CONSTITUTIONAL LAW—FIFTH AMENDMENT—SURTAXES AND ASSESSMENTS IMPOSED BY NEW JERSEY'S FAIR AUTOMOBILE INSURANCE REFORM ACT DO NOT VIOLATE DUE PROCESS OR CONSTITUTE A TAKING WITHOUT JUST COMPENSATION—*State Farm v. State of New Jersey*, 124 N.J. 32, 590 A.2d 191 (1991).

The Fifth Amendment to the United States Constitution[1] prohibits the deprivation of life, liberty, or property without due process of law,[2] and proscribes the taking of private property for

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[1] U.S. CONST. amend. V. The Fifth Amendment provides: "No person shall . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." *Id.*

[2] *Id. See generally*, LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW § 8, at 427-455 (1978). Implied limits on governmental authority evolved from the natural law tradition of the seventeenth and eighteenth centuries. *Id.* § 8-1, at 427. This tradition harmonized individual liberties with governmental entitlement by relegating each to a specific sphere of authority, beyond which neither could extend. *Id.* Inherent limitations on governmental authority were recognized as early as 1798 by Justice Chase who opined that "a law that 'takes property from A and gives it to B'. . . would exceed the proper authority of government and would thus be invalid." *Id.* § 8-1, at 428 (quoting Calder v. Bull, 3 U.S. 386, 388 (1798)).

In the Slaughter-House Cases, 83 U.S. 36 (1873), Justice Miller, writing for a five to four majority, declined to employ the express due process limitations of the Fourteenth Amendment to invalidate a Louisiana law giving a corporation a private monopoly on the maintenance of New Orleans stockyards and slaughterhouses. TRIBE, *supra*, § 8-1, at 430. Instead, Justice Miller narrowly construed the Fourteenth Amendment and upheld the legislated monopoly. *Id.* In separate dissenting opinions, however, Justices Field and Bradley contended that the Fourteenth Amendment empowered the federal government to protect certain basic rights, including the free pursuit of an occupation, from abridgement by the states. *Id.*

Scrutiny of state legislation and protection of substantive due process rights increased in several decisions following the Slaughter-House Cases. *Id.* § 8-1, at 432-33. For example, in Munn v. Illinois, 94 U.S. 113, 125 (1876), the Court analyzed the scope of state power to regulate and noted that prior to the Fourteenth Amendment, state usage and price regulation of private property did not violate due process per se. TRIBE, *supra*, § 8-1, at 433. The Court asserted that the Fourteenth Amendment did not alter that principle but explicitly prohibited state regulation that deprived citizens of due process. *Id.* The *Munn* Court cautioned that when public interest was not involved "what is reasonable must be ascertained judicially." *Id.* at 433; *see also infra* notes 44-51 and accompanying text for further discussion of *Munn*. In Allgeyer v. Louisiana, 165 U.S. 578 (1897), the Court abandoned the implied limitations analysis and invalidated a Louisiana statute restricting marine insurance contracts as exceeding the state's power to regulate and violating *specific* guarantees of the Fourteenth Amendment. TRIBE, *supra*, § 8-1, at 434. The Court further explained the distinct powers of the government and its citizens in Loan Association v. City of Topeka, 87 U.S. 655 (1874), declaring that " '[t]here are rights in every free government beyond the control of the State.' " TRIBE, *supra*, § 8-1, at 431.

In Lochner v. New York, 198 U.S. 45 (1905), the Court denounced property regulations purportedly designed to protect public welfare. TRIBE, *supra*, § 8-1, at 439. The Court invalidated a New York law limiting bakery worker hours as unduly

public use without just compensation.[3] These Fifth Amendment precepts, applied to the states through the Fourteenth Amendment,[4] have been used by courts to delineate the proper scope of

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restrictive and beyond the state's police power, exemplifying the prevailing judicial intolerance for statutes viewed as attempts to legislatively re-allocate economic power. *Id.* § 8-1, at 437.

Finally, in Nebbia v. New York, 291 U.S. 502 (1934), the Court delineated the modern standards for statutory validity under substantive due process analysis. *Id.* Upholding a New York law that set minimum milk prices, the *Nebbia* Court held that due process required only that a law be substantially related to the end sought and not arbitrary or capricious. *Id.* at 525; *see also infra*, note 52-57 and accompanying text for a discussion of the Court's holding; *see also* JOHN E. NOWAK ET AL., CONSTITUTIONAL LAW, Ch. 13, 425 2d ed. 1983) (providing an expansive analysis of substantive due process); Bruce N. Morton, *John Locke, Robert Bork, Natural Rights and the Interpretation of the Constitution*, 22 SETON HALL L. REV. 709 (1992) (tracing the development of natural law philosophy and the proper balance between individual rights and majoritarian government restrictions); Herbert Hovenkamp, *The Political Economy of Substantive Due Process*, 40 STAN. L. REV. 379, 380 (1988) (tracing the economic influences on judicial philosophies regarding substantive due process); Richard S. Myers, *The End of Substantive Due Process?* 45 WASH. & LEE L. REV. 557, 558 (1988) (analyzing current due process jurisprudence and the outlook for the future).

[3] U.S. CONST. amend. V. For a discussion of the constitutional ban on takings, *see generally* TRIBE, *supra* note 2, §§ 9-2 to 9-4, at 457-65. The common law of takings did not absolutely proscribe governmental taking of private property; rather, it merely required that such taking not serve a private end. *Id.* § 9-2, at 457. Legislative taking powers, as well as regulation and taxation powers, could only be exercised to advance an overriding public purpose. *Id.* The Supreme Court acknowledged this principle for the first time in Missouri Pacific Railway Co. v. Nebraska, 164 U.S. 403 (1896), holding that despite compensation, takings for a private purpose violated Fourteenth Amendment due process guarantees. TRIBE, *supra* note 2, § 9-2, at 457-58 n.3.

