Commissioner from agreeing in a settlement agreement related to unfair claims practices that "extraordinary circumstances" existed for longer than six months, unless the Commissioner includes a written justification and states the dates during which the extraordinary circumstances existed; (10) require DOI to adopt regulations relating to training and accrediting insurance adjusters in the evaluation of earthquake damage; and (11) require that any earthquake claim adjusted by an unaccredited adjuster be reported along with the adjuster's name to DOI. *[S. Appr]*

**SB 798 (Speier)**, as introduced February 23, 2001, is similar to 2000's SB 953 (Speier). and would prohibit the following entities from either directly or indirectly making campaign contributions or gifts of any kind to the Insurance Commissioner, to any candidate for that office, or to any committee that is formed primarily to elect an individual to the office of Insurance Commissioner: (1) any person or business regulated by the Commissioner, and persons or committees who are acting on behalf of regulated persons or businesses; (2) any private attorney or law firm that is under contract or is bidding on or under consideration for a contract to represent either DOI or the Commissioner in his/her official capacity; and (3) any private attorney or law firm that seeks to be awarded, or has been awarded, advocacy fees under Insurance Code section 1861.10(b). This bill would also prohibit private attorneys or law firms who have made contributions or gifts to the Insurance Commissioner, to a candidate for Insurance Commissioner, or to any committee formed to elect an individual to that office from later contracting to represent DOI or the Commissioner in his/her official capacity during the tenure in office of the Insurance Commissioner that the contribution or gift was made to support. Specified individuals who use their personal funds to make a contribution or gift would be exempt from these prohibitions. This bill would also prohibit any person or business regulated by the Commissioner or any private attorney or law firm subject to this bill from coercing any person to make an otherwise prohibited contribution or gift. *[S. Appr]*

## Auto Insurance

**AB 491 (Frommer)**, as introduced February 21, 2001, is a spot bill intended to address the terms of rental agreements for passenger vehicles, including the manner in which rates are advertised, quoted, confirmed, and charged; collision damage waivers; customer facility charges at airports; and vehicle license fees. *[A. Jud]*

**SB 81 (Speier)**, as amended April 24, 2001, would permit an injured insured owner of a motor vehicle to recover damages under the uninsured motorist coverage of his/her policy, if he/she was struck by his/her own insured car while it was being operated without his/her permission in the course of criminal activity. The criminal activity must be one to which the injured insured was not a party, and must have been reported to the police. According to the author, this bill is intended to overturn a recent unpublished opinion of the Sec-

ond District Court of Appeal in a carjacking case, in which the court concluded that the uninsured motorist insurance statute excludes coverage to a motor vehicle owner who is struck by his own car, and that any unfairness in this statutory scheme is for the legislature to correct. *[S. Jud]*

**SB 1178 (Burton)**, as amended April 26, 2001, would require the Bureau of Automotive Repair, in consultation with DOI and other interested parties, to conduct a study in order to determine the best process for certifying crash parts. The bill would require the study to consider the appropriate standards or criteria for certifying crash parts and to include a recommendation to the legislature as to which agency should oversee crash parts certification by March 1, 2002. *[S. B&P]*

**AB 1488 (Chavez)**, as introduced February 23, 2001, would authorize an automobile insurer to offer a discount to policyholders who are "claims-free." Because the bill would authorize the use of an additional factor in the determination of premiums for automobile insurance policies, it would amend Proposition 103, require a two-thirds vote, and must be found to "further the purposes" of Proposition 103. According to the bill's sponsor, Mercury Insurance Company, "a no-claim discount properly rewards, and returns premium to, insureds who impose no expense burden on an insurer by making a claim." The bill is opposed by the Foundation for Taxpayers and Consumer Rights, which points out that the proposal contradicts the purpose of insurance and would harm millions of California consumers who pay insurance premiums to ensure that they are covered if they are in an accident. *[A. Ins]*

### Earthquake Insurance

**AB 1118 (Corbett)**, as amended April 16, 2001, would appropriate money to DOI to administer a program that provides residential grants and loans to low- and middle-income households for seismic retrofitting, and authorize a 55% tax credit for the amount paid or incurred to seismically retrofit single-family or multiple-family residential structures constructed before 1979, in order to minimize the risk of earthquake damage to those dwellings and thereby reduce the costs of residential earthquake insurance. *[A. Rev&Tax]*

### Health/Disability Insurance

**SB 454 (Committee on Insurance)**, as amended April 16, 2001, would—for purposes of legislation that becomes effective on or after January 1, 2002—define the term "health insurance" (which is currently not defined in the Insurance Code) as a disability insurance policy that provides coverage for hospital, medical, or surgical benefits but does not include certain kinds of insurance. The bill would also define the term "specialized health insurance" as a disability insurance policy that provides coverage for hospital, medical, or surgical benefits under specified kinds of insurance, and would specify that new coverage benefits mandated by a statute that is effective on or after January 1, 2002, shall apply to a specialized health insurance policy despite the statute exempting these policies from its provisions, if the new mandated coverage benefit is included under the general terms and conditions of the specialized health insurance policy. *[A. Desk]*