The law of takings was further distilled in a series of cases involving privately owned land. *Id.* § 8-5, at 444. In Pennsylvania Coal Co. v. Mahon, 260 U.S. 393 (1922), the Supreme Court struck down a statute that proscribed certain mining operations, thereby destroying property rights without providing compensation. TRIBE, *supra* note 2, § 8-5, at 444. In Miller v. Schoene, 276 U.S. 272 (1928), however, the Court upheld a statute that mandated the destruction without compensation of privately-owned infected trees because of the overriding public benefit. TRIBE, *supra* note 2, § 8-5, at 445.

Austere governmental regulations of private property have also been the subject of takings claims where the regulations substantially impaired the property value. *Id.* § 9-3, at 460. The Court, in Village of Euclid v. Ambler Realty Co., 272 U.S. 365 (1926), upheld a local zoning ordinance which closed down a fertilizer company, despite the uncompensated diminution in property values. TRIBE, *supra* note 2, § 9-3, at 461-62. Takings jurisprudence, however, is not confined to the real property arena. *See infra* note 5 (cases in diverse areas involving private property affected by government regulation); *see also* Frank R. Strong, *On Placing Property Due Process Center Stage in Takings Jurisprudence*, 49 OHIO ST. L. J. 591, 593 (1988) (focusing on *Pennsylvania Coal* and noting that the takings clause merely mandated government compensation for a taking; due process determined whether a taking had in fact occurred).

[4] U.S. CONST. amend. XIV. Section 1 of the Fourteenth Amendment states, in pertinent part:

government regulation in diverse areas.[5] The Due Process Clause mandates that governmental regulation of private industry must be substantially related to the object sought and that industry participants be guaranteed an adequate rate of return on their investments.[6]

In this arena, particularly troublesome cases have involved attempts to quantify an adequate rate of return with regard to governmental rate or price control in a particular industry.[7] The

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> No State shall make or enforce any law which shall abridge the privileges and immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

The Bill of Rights was held to be inapplicable to state action in the pre-Civil War era. NOWAK, *supra* note 2, Ch. 13, § V, at 452 (citing Barron v. Baltimore, 32 U.S. 243 (1833)). Following the ratification of the Fourteenth Amendment, the Court initially rejected assertions that the Bill of Rights was applicable to state and local governments via the Fourteenth Amendment. *Id.* Nonetheless, individual rights enjoyed protection under the Court's broad interpretation of the Due Process Clause, which allowed it to safeguard basic freedoms and natural law rights without reference to specific Constitutional provisions. *Id.*

A number of competing views emerged, including Justice Black's proffer that the entire Bill of Rights should be applied directly to the states. *Id.* Ch. 13, § V at 454. Alternatively, Justice Frankfurter posited that the concept of "liberty" did not rely on specific Bill of Rights guarantees and should be judicially defined. *Id.* At present, the Fourteenth Amendment incorporates nearly all of the Bill of Rights guarantees, particularly those considered " 'fundamental to the American scheme of justice.' " *Id.* Ch. 13, § V at 455 (quoting Duncan v. Louisiana, 391 U.S. 145, 148-49 (1968)). Furthermore, provisions incorporated via the Fourteenth Amendment are applied consistently, whether the actor is a local, state or federal government. *Id.* Ch.13, § V at 456-57. *See also* William Cohen, *Justices Black and Douglas and the "Natural-Law-Due-Process Formula": Some Fragments of Intellectual History*, 20 U.C. DAVIS L. REV. 381, 382 (1987) (analyzing the incorporation doctrine in light of natural law concepts).

5 *See, e.g.*, Duquesne Light Co. v. Barasch, 488 U.S. 299, 301 (1989) (state regulatory scheme for electrical generating facilities); Penn Central Transportation Co. v. New York City, 438 U.S. 104, 107 (1978) (historical landmark designation restricting exercise of property rights); Permian Basin Area Rate Cases, 390 U.S. 747, 754 (1968) (federal regulation of natural gas rates); FPC v. Hope Natural Gas Co., 320 U.S. 591, 594 (1944) (federal rate order fixing natural gas prices); Village of Euclid v. Ambler Realty, 272 U.S. 365, 379 (1926) (municipal zoning ordinance); Hadacheck v. Sebastian, 239 U.S. 394, 404 (1915) (municipal ordinance limiting land use).

6 *Nebbia v. New York*, 291 U.S. 502, 525 (1934); *see also infra* notes 52-57 and accompanying text for discussion of the Court's holding in *Nebbia*.

7 *See, e.g.*, Guaranty Nat'l Ins. Co. v. Gates, 916 F.2d 506 (1990) (auto insurance rate scheme precluding relief to insurers who were not threatened with insolvency held unconstitutional); Calfarm Ins. Co. v. Deukmejian, 771 P.2d 1247 (1989) (provisions placing undue restriction on rate relief severed from auto insurance rate regulations); Helmsley v. Borough of Fort Lee, 78 N.J. 200, 210, 394 A.2d 65, 70 (1978) (examining a rent control ordinance, the court noted that "[s]atisfactory

New Jersey auto insurance industry provides a contemporary gridiron for the divisive struggle to determine the proper ambit of legislative action.[8]

In *State Farm v. State*,[9] the New Jersey Supreme Court entered this fray and considered whether surtaxes and assessments levied by the Fair Automobile Insurance Reform Act (Reform Act) precluded auto insurance companies from receiving an adequate rate of return.[10] After distilling a body of nebulous background material, the court voiced concerns about the actual effectiveness of the Act.[11] Nonetheless, the court deferred to the legislature and determined that because the prohibitions on rate increases were not absolute, the Reform Act did not work an unconstitutional taking or violate due process.[12]

SALIENT FACTS

Over the last decade, New Jersey has grappled unremittingly with the chronic, vexing problem of supplying automobile insurance to high-risk drivers.[13] Before 1983, high-risk drivers unable

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formulations of just and reasonable return . . . have proven to be elusive") *appeal dismissed*, 440 U.S. 978 (1979).

8 *See* State Farm v. State, 124 N.J. 32, 590 A.2d 191 (1991). New Jersey is merely the most recent jurisdiction in which the auto insurance battle has been waged; both California and Nevada hosted challenges to legislation regulating auto insurance rates. *See infra* notes 87-101 and accompanying text for analysis of the statutes in those jurisdictions.

9 124 N.J. 32, 590 A.2d 191 (1991).

10 *Id.* at 38, 590 A.2d at 194. In addition to the takings and due process claims, the court briefly considered a number of other constitutional challenges to the Reform Act's validity. *Id.* at 64-66, 590 A.2d at 207-09; *see infra* notes 136-43 and accompanying text for a discussion of those issues.

11 *Id.* at 62, 590 A.2d at 207. Particularly, the court expressed concern that the language of the rate increase provisions allowed but did not require the Insurance Commissioner to order rate relief for insurers denied an adequate rate of return. *Id.* While acknowledging the complexity of the rate increase filing process and the potential for unreasonable delays, the court presumed that rate relief would be available in a timely fashion. *Id.* at 62-63, 590 A.2d at 207.

12 *Id.* at 61-62, 590 A.2d at 206. In rendering this decision, the court divined the legislative intent to protect insurers against a denial of a fair rate of return caused by surcharges and assessments. *Id.* at 61, 590 A.2d at 206. The court added that even if this interpretation was questionable, the court would approve it to preclude an unconstitutional construction of the statute. *Id.*

13 *Id.* at 40, 590 A.2d at 195. "High-Risk Driver" is not defined in the JUA definitions section. N.J. STAT. ANN. § 17:30E-3 (West 1985). High-risk drivers, as well as other drivers unable to secure auto insurance, comprise the "Residual Market" which necessitated the loathsome Residual Market Equalization Charge (RMEC). *See id.* at 41-42, 590 A.2d at 196; N.J. STAT. ANN. § 17:30E-8(d) (West 1985). These charges reached a highwater mark of $222 for each car owned. *See* Joseph F. Sullivan, *Florio's Auto Insurance Law Upheld*, N.Y. TIMES, May 17, 1991, at B2; *see also*

to secure coverage in the voluntary market were allocated to insurance carriers through the Assigned Risk Plan.[14] The Assigned Risk Plan yielded, in 1983, to the Automobile Full Insurance Availability Act,[15] which created the Joint Underwriting Association (JUA).[16]

All automobile insurers licensed in New Jersey were brought under the aegis of the JUA,[17] with designated "servicing carriers" managing administrative details and issuing insurance policies to qualified applicants.[18] Foreseeing that the revenues

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Stephen Barr, *Auto Insurance: Legal Wrangling*, N.Y. TIMES, March 10, 1991, § 12NJ, at 1 (predicting that elimination of surcharges will result only in shifting of costs, not reduced rates).

[14] *State Farm*, 124 N.J. at 40, 590 A.2d at 195. This plan empowered the Commissioner of Insurance to apportion coverage of high risk drivers among all auto insurance carriers operating in New Jersey. *Id.*

[15] N.J. STAT. ANN. §§ 17:30E-1 to -24 (West 1985).

[16] *State Farm*, 124 N.J. at 40, 590 A.2d at 195. Section 17:30E-2 of the Automobile Full Insurance Availability Act provided:

> The purpose of this act is to assure to the New Jersey insurance consumer full access to automobile insurance through normal market outlets at standard market rates, to encourage the use of available market facilities, to provide automobile insurance for qualified applicants who cannot otherwise obtain such insurance through a full automobile insurance underwriting association, and to require that companies be made whole for losses in excess of regulated rates on all risks not voluntarily written by providing procedures for the spreading and recoupment of losses based on actual experience.

N.J. STAT. ANN. § 17:30E-2 (West 1985).

Thus, the JUA was created to match New Jersey drivers with insurance carriers and to make auto insurance available to drivers otherwise unable to secure insurance. *State Farm*, 124 N.J. at 41, 590 A.2d at 195. Accordingly, high risk drivers would obtain auto insurance at standard market rates and through regular market outlets. N.J. STAT. ANN. § 17:30E-2 (West 1985). The plan also promoted the use of the existing market structure. *Id.*

[17] *State Farm*, 124 N.J. at 41, 590 A.2d at 195. *See also* N.J. STAT. ANN. § 17:30E-4 (West 1985). All insurers were constrained to abide by a Plan of Operation, subsequently adopted by the association's governing Board of Directors. *State Farm* 124 N.J. at 41, 590 A.2d at 195. Although the Commissioner of Insurance retained ultimate authority to overrule board actions potentially incongruous with state regulations, the Board of Directors, primarily comprised of representatives from insurance carriers, brokers, and agents, managed the JUA. *Id.* at 41, 590 A.2d at 196.

Recognizing the inequity of requiring insurance carriers to involuntarily assume certain risks, the Act provided that all companies would be indemnified for losses exceeding regulated rates incurred on policies written pursuant to this Act. N.J. STAT. ANN. § 17:30E-2 (West 1985).