**SB 455 (Committee on Insurance)**, as amended March 26, 2001, is intended to clean up inadvertent drafting errors in various pieces of 2000 legislation, including SB 1988 (Speier) (see 2000 LEGISLATION; see also agency report on MEDICAL BOARD OF CALIFORNIA). Among other things, SB 455 would require DOI to report, to the appropriate regulatory agency, a suspected violation by physicians and by organizations being operated in violation of provisions governing clinics, professional corporations, and physicians, relative to potential insurance fraud. The bill would require the appropriate regulatory agency, upon receiving a report from DOI, to conduct an investigation; and would also require the permanent revocation of the license of a physician who practices medicine with a business organization that is in violation of the above provisions. *[S. Appr]*

**SB 37 (Speier)**, as amended April 16, 2001, is Senator Speier's response to the Governor's 2000 veto of SB 1839 (Speier) (see above). SB 37 would require health plans and certain disability insurers to cover the cost of health care services related to a cancer patient's enrollment in a cancer clinical trial, if the patient's physician has recommended participation in the trial. However, plans and insurers would not be responsible for costs related to a drug or device not approved by the FDA, management of the trial, the enrollee's travel and nonclinical expenses, or items and services provided free to the enrollee by the research sponsors. *[S. Appr]*

**SB 1219 (Romero, Kuehl)**, as amended April 16, 2001, would require health plans and disability insurers to offer coverage for an annual liquid based cervical cancer screening test as approved by the FDA. *[S. Appr]*

**AB 207 (Matthews)** as amended April 17, 2001, would require certain health plans and disability insurers that offer coverage for prescription drug benefits and that issue identification cards to enrollees and insureds to issue a card containing uniform information necessary to process claims for prescription drug benefits. *[A. Appr]*

**AB 1178 (Calderon)**, as amended April 30, 2001, would require disability insurers that issue policies or certificates using direct marketing methods to include questions in their application to determine whether the prospective insured is 65 years of age or older and whether the prospective insured is covered by Medi-Cal or a Medicare supplement policy. The bill would also require these insurers to provide comparison data and an informational brochure to the insured senior citizen as early as possible in the transaction, but not later than the delivery of the policy or certificate. *[A. Ins]*

### Other Insurance-Related Legislation

**AB 202 (Corbett)** as introduced February 9, 2001, would include DOI representatives within the Joint Enforcement Strike Force on the Underground Economy. *[A. Appr]*

**AB 203 (Jackson)**, as amended March 26, 2001, would enact the Consumers' Financial Privacy Act. The bill would

ies) from disclosing or making an unrelated use of the personal information collected by the financial institution in any transaction with the consumer without the consumer's prior written consent. The bill would also require various disclosures by the financial institution to the consumer, and allow an individual to bring an action against a financial institution, affiliate, or non-affiliated third party that has negligently disclosed or used personal information. *[A. B&F]*

**SB 773 (Speier)**, as amended April 25, 2001, would enact the Financial Information Privacy Act of 2002, which would require a financial institution to provide specified notice to, and to obtain the consent of, a customer before disclosing to or sharing confidential customer information with any third party, subject to certain exceptions. This bill would also require a financial institution, prior to using confidential customer information provided by certain third parties, to take reasonable steps to ensure that the party providing the information had previously followed similar notice and consent procedures. SB 773 would also establish various civil and criminal remedies and penalties for negligent, or knowing and willing violations of these provisions. *[S. Rls]*

**AB 392 (Maddox)**, as amended April 23, 2001, would require the Real Estate Commissioner, the Commissioner of Corporations, and the Insurance Commissioner to notify each other when taking enforcement or disciplinary action related to certain escrow services (see LITIGATION). The bill would require the Department of Real Estate, the Department of Corporations, and DOI to each maintain a Web site that displays a database of individuals who have been subject to disciplinary action related to the escrow industry. *[A. Ins]*

**AB 1183 (Calderon)**. Existing law provides for creation of the California Insurance Guarantee Association to provide insolvency insurance for its member insurers and requires certain insurers to be members of the Association as a condition of doing business. In the event an insurer becomes insolvent, the Association collects premium payments from its members in an amount sufficient to pay covered claims of the insolvent insurer and the associated adjustment costs. Existing law provides that the premium charged to any member insurer in that event for any of certain categories shall not be more than 1% of the net direct premium written in the category in this state by that member. As amended April 23, 2001, this bill would increase this amount from 1% to 2%. The bill would require DOI to conduct a financial audit of the Association and to provide a copy of the audit report to the chairpersons of the Senate and Assembly Committees on Insurance. *[A. Appr]*

**AB 1193 (Steinberg)**, as amended April 30, 2001, would add section 676.10 to the Insurance Code. Section 676.10 would provide that an insurer issuing policies protecting against certain residential, liability, and commercial risks may not cancel or refuse to renew a policy issued to a place of worship (including but not limited to a church, synagogue, temple, or a nonprofit entity organized and operated for religious, charitable, educational, health, or welfare purposes) solely on the basis that one or more claims has been made against the policy during the preceding 60 months for a loss that is the result of a hate crime committed against the person or property of an insured. AB 1193 would also classify violations of section 676.10 as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance under Insurance Code section 790.03. *[A. Ins]*