[18] *State Farm*, 124 N.J. at 41, 590 A.2d at 196. Section 17:30E-7 empowered the JUA to authorize "servicing carriers" to act as agents of the association. N.J. STAT. ANN. § 17:30E-7(e) (West 1985). The JUA invited insurers to apply for the "servicing carrier" designation. *State Farm*, 124 N.J. at 41, 590 A.2d at 196. All "servicing carriers" collected premiums and issued coverage and, in return were compensated for these services by the JUA. *Id.*

generated by insuring high risk drivers at voluntary market rates would not offset the liabilities on claims, JUA income was supplemented by funds from various external sources.[19]

Despite the supplemental income and numerous other provisions intended to safeguard the JUA's operational solvency,[20] the system became overburdened.[21] Substantial surcharges, imposed on policy holders from 1988 to 1990, failed to remedy the JUA's fiscal woes, as liabilities of the association outstripped revenues.[22] By 1990, the exorbitant JUA debt became a priority of

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[19] *Id.* at 41-42, 590 A.2d at 196. In addition to net premiums collected by the JUA, income was to be derived from any accident surcharge system adopted by the association, portions of the Division of Motor Vehicles surcharges for drunk driving and other moving violations, and the residual market equalization charges. N.J. STAT. ANN. § 17:30E-8 (West 1985). "Residual market equalization charges" (RMEC's) (alternatively labelled flat charges, capitation fees, or policy constants) were surcharges placed on basic policy rates intended to bridge the deficit between the costs of operating the JUA and the other collective sources of income, so that the association would operate on a break even basis. N.J. STAT. ANN. § 17:30E-3(o) (West 1985). The RMEC's were subject to change in response to, and in order to preserve, the financial vitality of the JUA. N.J. STAT. ANN. § 17:30E-8(b) (West 1985).

[20] N.J. STAT. ANN. § 17:30E-7 (West 1985). In addition to supplemental income sources, the JUA also provided numerous procedural safeguards, including: § 17:30E-7(d) (association shall take steps necessary to prevent payment of improper claims); § 17:30E-7(g) (association shall introduce standards for review of producer and servicing carrier operating practices and eliminate inadequate practices); § 17:30E-7(k) (association shall establish regulatory bylaws regarding internal affairs); § 17:30E-7(o) (association shall scrutinize complaints concerning producer conduct and take action when necessary); § 17:30E-7(p) (association shall evaluate operations of serving carriers and charge servicing carriers for JUA efforts to improve inadequate practices); § 17:30E-7(s) (association shall act as needed to achieve the goals of the Act). *Id.*

[21] *State Farm*, 124 N.J. at 42; 590 A.2d at 196. Unable to secure coverage in the voluntary market, hordes of drivers were corralled into the JUA, so that by 1988 over 50% of New Jersey drivers were compelled to seek coverage through the JUA. *Id.* The ultimate absurdity of the JUA system was manifest by the fact that an insurer could realize a greater profit by settling a claim filed by one of its own policy holders for a *higher* amount. Wayne King, *New Jersey Cuts Cost of Driving*, NEW YORK TIMES, April 1, 1991, at B1. Because the money to pay the claim came from a JUA pool rather than directly from the insurer, and because the insurer received a percentage of each claim settled, insurers had an incentive to settle claims at inflated amounts, thereby increasing their own profits and draining JUA funds. *Id.*

[22] *State Farm*, 124 N.J. at 42, 590 A.2d at 196. Prior to adoption of the Fair Automobile Insurance Reform Act, the JUA was described as "a bureaucratic nightmare" and "a system choked by its own red tape." Suzanne Riss, *For its Closing Act, JUA Goes From Bad to Worse; Plaintiffs' Lawyers Cite Mounting Delays and Lower Settlements*, N.J.L.J., April 12, 1990, at 3.

The exact magnitude of the JUA debt was the subject of continuing speculation; an October 1991 estimate surmised that the debt would eventually reach $3.4 billion, and that New Jersey drivers would be paying off this debt well into 1996. Joe Donohue, *Study Predicts Deficit for Auto Insurance Pool*, THE STAR-LEDGER, October

the government.[23]

Responding to this mounting problem, in March 1990, the legislature adopted the Fair Automobile Insurance Reform Act (Reform Act).[24] The primary objectives of the Reform Act included effectuating a general reduction of car insurance costs, depopulating and dissolving the JUA, and establishing a means of eradicating the mammoth JUA debt.[25] The Reform Act addressed the JUA deficit, by creating a special fund within the State Treasury, the New Jersey Automobile Insurance Guaranty Fund (Auto Fund), for the collection and disbursement of monies dedicated exclusively to satisfying the debt.[26] Section 74 of the Reform Act imposed large assessments on the insurance compa-

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20, 1991, at 1,2; *see also* King, *supra* note 21, at B1 (detailing the over $3 million dollar JUA debt that had accumulated by the time the legislature voted to abolish the association).

[23] *State Farm*, 124 N.J. at 42, 590 A.2d at 196; *see also* Barr, *supra* note 13, at 1 ("For Mr. Florio, 'junk the J.U.A.' was a key campaign pledge.")

[24] *State Farm*, 124 N.J. at 42, 590 A.2d at 196; *see also* N.J. STAT. ANN. § 17:33B-1 to -63 (West Supp. 1991) for text of the Act.

[25] *State Farm*, 124 at 42, 590 A.2d at 196. The Act proclaimed that as of October 1990, the JUA would discontinue writing and renewing policies. *Id.* Furthermore, as part of the depopulation of the JUA, drivers would be grouped into one of three classifications, with policy rates corresponding to the estimated risk. *Id.* at 42-43, 590 A.2d at 196. Under these new categories, "high-risk drivers," comprising approximately 10% of the New Jersey market, were placed in a re-animated Assigned-Risk Plan. *Id.* at 42, 590 A.2d at 196. Private carriers insured "non-standard risk drivers," which comprised 15% of the market, at rates up to 135% of standard risk drivers. *Id.* at 42-43, 590 A.2d 196. The remainder of the market, classified as "standard risk drivers," were to be covered in the voluntary market, at prevailing rates. *Id.* at 43, 590 A.2d 196. "High-risk" drivers would no longer be subsidized by the rest of the market because the higher rates assessed on their policies would be sufficient to indemnify the liabilities these drivers would incur. *Id.*

[26] *Id.* at 43, 590 A.2d at 196-97. The Auto Fund received income from sources previously allocated to the JUA, including surcharges on drivers for drunk driving convictions and other driving infractions. *Id.* at 43, 590 A.2d at 197.

The Reform Act also created several additional sources of revenue for the Auto Fund through increased automobile registration fees and the imposition of assessments on doctors, lawyers, and auto body repair shops. *Id.* These assessments, intended to net approximately $6 million, were challenged on separation of powers, equal protection, and substantive due process grounds, and were subsequently upheld. N.J. State Bar Ass'n v. Berman, 11 N.J. Tax 433, 437 (1991); *see also* Jeffrey Kanige, *Court Upholds JUA-Bailout Fees on Lawyers, MDs; State Bar, Medical Groups to Appeal Constitutional Issues* N.J.L.J., January 24, 1991, at 3 (discussing the *Berman* holding).

The sources of income for the JUA bailout central to State Farm's complaint were the assessments and surtaxes on insurance carriers in New Jersey. *State Farm*, 124 N.J. at 43, 590 A.2d at 197; *see also* Reform Act, §§ 63 to 68, N.J. STAT. ANN. § 17:33B-58 to -63 (West Supp. 1991) (imposing additional fees); § 74, N.J. STAT. ANN. 17:30A-a(9)-(10) (West Supp. 1991) (granting the powers to levy assessments); § 76, N.J. STAT. ANN. 17:33B-49 (West Supp. 1991) (imposing surtaxes).

nies to be collected by the Property Liability Insurance Guaranty Association (PLIGA).[27] Section 75 explicitly prohibited insurers from recouping assessments via "passthroughs" or surcharges on policy holders.[28]

In addition to the section 74 assessments, section 76 of the Reform Act levied a surtax on insurers to alleviate the JUA debt.[29] Section 78 precluded insurance carriers from passing

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[27] *State Farm*, 124 N.J. at 43, 590 A.2d at 197. PLIGA was codified in N.J. STAT. ANN. § 17:30A-6 and § 17:30A-8(a) (referred to in *State Farm* as Section 74), which delineated the association's powers, providing that PLIGA shall:

> (9) Assess member insurers in amounts necessary to make loans pursuant to paragraph (10) of this subsection. Estimated assessments of each member insurer shall be in the proportion that the net direct written premiums of the member insurer for the calendar year preceding the assessment bears to the net direct written premiums of all member insurers for the calendar year preceding the assessment with actual assessments adjusted in the succeeding year based on the proportion that the insurer's net direct written premiums in the year of assessment bears to the net direct written premiums of all member insurers for that year.
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> (10) Make loans in the amount of $160 million per calendar year, beginning in calendar year 1990, to the New Jersey Automobile Insurance Guaranty Fund created pursuant to section 23 of P.L. 1990, c. 8 (C.17:33B-5), except that no loan shall be made pursuant to this paragraph after December 31, 1997.

N.J. STAT. ANN. § 17:30A-8(a)(9)-(10) (West Supp. 1991).

Thus, assessments were to be collected by PLIGA, deposited into the Auto Fund, and dedicated solely to the objective of eliminating the JUA deficit. *State Farm*, 124 N.J. at 43, 590 A.2d at 197. PLIGA was originally established in 1974 to levy assessments on property-casualty insurers in New Jersey for the payment of claims filed against insolvent carriers. *Id.* Designated as "loans" under the Reform Act, these assessments were intended to produce yearly revenues of $160 million for the period of 1990 to 1997. *Id.* at 44, 590 A.2d at 197. In 1990, the assessments totalled 2.7% of property-casualty insurer net premiums. *Id.*

[28] *Id.* Section 75 stated: "No member insurer shall impose a surcharge on the premiums of any policy to recoup assessments paid pursuant to paragraph (9) of subsection (a) of section 8 of P.L. 1974, c. 17 (C. 17:30A-8)." N.J. STAT. ANN. § 17:30A-16b (West Supp. 1991).

Insurers have invariably been authorized to pass through, in one form or another, the cost of PLIGA insolvency assessments to policyholders. *State Farm*, 124 N.J. at 44, 590 A.2d at 197. Prior to 1979, insolvency assessments were passed on to policyholders in the form of rate increases. *Id.* Subsequent legislation authorized direct surcharges on policy premiums, a procedure still authorized for recoupment of insolvency assessments. *Id.* (citing N.J. STAT. ANN. § 17:30A-16a). The Reform Act explicitly proscribed surcharges designed to recover the cost of assessments made to fund the JUA bailout. *Id.*

[29] *Id.* (citing N.J. STAT. ANN. 17:33B-49). The statute provided, in pertinent part:

> In addition to the tax on net premiums paid pursuant to section 1 of P.L. 1945, c. 132 (C.54:18A-1), each taxpayer under that section shall pay to the Director of the Division of Taxation an annual surtax at a rate of 5%, or a rate adjusted pursuant to section 77 (section 17:33B-

through the expense of these surtaxes to policy holders, and empowered the Insurance Commissioner to protect consumers from shouldering any of the surtax burden.[30]

Although these provisions seem to preclude insurers from obtaining rate relief by passing costs on to policy holders, section 2g[31] granted the Commissioner of Insurance implicit authority to guarantee all insurers an adequate rate of return.[32] The proper harmonization of section 75, section 78 and section 2g provided the gravamen of the dispute between insurers and the State.[33]

In May 1990, State Farm Mutual Automobile Insurance Company (State Farm) filed suit in New Jersey Superior Court, Chancery Division, attacking the facial constitutionality of the Reform Act, characterizing it as a confiscatory taking and a violation of due process.[34] The court granted State Farm's motion for a