**SB 63 (Scott)**, as amended April 17, 2001, is intended to make clarifying and technical changes to AB 393 (Scott), which created the personal lines license (see 2000 LEGISLATION). This bill would authorize a fire and casualty licensee to transact the coverages that a personal lines licensee is authorized to transact. The bill would also authorize the Commissioner to exempt an applicant for a personal lines license from having to fulfill the examination requirement if the three years of required employment were immediately prior to January 1, 2001. The bill would provide that a personal lines licensee includes a person authorized to transact recreational vehicle and inland marine insurance. The bill would also specify the prelicensing education and other requirements for a personal lines agent who applies to become a fire and casualty broker-agent. *[A. Appr]*

**SB 658 (Escutia)**, as amended April 16, 2001, would require insurers, upon receiving notice of a claim, to immediately (no more than 15 calendar days after receipt of the claim) provide the insured with a legible reproduction of Insurance Code section 790.03 (in at least 12-point type). The bill would also modify the standard fire insurance policy form relative to the obligations of the insurer and the insured and to appraisals and adjusters. *[S. Jud]*

**SB 1136 (Polanco)**, as amended April 3, 2001, would repeal the sunset clause in sections of the Insurance Code governing the extent and manner in which surplus line or nonadmitted insurers may advertise in California. *[S. Appr]*

## LITIGATION

The courts are now handling fallout from the scandal surrounding former Commissioner Quackenbush's "pardon" of the insurance industry for its alleged mishandling of Northridge earthquake claims. As noted above, former Deputy Insurance Commissioner George Grays awaits sentencing after pleading guilty to several federal counts of mail fraud and money laundering, and ongoing investigations by the state and federal governments may yet yield charges against others; Attorney General Bill Lockyer is trying to void the "final settlements" reached between Quackenbush and four insurance companies, thus restoring DOI jurisdiction over Northridge claims handling practices; the insurance industry is challenging the validity of SB 1899 (Burton), which re-

**The courts are now handling fallout from the scandal surrounding former Commissioner Quackenbush's "pardon" of the insurance industry for its alleged mishandling of Northridge earthquake claims.**

vives some time-barred Northridge earthquake claims; and several Northridge victims have taken matters into their own hands and have sued their insurers, Quackenbush, or both (see MAJOR PROJECTS).

In addition, the California Supreme Court is still considering ***Vu v. Prudential Property & Casualty Insurance Company***, a Northridge-related matter referred to it by the U.S. Ninth Circuit Court of Appeals. *[17:1 CRLR 166–67]* Peter Vu's home was damaged in the January 1994 Northridge quake. He contacted Prudential within days of the disaster, and Prudential's inspector told him that the damage to his home was below his $30,000 deductible. Relying on Prudential's inspection and denial of his claim, Vu took no further action until August 1995, when he discovered substantial additional damage that had been caused by the earthquake. Vu filed a supplemental claim with Prudential, which denied the claim because it had been filed more than one year after "inception of the loss" under Insurance Code section 2071. Vu sued Prudential in federal district court, which dismissed the case as time-barred. Vu appealed to the Ninth Circuit, and the federal appellate court referred the following issue to the California Supreme Court: When an insured notifies an insurer of property damage, the insurer's agent inspects the property but fails to discover the full extent of the covered damage, and the insured relies on the insurer's representation, does California law bar a claim brought after the statute of limitations period has expired? At this writing, Peter Vu and other quake victims are still waiting for an answer.

Consumer advocates were stunned on December 29, 2000 when the First District Court of Appeal—in ***Spanish Speaking Citizens' Foundation, Inc. v. Low***, 85 Cal. App. 4th 1179 (2000)—overturned a 1998 trial court decision prohibiting DOI from enforcing section 2632.8, Title 10 of the CCR. Section 2632.8 is a key provision of former Commissioner Quackenbush's "auto rating factor" regulations that implement Insurance Code section 1861.02(a), a provision added by Proposition 103. In an effort to end so-called "territorial rating," whereby insurers base auto insurance premiums primarily on the ZIP code in which the driver resides rather than on his/her driving experience and safety record, section 1861.02(a) requires insurers to base auto rates on "the following factors in decreasing order of importance: (1) the insured's driving safety record; (2) the number of miles he or she drives annually; (3) the number of years of driving experience the insured has had; and (4) such other factors as the commissioner may adopt by regulation that have a substantial relationship to the risk of loss. The regulations shall set forth the respective weight to be given each factor in determining automobile rates and premiums." Between 1990 and 1994, former Commissioners Roxani Gillespie and John Garamendi adopted temporary "auto rating factor" regulations that attempted to comply with the "sequential" weighting hierarchy set forth in section 1861.02(a). *[14:4 CRLR 123; 14:2&3 CRLR 132; 14:1 CRLR 101–02]*

**Consumer advocates were stunned on December 29, 2000 when the First District Court of Appeal—in *Spanish Speaking Citizens' Foundation, Inc. v. Low*—overturned a 1998 trial court decision prohibiting DOI from enforcing section 2632.8, Title 10 of the CCR.**

In 1996, Commissioner Quackenbush amended DOI's auto rating factor regulations to permit insurers to calculate one factor weight for each of the mandatory factors, and one factor weight for all of the optional factors combined (despite the statute's requirement that "the regulations shall set forth the respective weight to be given each factor in determining automobile rates and premiums"). Further, the regulations permit the single weight for the optional factors to be "the summation of the amounts...divided by the number of calculations" (that is, the average of the weight of all optional factors). Concerned that this scheme would permit insurers to base rates on optional factors with weights greater than any of the mandatory factors, the Proposition 103 Enforcement Project, the Spanish Speaking Citizens' Foundation, Consumers Union, and other consumer groups first initiated an unsuccessful DOI administrative proceeding, and then challenged Commissioner Quackenbush's regulations in court in March 1998.

In June 1998, Alameda County Superior Court Judge Henry E. Needham, Jr. invalidated Quackenbush's rules on two grounds: (1) "contrary to the requirement of Insurance Code section 1861.02(a)(4), respondent's regulations (10 CCR 2632.1 *et seq.*) do not set forth the respective weight to be given each optional rating factor in determining automobile rates and premiums"; and (2) "contrary to the requirements of Insurance Code section 1861.02(a), 10 CCR section 2632.8 permits insurers to use individual optional factors that have a greater impact in the determination of rates and premiums than one or more of the three mandatory factors...." *[17:1 CRLR 169; 16:1 CRLR 155–56]* The Commissioner appealed; several insurers sought and were granted leave to intervene in support of the Commissioner's position. In addition, because insurers have long predicted that their inability to use geography in setting rates will cause policyholders in rural areas to suffer serious premium increases while the rates of many urban drivers will decrease, several rural counties filed *amicus* briefs in support of the Commissioner, while the Los Angeles County Board of Supervisors filed an *amicus* brief in support of the consumer groups' position.

On appeal, the First District framed the issue as "whether the factor weight regulation, section 2632.8, as interpreted in the administrative proceeding, is consistent with the factor ordering provisions of Insurance Code section 1861.01, subdivision (a)." Following a detailed explanation of the way in which insurers calculate rates (in which the court appears to have assumed the truth of the insurers' predictions of premium increases for the majority of Californians if the

Commissioner's regulations are invalidated, and agreed with their arguments that such increases would be inconsistent with other provisions of Proposition 103), a description of the legislative history of Proposition 103 and "the long and tortured history of the rating factor regulations," an approving "book review" of a law review article by UCLA Law Professor Michael Asimow on the extent of deference to be given to state agencies in interpreting their own statutory language, and much commentary about perceived "ambiguities" and "potential conflicts" within Proposition 103, the court upheld the regulations—despite its express acknowledgments that "the regulations...permit the use of optional factors which, both individually and collectively, may have greater weight than any of the mandatory factors," "this interpretation allows individual optional factors to outweigh mandatory factors and thus...permits territory to have a greater influence on premiums than any mandatory factor," and "what the regulations do not do is ensure that rates will be determined primarily by driving safety record and mileage driven." Remarkably, the court also flatly rejected the will of the voters in enacting Proposition 103: "The shared assumption underlying all of [the declarations, provisions, and representations in Proposition 103] is that safety record and other mandatory factors are more indicative of the insurance risk drivers pose than where they live. The line between these declarations, provisions, and representations marks a conflict because that assumption is false. Unrefuted evidence establishes that territory is a more important determinant of the risk of loss than any other single factor."

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Rather than focusing on the regulations at issue and their consistency with the statute that authorizes them, the court considered all the other auto rating factor regulations that have ever been adopted or considered by any commissioner or proposed by any party and/or its expert witness, and determined that "the current regulations manage to implement most of the law's conflicting demands....The current regulations constitute a lawful choice among imperfect options." The court rejected the consumer groups' plea that it focus "simply and properly upon the plain language of the single, voter-enacted statute and single regulation here at issue" as "untenable," because "we find no 'plain meaning' in the statute that resolves any significant issue."

The court acknowledged that the consumer groups' proposal "may be a permissible interpretation of the statute." Unfortunately for the consumer groups, however, their proposal was not adopted by Commissioner Quackenbush, whose view was afforded "great weight" by the court because—in Professor Asimow's words—he has a "comparative interpretative advantage" and he is "probably correct." And unfortunately for the consumer groups, the court did not accord the same deference to former Commissioner Garamendi, whose 18-month actuarial analysis of the weighting issues surrounding Proposition 103's auto rating factors indicated that proper application of either of two weighting methodologies in a revenue-neutral fashion to the 11 million consumers in its database would result in "little average change in premium from what they currently pay." Garamendi's 1994 study concluded: "Most of the larger average changes occur at the extreme ends of the mileage groups (the very low mileage driver and the very high-mileage drivers), and among the very young or inexperienced drivers. These changes seem to be consistent with the intent of Proposition 103. For both methods using the standardized factors, Los Angeles County averaged a reduction in premium of $7 to $8, while Sacramento and Fresno counties averaged increases of $13 to $14, and the San Francisco Bay Area averaged around a $4 increase." *[15:2&3 CRLR 183–84; 15:1 CRLR 110–11]*

To add insult to injury, the California Supreme Court denied review of the First District's decision on March 28, 2001. Rejecting the pleas of numerous consumer groups, legislators, local governments, and newspaper editors, a four-member majority blocked review of the case. Justices Marvin R. Baxter, Janice Rogers Brown, Ming W. Chin, and Kathryn Mickle Werdegar voted against review; Chief Justice Ronald R. George and Justices Joyce Kennard and Stanley Mosk voted to review the decision.