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50) of this 1990 amendatory and supplementary act, on all taxable premiums collected in this State, except premiums collected by the New Jersey Automobile Full Insurance Underwriting Association created pursuant to section 16 of P.L. 1983, c. 65 (C.17:30E-4), and premiums collected by the market Transition Facility created pursuant to section 88 of P.L. 1990, c. 8 (C.17:33B-11), in calendar years 1990, 1991 and 1992 for contracts of automobile insurance, notwithstanding section 6 of P.L. 1945, c. 132 (C.54:18A-6). The surtax shall be administered pursuant to the provision of P.L. 1945, c. 132 (C.54:18A-1 et seq.), except that if any provision of that act is in conflict with a specific provision of this 1990 amendatory and supplementary act, the provision or provisions of this 1990 amendatory and supplementary act shall govern.

N.J. STAT. ANN. § 17:33B-49(a) (West Supp. 1991).

The initial surtax rate was set at five percent of insurer's net premiums. *State Farm*, 124 N.J. at 44, 590 A.2d at 197. The surtax was intended to net $300 million dollars during 1990-1992. *Id.* The Director of the Division of Taxation, however, was vested with authority to adjust surtax rates to ensure that total revenues approached, but did not exceed, the target amount of $300 million. *Id.* (citing N.J. STAT. ANN. 17:33B-50).

30 *Id.* at 45, 590 A. 2d at 197. Section 78 stated that "[t]he Commissioner of Insurance shall take such action as is necessary to ensure that private passenger automobile insurance policyholders shall not pay for the surtax imposed pursuant to section 76." *Id.* (quoting N.J. STAT. ANN. 17:33B-51).

31 N.J. STAT. ANN. 17:33B-2g (West Supp. 1991). This section declared: "To provide a healthy and competitive automobile insurance system in this State, automobile insurers are entitled to earn an adequate rate of return through the ratemaking process." *Id.*

32 *State Farm*, 124 N.J. at 54, 590 A.2d at 202; *see infra* note 153 and accompanying text for a comprehensive analysis of the impact of § 2g.

33 *Id.* at 51-52, 590 A.2d at 201. The court noted that the factors in this constitutional calculus included examination of the legislative history, scrutiny of the statutory language, and deference to the administrative interpretation of the Reform Act. *Id.*

34 *Id.* at 38-39, 590 A.2d at 194. Although the main thrust of this attack was a takings and due process challenge, the insurers' raised a number of other claims,

preliminary injunction and permitted the insurers to pay the statutory assessments and surtaxes to the court rather than the State.[35]

The New Jersey Superior Court, Appellate Division, granted the State's motions for a stay of the preliminary injunction and for leave to appeal.[36] Subsequently, the appellate court permitted Allstate Insurance Company (Allstate) to intervene.[37]

State Farm petitioned the New Jersey Supreme Court for direct certification.[38] Following State Farm's petition, Liberty Mutual Insurance Company (Liberty Mutual) successfully moved before the court to intervene.[39] The New Jersey Supreme Court granted State Farm's petition for direct certification in November 1990.[40] In an opinion by Justice Handler, the supreme court held that the Reform Act did not absolutely preclude insurers from earning a fair rate of return.[41] The court therefore held that the Reform Act was not facially unconstitutional as either a taking without just compensation or as a violation of due process.[42]

PRIOR CASES

Historically, the standards applied to regulatory takings

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including allegations of a contracts clause violation, and a claim that the Reform Act was an unconstitutional bill of attainder. *Id.*; *see infra* notes 136-43 and accompanying text for a discussion of the court's examination of these claims.

35 *State Farm*, 124 N.J. at 39-40, 590 A.2d at 195. The trial court determined that the contract impairment and takings claims were related and that proof of a takings violation was imperative to establishing the contract clause violation. *Id.* at 39, 590 A.2d at 195. The court declared that the statutory assessments were valid as long as they did not attain confiscatory proportions, or violate due process. *Id.* Although relief from the surtaxes was forbidden, the court found that the Reform Act did not absolutely prohibit rate relief from the assessments. *Id.* In conclusion, the court held that a hearing was mandated to ascertain whether State Farm could secure an adequate rate of return via rate increase filings. *Id.*

36 *Id.* at 40, 590 A.2d at 195. The stay remained intact when the New Jersey Supreme Court denied State Farm's application, filed the next day, to vacate the stay. *Id.* The motion for leave to appeal was granted in July 1990. *Id.*

37 *Id.* Allstate was simultaneously pursuing a similar claim in the Chancery Division. *Id.* Originally, Allstate had commenced an action in federal court, which was dismissed without prejudice on the grounds that the power to decide state tax matters resided in the state courts. *See* Jeffrey Kanige, *If At First*, N.J.L.J., July 19, 1990, at 6.

38 *State Farm*, 124 N.J. at 40, 590 A.2d at 195.

39 *Id.* Liberty Mutual, like Allstate, had filed in federal court, only to have the complaint dismissed without prejudice. *Id.*; *see also* Kanige, *supra* note 37 at 6.

40 *State Farm*, 124 N.J. at 40, 590 A.2d at 195.

41 *Id.* at 62-63, 590 A.2d at 207.