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California courts continue to address the scope of Proposition 213, a 1996 initiative which—among other things—precludes uninsured drivers from collecting noneconomic damages in any action arising out of the operation or use of motor vehicles (Civil Code section 3333.4). *[17:1 CRLR 167–68]* On April 5, 2001 in ***Day v. City of Fontana***, 25 Cal. 4th 268 (2001), the California Supreme Court ruled that the initiative even protects municipalities from pain-and-suffering damages in lawsuits filed by uninsured motorists alleging negligent road maintenance. In *Day*, plaintiff Day was seriously injured when a car driven by William Honda struck Day's motorcycle in an intersection in Fontana. Day filed an action against Honda, the County of San Bernardino, and the

City of Fontana. As against the public entities, Day alleged that overgrown vegetation at the intersection constituted a dangerous condition of public property and also that the public entities maintained a nuisance on their property by failing to correct, remove, reduce, or warn of the overgrown vegetation. Over plaintiff's objections, the trial court and the appellate court applied section 3333.4 and refused to admit evidence of plaintiff's damages for pain and suffering.

On a 5–2 vote, the Supreme Court affirmed, holding that section 3333.4 applies because it bars uninsured motorists from recovering noneconomic damages "in *any* action to recover damages arising out of the operation or use of a motor vehicle" (emphasis added by court) and contains no exception for suits against public entities. The majority noted that public entities are among those harmed by motorists who fail to carry insurance as required by financial responsibility laws and that, by refusing to allow an uninsured driver to be rewarded for his failure to comply, the holding in this case furthers the legislative intent behind Proposition 213. In dissent, Justice Mosk disagreed with the majority's expansion of section 3333.4 and argued that the voters who passed Proposition 213 did not intend to limit damages for injuries to motorists based on "a dangerous condition of property or nuisance." Mosk noted that, at trial, the jury found no fault at all on the part of Day, "allocating responsibility about equally between the driver of the car and the city and county." Justice Mosk also pointed to the Supreme Court's 1999 decision in *Hodges v. Ford Motor Company*, 21 Cal. 4th 109 (1999), in which the court held that Proposition 213 was not intended to bar uninsured motorists from seeking noneconomic damages against an auto manufacturer based on a defective design theory because Proposition 213 "was primarily intended to limit awards against insured drivers." *[17:1 CRLR 168]* Justice Mosk further warned that "the majority's broad application of Civil Code section 3333.4, by relieving cities and counties of liability for all damages caused by their negligence, will erode public policy aimed at securing the safety of *all* motorists" (emphasis original).

In other Proposition 213 cases, the Second District Court of Appeal held in ***Nakamura v. Superior Court***, 83 Cal. App. 4th 825 (2000), that while section 3333.4 prohibits the recovery of noneconomic damages, the statute does not preclude recovery of punitive damages by an uninsured driver or owner of a vehicle. On October 16, 2000 in ***Harris v. Lammers***, 84 Cal. App. 4th 1072 (2000), the First District Court of Appeal held that an accident that occurred while the plaintiff—an uninsured motorist—was standing behind her vehicle handing balloons to her children inside, was an accident "arising out of the operation or use of a motor vehicle" and thus, section 3333.4 bars her from seeking noneconomic damages sustained from the accident.

In ***Anserv Insurance Services v. Kelso***, 83 Cal. App. 4th 197 (Aug. 7, 2000), the Fourth District Court of Appeal upheld the Department's jurisdiction under Insurance Code section 35(d) to regulate conduct of its licensees occurring within their capacity as licensees regardless of whether the licensees' acts occurred within or outside the state. DOI revoked the professional licenses of appellant Anserv and two of its officers. Anserv claimed that the Department exceeded its jurisdiction in revoking the licenses based on conduct involving the sale in Mexico of insurance covering Mexican residents while they drove in the United States. Under section 35(d), the transaction of insurance includes "matters subsequent to the execution of the [insurance] contract and arising out of it." Appellant's offices were in California and numerous monetary transactions (including the collection of premiums) took place here. Further, the risk to the insureds were those arising from driving within the United States and California; thus, there was a sufficient nexus between the insurance transactions Anserv facilitated and protection of the California public. Therefore, the Department did not exceed its jurisdiction in revoking the licenses.

On May 10, 2000 in ***De La Cruz v. Quackenbush***, 80 Cal. App. 4th 775 (2000), the Second District Court of Appeal held that the Insurance Commissioner may not revoke an insurance broker's license for refusing to permit a warrantless search of his books and records. After DOI received an anonymous complaint alleging that certain agencies were selling insurance through unlicensed agents, it began an inquiry which led it to respondent Jose De La Cruz, a licensed broker. A DOI investigator sent respondent a letter in which he proposed to examine all of respondent's records at a date and time certain three weeks hence. Respondent's attorney replied that an examination of "all" of his client's records without a warrant or administrative subpoena is unconstitutional, and invited the Department to specify the exact records it wished to inspect or obtain an administrative subpoena. When the investigator arrived at respondent's premises without a warrant, respondent refused to comply; the Commissioner thereafter brought proceedings to revoke respondent's license to sell insurance. The matter was tried before an administrative law judge, who issued a proposed decision ruling that a warrantless search of an insurance broker's records is unconstitutional and that De La Cruz may not be disciplined for failure to permit the search. The Commissioner rejected the ALJ's decision and decided the matter himself, ruling that the Department's warrantless inspection scheme is reasonable under the fourth amendment, that De La Cruz was required to submit to the inspection, and that his failure to do so constitutes good cause for revocation of his license.

**On May 10, 2000 in *De La Cruz v. Quackenbush*, the Second District Court of Appeal held that the Insurance Commissioner may not revoke an insurance broker's license for refusing to permit a warrantless search of his books and records.**

De La Cruz filed a petition for administrative mandate in the superior court, alleging that the Commissioner's decision was an abuse of discretion because it violates the fourth amendment's protection against unreasonable searches and

seizures. The trial court agreed and issued a writ of mandate directing the Commissioner to reinstate respondent's license. The Commissioner appealed, arguing that the "closely regulated business" exception, as set forth in *New York v. Burger*, 482 U.S. 691 (1987), allows DOI to conduct warrantless searches of its licensees' records. The court noted that this exception to the warrant requirement applies only when a business is "closely" or "pervasively" regulated and three criteria are met: (1) the search is reasonable because there is a substantial government interest underlying the inspection scheme; (2) a warrantless inspection is necessary to further the regulatory scheme; and (3) the inspection program provides a constitutionally adequate substitute for a warrant.

Noting that an entire executive department, five volumes of annotated statutes, and a plethora of regulations are devoted to the insurance industry, and citing *Calfarm v. Deukmejian*, 48 Cal. 3d 805 (1989) ("insurance...is a highly regulated industry"), the court concluded that insurance is a closely regulated business. The court then turned to the factors related to the "closely regulated business" exception, and found that the warrantless search in this case failed to satisfy any of *Burger*'s criteria for reasonableness. First, the court disagreed with the Commissioner's contention that DOI's interest in the prevention and detection of fraud is a substantial government interest outweighing fourth amendment protections, saying: "Virtually all laws licensing businesses or professions were enacted at least in part to protect the public from dishonest or incompetent persons engaging in the licensed activity. If this was all that was needed to satisfy the substantial government interest criterion then the criterion would be meaningless because it would not screen out any regulatory scheme." Nor was the court convinced that warrantless inspections are necessary to accomplish DOI's regulatory objective. Department employees testified at the hearing regarding concerns that unannounced inspections are needed because licensees may be able to add, remove, or alter documents in the time needed to enforce an administrative subpoena. The court again noted that these concerns apply to virtually every licensed industry and pointed to "the languid pace of the De La Cruz investigation," which was attributable not to respondent but to DOI's investigator. "We find it difficult to square the need for immediate access to records to avoid tampering with a three-week notice of an impending inspection." Finally, the court noted that DOI's regulatory inspection scheme does not provide a constitutionally adequate substitute for a warrant because it has neither a properly defined scope nor a limit on the discretion of the inspecting officers. Thus, the court held that the Commissioner exceeded his authority in revoking De La Cruz's license.

On January 19, 2000 in ***Walker v. Allstate,*** 77 Cal. App. 4th 750 (2000), the First District Court of Appeal affirmed the lower court's dismissal of a class action challenging insurance rates approved by the Commissioner, finding that the class action was essentially a rate challenge over which the Commissioner has exclusive original jurisdiction under Insurance Code sections 1860.1 and 1860.2. In 1998, plaintiff Walker brought a putative class action against more than 70 automobile insurers seeking damages or disgorgement of allegedly excessive premiums that the insurers have been authorized to collect since 1994. Walker claimed that the insurance companies charged approved rates that are "excessive" within the meaning of Insurance Code section 1861.05(a). The trial court granted the insurance companies' demurrer, and the First District affirmed. Under Proposition 103, insurers that desire to raise their rates must file a rate application with the Commissioner, and the Commissioner must notify the public of the application. Consumers may request a hearing on the rate application, and the Commissioner must hold a hearing if the proposed rate increase exceeds certain percentages. Proposition 103 and DOI's regulations provide for consumer participation in the administrative ratesetting process, and judicial review of the Commissioner's decision is available via a timely filed petition for writ of mandate. Further, a consumer may petition the Commissioner to review the continued use of any rate. The appellate court agreed with the respondent insurers that Insurance Code sections 1860.1 and 1860.2, neither of which were amended or repealed by Proposition 103, provide exclusive original jurisdiction over ratemaking-related issues to the Commissioner, and that section 1860.1 bars "claims based upon an insurer charging a rate that has been approved by the commissioner...." The court reiterated the administrative opportunities for consumers to involve themselves in the ratesetting process, the availability of judicial review of the result pursuant to a petition for writ of mandate, and the "explicit statutory authority [that] precludes any further civil challenges to those actions to recoup premiums charged pursuant to approved rates," and affirmed the lower court's dismissal.