42 *Id.* at 63, 590 A.2d at 207.

claims have varied, depending on the precise nature of the industry subject to governmental control.[43] In *Munn v. Illinois*,[44] the Court explored the constitutional propriety of an Illinois statute which set maximum prices for grain storage.[45] The owner of a grain storage and weighing facility challenged the law as an un-

[43] *Id.* at 47, 590 A.2d at 199. Takings jurisprudence originally developed in the land use arena. *See, e.g.*, First Lutheran Church v. Los Angeles County, 482 U.S. 304, 306-7 (1987) (takings which deny property owner all use of land, though temporary, require just compensation); Penn Central v. New York, 438 U.S. 104, 109, 138 (1978) (historical landmark designation restricting exercise of property rights did not constitute a taking); Miller v. Schoene, 276 U.S. 272, 279-80 (1928) (statute taking private property to benefit private parties upheld due to overriding public benefit); Village of Euclid v. Ambler Realty Co., 272 U.S. 365, 390 (1926) (local zoning ordinance upheld despite diminution in certain property values); Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 414 (1922) (statute proscribing certain mining operations, thereby destroying property rights without compensation, struck down as beyond the scope of the state's police power); Hadacheck v. Sebastian, 239 U.S. 394, 414 (1915) (municipal ordinance limiting land use upheld); *see also* Sandra L. Vieser, Note, *Monetary Compensation for Temporary Regulatory Taking is Required for the Period During which the Regulation is Effective*, 18 SETON HALL LAW REV. 1041 (1988) (tracing the evolution of the standards applied to regulatory takings of real property); John H. Klock & Peter H. Cook, *The Condemning of America: Regulatory "Takings" and the Purchase By the United States of America's Wetlands*, 18 SETON HALL LAW REV. 330, 331 (1988) (analyzing regulatory takings claims with regard to privately owned wetlands).

The supreme court developed and refined takings standards in a line of cases examining the constitutional implications of public utility rate regulation. *State Farm*, 124 N.J. at 47, 590 A.2d at 199. *See, e.g.*, Duquesne Light Co. v. Barasch, 488 U.S. 299, 301 (1989) (state regulatory scheme for electrical generating facilities did not constitute a taking); *In re* Permian Basin Area Rate Cases, 390 U.S. 747, 771-72 (1968) (although regulation of natural gas did not explicitly set forth conditions mandating relief, the Commission's guarantees for special relief were sufficient to pass constitutional muster); FPC v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944) (natural gas rates constitutional if return on investment is comparable to the return received by similar businesses).

The Supreme Court further distilled these criteria in a series of challenges to rent-control ordinances and established a polestar for analyzing subsequent takings claims. *State Farm*, 124 N.J. at 47, 590 A.2d at 199; *see also*, Pennel v. City of San Jose, 485 U.S. 1, 4 (1988) (city rent control ordinance designed to prevent unreasonable rent increases is valid exercise of police powers); Helmsley v. Borough of Fort Lee, 78 N.J. 200, 226, 394 A.2d 65, 78 (1978) (effective administrative relief mechanism is constitutionally mandated where a regulatory scheme will have a predictable and extensive confiscatory impact) *appeal dismissed*, 440 U.S. 978 (1979); Hutton Park Gardens v. Town Council, 68 N.J. 543, 574 350 A.2d 1,17 (1975) (apartment owners are entitled to fair rate of return, though no precise rate relief mechanism is required).

[44] 94 U.S. 113 (1876).

[45] *Id.* at 123. Generally, the statute governed the licensing of operators of grain storage and weighing facilities. *Id.* at 116. Munn & Scott had operated a grain handling and storage business for nearly ten years prior to enactment of the statute. *Id.* at 118. Munn & Scott violated the act by failing to take out a license allowing them to conduct business as public warehousemen. *Id.* Additionally, Munn & Scott charged rates for storage and handling in excess of the statutory limit. *Id.*

constitutional regulation of private property, violative of Fourteenth Amendment due process.[46]

Writing for the majority, Chief Justice Waite noted that industries "affected with a public interest" have traditionally been subject to regulation for the public good.[47] After protracted analysis of the grain business, the Court identified it as an industry clearly affected with a public interest[48] and concluded that the governmental prerogative to regulate grain storage was firmly entrenched in the common law.[49]

The power to regulate, the Court observed, included im-

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[46] *Id.* at 123. Munn & Scott also contended that the statute violated the Commerce Clause. *Id.* The Court dismissed this claim, noting that interstate commerce was not involved and therefore the regulation was solely a state concern that did not encroach Congress' exclusive domain to regulate interstate commerce. *Id.* at 135.

[47] *Id.* at 126. Chief Justice Waite began by observing that all statutes are accorded a presumption of validity, and should not be declared invalid unless clearly repugnant to the Constitution. *Id.* at 123. The Chief Justice further proclaimed that in passing on close questions of statutory constitutionality, courts must defer to the legislature's expressed intent. *Id.*

Chief Justice Waite next traced the common law history of state regulatory practices. *Id.* 124-25. At common law, many occupations were deemed to be invested with a public interest and thus subject to government regulation, including innkeepers, wharfingers, bakers, millers, common carriers, hackmen, ferry operators and chimney sweeps. *Id.* at 125.

The Chief Justice also remarked that this concept pre-dated the adoption of the Fourteenth Amendment. *Id.* Delving into common law annals, Chief Justice Waite cited a then two-hundred year old authority, Lord Chief Justice Hale, who in his treatise De Portibus Maris, 1 Harg. Law Tracts, 78, declared that when private property is "affected with a public interest, it ceases to be *juris privati* only"; *Id.* at 125-126. The Court concluded that when used in ways that affect the community at large, property becomes cloaked with a public interest and thus subject to government regulation. *Id.* at 126. The holder of the property, by devoting his property to a public use, implicitly agrees to regulation for the common good. *Id.*

The Court professed that this concept was embodied in the epigram "*sic utere tuo ut alienum non laedas*" which dictated that each individual must use his or her property in a manner that will not injure others. *Id.* at 124-25. The expression's reasoning is circuitous and has been characterized as "[u]tterly useless as a legal maxim." JESSE DUKEMINIER & JAMES E. KRIER, PROPERTY 923 (1981) (quoting BLACK'S LAW DICTIONARY (4th ed. 1951)). Dukeminier & Krier illustrate this criticism by posing a hypothetical in which one landowner's property use is restricted because of potential impairment to a neighbor's land. *Id.* Thus, the jurisprudence in this area has been a constant struggle to properly balance these competing interests. *Id.*

[48] *Id.* at 131-32; *see also supra* note 47 for an explanation of this standard.