In ***State Farm Mutual Auto Insurance v. Birnbaum, et al.***, No. 308274, filed on December 2, 1999, State Farm sued Insurance Commissioner Chuck Quackenbush and consumer advocate David "Birny" Birnbaum after Birnbaum requested and received State Farm's "community service statements" from DOI. Since 1995, companies that sell auto, homeowners, or small business commercial insurance have been required to file "community service statements" with DOI pursuant to section 2646.6, Title 10 of the CCR. Section 2646.6 is intended to enable the Commissioner to detect the widespread insurance industry practice of "redlining"—the industry's refusal or failure to sell insurance in low-income and minority communities. In their community service statements, insurers are required to report numerous categories of data sorted by ZIP code and intended to enable the Commissioner to determine whether particular ZIP code areas are underserved by the insurance industry. By ZIP code, insurers must report total earned exposures and earned premiums; total number of new exposures, canceled exposures, and nonrenewed exposures; and the number of office, agents, claims adjusters, direct mail or telephone solicitations for new insurance business, agents and claims adjusters conversant in a language other than English, applications for each line of insurance, and applications for which the insurer declined to provide cover-

age, as well as the race or national origin and gender of all applicants. Section 2646.6(c) requires the Commissioner to issue an annual "Report on Underserved Communities" which identifies those communities that are underserved by the insurance industry. *[17:1 CRLR 152–53; 16:2 CRLR 128–30]*

Section 2646.6(c) also states that "the community service statement shall be subject to California Insurance Code section 1861.07," which declares that "all information provided to the Commissioner pursuant to this article shall be available for public inspection...." Pursuant to section 2646.6(c) and the California Public Records Act, Birnbaum requested State Farm's community service statement from DOI, and the Department disclosed it. Thereafter, Birnbaum used State Farm's California redlining data in litigation against State Farm in Texas. State Farm filed suit in San Francisco Superior Court against Birnbaum and DOI, claiming that the redlining information includes privileged trade secret data (such as the company's placement of its agents) and seeking to require Birnbaum to return the data and to block the Commissioner from disclosing the data to any other member of the public.

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On December 13, 1999, San Francisco Superior Court Judge Ronald Quidachay denied State Farm's request for an emergency restraining order; on March 8, 2000, the judge dismissed State Farm's lawsuit as against Birnbaum, finding that the action constitutes a SLAPP suit and ordering State Farm to pay Birnbaum's legal fees. On September 13, 2000, Judge Quidachay dismissed the case as against the Department as well, ruling that DOI did not exceed its powers in promulgating section 2646.6 and that community service statements are public records subject to public inspection. State Farm has filed a notice of appeal with the First District Court of Appeal.

***People v. Fidelity National Title Insurance Co., et al.***, No. 99AS02793 (Sacramento County Superior Court), is a class action filed in May 1999 by Attorney General Bill Lockyer on behalf of State Controller Kathleen Connell and then-Commissioner Quackenbush against most DOC-licensed escrow companies and DOI-licensed title insurance companies doing business in California. The Attorney General alleged that, starting in 1970 and continuing to the present, the defendant escrow and title insurance companies: (1) "intentionally took millions of dollars of escrow funds, which remained unclaimed in escrow accounts, that should have escheated to the State of California;" (2) "charged home buyers and other customers improper fees for services that defendants did not and never intended to provide" (including fees for reconveyances that never occurred, delivery services that were not performed, and illegal administration fees); and (3) "collected millions of dollars in interest payments, or payments in lieu of interest, from banks. None of this interest was paid to escrow depositors, as required by Insurance Code section 12413.5 and Financial Code section 17409." According to State Controller Connell, "as much as $500 million is owed to Californians for the mishandling and diverting of escrow funds to industry profit...." *[17:1 CRLR 169]*

**Testimony at Senate and Assembly Insurance Committee hearings regarding DOI's settlement practices suggested that the settlements reached in these cases had less to do with protecting consumers or regulating misconduct by the insurers than with Quackenbush's need to raise $4 million for a "media buy" that touted his supposed efforts for consumers.**

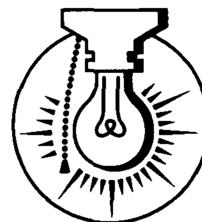
As noted, former Commissioner Quackenbush was originally a named plaintiff in this matter. In February 2000, Quackenbush withdrew from the litigation and began to issue a series of press releases purporting to settle both the Attorney General's lawsuit as to his licensees and ongoing DOI administrative disciplinary actions against the same companies. Fidelity National Title Company was the first defendant to settle, agreeing to reimburse DOI for its investigation and litigation costs plus an additional payment of $425,000 to be used by DOI for "consumer educational outreach" on title insurance issues. Chicago Title Company, First American Title Insurance Company, Old Republic Title Company, and American Title were the next to agree to a settlement, paying costs plus $650,000, $840,000, $513,500, and $85,000 respectively. Most of these settlement funds—totaling $3.24 million—were deposited into the "Title and Escrow Consumer Education and Outreach Corporation," a nonprofit foundation similar to CRAF set up by DOI officials. As a part of the settlements, the insurers were also required to publicly support new regulations announced by Quackenbush on February 16, 2000; to "clarify previous governing code language that, because of its lack of precision was resulting in confusion and litigation that were ultimately having a negative impact on consumers," Quackenbush adopted emergency regulations requiring title/escrow companies under his jurisdiction to provide their customers with the choice of either establishing an interest-bearing account for their funds held in escrow or foregoing the account interest and opting instead to pay a reduced escrow fee. Further, the regulations would require title/escrow agencies to charge a single, all-inclusive rate for all escrow services except for those required by law to be itemized.

Shortly after these settlements were announced, however they came under fire as the legislature's investigation into Quackenbush's settlement practices expanded beyond his handling of Northridge earthquake insurance settlements to include the title insurance industry. Testimony at Senate and Assembly Insurance Committee hearings regarding DOI's settlement practices suggested that the settlements reached in these cases had less to do with protecting consumers or

regulating misconduct by the insurers than with Quackenbush's need to raise $4 million for a "media buy" that touted his supposed efforts for consumers (see MAJOR PROJECTS). At this writing, it is unclear whether these settlements are valid; further, the Commissioner's emergency regulations were disapproved by OAL and were never pursued by DOI after Quackenbush's resignation (see MAJOR PROJECTS). The Attorney General's lawsuit is stayed while the state Controller's Office continues to audit the books of 114 title and 477 escrow companies in California (see agency report on DEPARTMENT OF CORPORATIONS for related discussion).

***People v. Old Republic Title Co.***, No. 993507 (San Francisco Superior Court), is similar litigation filed in May 1998 by the San Francisco City Attorney and the San Francisco District Attorney. The suit charges Old Republic with unfair business practices and invokes the False Claims Act, a 1986 law intended to identify and punish companies who defraud the government. The city claims that Old Republic defrauded consumers of $30 million by failing to return unclaimed escrow accounts to homeowners or to the state; instead, the city alleges that Old Republic treated these funds as profit and placed them in its own accounts. The suit also alleges that the company falsified documents and charged illegal fees for services it did not provide. After a preliminary scuffle over the city's standing to bring a False Claims Act case (which ended in June 2000 when San Francisco Superior Court Judge Stuart Pollak ruled in the city's favor), Judge Pollak issued a "tentative decision" on April 16, 2001 finding that the escrow firm's practice of retaining interest earned on investments made with escrow funds is illegal. According to Judge Pollak, Insurance Code section 12413.5 "does not permit escrow companies to retain the net interest on instruments required to be purchased with the proceeds of below-market rate loans extended in exchange for depositing escrow funds in demand accounts at the bank making the loan." The judge noted that although state regulations do not specifically prohibit the escrow company's practice, neither do they affirmatively permit it. At this writing, Judge Pollak has yet to finalize his ruling; assess damages, civil penalties, and potentially punitive damages; and decide whether Old Republic also kept money from unclaimed escrow accounts that should have escheated to the state.

# Public Utilities Commission



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The California Public Utilities Commission (PUC) was created in 1911 to regulate privately-owned utilities and ensure reasonable rates and service for the public. Today, under the Public Utilities Act of 1951, Public Utilities Code section 201 *et seq.*, the PUC regulates more than 1,200 privately-owned and operated gas, electric, telephone, water, sewer, steam, and pipeline utilities, as well as 3,300 truck, bus, railroad, light rail, ferry, and other transportation companies in California. The Commission grants operating authority, regulates service standards, and monitors utility operations for safety.

The agency is directed by a commission consisting of five full-time members appointed by the Governor and subject to Senate confirmation. The Commission is authorized directly by the California Constitution, which provides it with a mandate to balance the public interest—that is, the need for reliable, safe utility services at reasonable rates—with the constitutional right of a utility to compensation for its "prudent costs" and a fair rate of return on its "used and useful" investment.

The Commission has quasi-legislative authority to adopt regulations, some of which are codified in Chapter 1, Title 20 of the California Code of Regulations (CCR). The Commission also has quasi-judicial authority to take testimony, subpoena witnesses and records, and issue decisions and orders. The PUC's Administrative Law Judge (ALJ) Division supports the Commission's decisionmaking process and holds both quasi-legislative and quasi-judicial hearings where evidence-taking and findings of fact are needed. In general, PUC ALJs preside over hearings and forward "proposed decisions" to the Commission, which makes all final decisions. At one time, PUC decisions were reviewable solely by the California Supreme Court on a discretionary basis; now, Public Utilities Code section 1756 permits courts of appeal to entertain challenges to most PUC decisions. Judicial review is still discretionary and most petitions for review are not entertained; thus, the PUC's decisions are effectively final in most cases.

The PUC allows ratepayers, utilities, and consumer and industry organizations to participate in its proceedings. Nonutility entities may be given "party" status and, where they contribute to a beneficial outcome for the general public beyond their own economic stake, may receive "intervenor compensation." Such compensation has facilitated participation in many Commission proceedings over the past twenty years by numerous consumer and minority-representation groups, including San Francisco-based TURN (The Utility Reform Network), San Diego-based UCAN (Utility Consumers' Action Network), and the Greenlining Institute, an amalgam of civil rights and community organizations in San Francisco.