[49] *Id.* at 133. Because this type of regulation was typically viewed as falling within the sovereign power, the Court determined that the concept of regulation for the public welfare had been embraced by and incorporated into the Due Process Clause of the Fourteenth Amendment. *Id.* at 125. The Court held that Fourteenth Amendment due process did not create new or unprecedented constraints on state regulation, but rather embodied this common law understanding. *Id.*

plicit authority to set prices, tempered by the common law restraint that the prices not be unreasonable.[50] In upholding the Illinois regulatory scheme, the Court concluded that reasonable regulation of property affected with a public interest was constitutional and did not violate Fourteenth Amendment due process guarantees.[51]

The Supreme Court delineated the modern standards for substantive due process analysis of state law in the landmark case *Nebbia v. New York*.[52] In *Nebbia*, the Court considered the constitutionality of a New York law designed to safeguard the public availability of wholesome milk by fixing minimum sale prices for the commodity.[53]

In an opinion by Justice Roberts, the Court provided the benchmark for assessing future due process challenges and held that due process only demanded that laws be rationally related to the legislative objective and not be capricious, arbitrary or unreasonable.[54] The Court found that New York's price fixing scheme was neither arbitrary nor unreasonable,[55] and concluded that the plan was rationally related to the goal of protecting the public availability of potable milk.[56] Accordingly, the Court upheld the

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50 *Id.* at 134. Munn & Scott argued that the determination of a reasonable return should be made by the courts, not the legislature. *Id.* at 133. The court rejected this contention and observed that traditionally, matters affecting the public interest were left to the legislature. *Id.* at 133-34. Failing to specify what a reasonable return means, Chief Justice Waite observed that such regulations could be changed on even a legislative whim provided that legislation did not exceed the boundaries of constitutional limitations. *Id.* at 134.

51 *Id.* at 134-35.

52 291 U.S. 502 (1934); *see also supra* note 2 for a survey of due process analysis prior to *Nebbia*.

53 *Nebbia*, 291 U.S. at 515. In response to a mounting crisis in the milk industry, the New York Legislature promulgated Chapter 158 of the Laws of 1933. *Id.* Section 302 of this Act established a Milk Control Board. *Id.* at 519 n.2. Subsequent sections empowered the board to take measures to guarantee the supply of unadulterated milk to the public, and to protect the milk industry from destructive competitive forces. *Id.* The express authority to establish minimum and maximum prices for milk was delegated in § 312(b). *Id.* at 520 n.2. Justice Roberts noted that this legislation was the product of extensive research into the nature and magnitude of the problem. *Id.* at 516.

54 *Id.* at 525. The Court also noted that each regulation must be assessed in light of the relevant circumstances and that a valid regulation in one industry may be invalid when applied to a different industry or under different circumstances. *Id.*

55 *Id.* at 530.

56 *Id.* Citing Munn v. Illinois, 94 U.S. 113 (1876), Justice Roberts observed that a state may legitimately regulate the price charged for goods or services affected with a public interest. *Id.* at 532-33; *see also supra* notes 44-51 and accompanying text for analysis of *Munn*.

Justice Roberts added that fixing minimum prices in furtherance of the public

New York law, concomitantly revising the contours of substantive due process analysis.[57]

One decade later, the Court defined the parameters of the takings clause in the realm of public utility rate and price control in *Federal Power Comm'n v. Hope Natural Gas Co.*[58] Hope Natural Gas challenged the validity of a rate order issued by the Federal Power Commission (FPC) fixing natural gas rates.[59]

Writing for the Court, Justice Douglas explained that the rate making formula at issue balanced competing interests to arrive at rates deemed just and reasonable.[60] Examining the elements of this balancing test, Justice Douglas delineated several investor and company interests and noted their significance in the rate setting process.[61] Justice Douglas declared that under this type of regulatory scheme, the return on investment should be comparable to the return received by other businesses facing similar risks and should sustain confidence in the economic sta-

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interest was not unprecedented and that such regulation would not be invalidated unless it was "arbitrary, discriminatory or demonstrably irrelevant" to the legislative objective. *Id.* at 538-39. The Court found that the law in question sought to regulate prices in an industry with a long history of regulation for the public welfare. *Id.*

57 *Id.* at 539. Justice Roberts opined that courts should not question economic policies adopted by legislatures but should defer to legislative prerogatives and presume the validity of these enactments. *Id.* at 537-38. Justice Roberts further declared that "[t]hough the court may hold views inconsistent with the wisdom of the law, it may not be annulled unless palpably in excess of legislative power." *Id.* at 538.

58 320 U.S. 591 (1944).

59 *Id.* at 593. The rate order was issued pursuant to § 4(a) and § 5(a) of the Natural Gas Act, which empowered the FPC to determine just and reasonable rates. *Id.* at 600. The primary purpose of the Act was to protect consumers from exploitation by the natural gas companies. *Id.* at 611. Hope was displeased with a reduction in the rates it was allowed to charge customers. *Id.* at 599. Specifically, Hope challenged the method by which the FPC determined depreciation and property values as part of the rate setting calculus. *Id.* at 597-98.

60 *Id.* at 603. In determining just and reasonable rates, the Court held that the outcome, and not the method used to reach it, was the controlling element. *Id.* at 602. Justice Douglas noted that in setting rates, the FPC was not obligated to use any particular formula because Congress failed to provide a specific calculus for arriving at just and reasonable rates. *Id.* at 600. Moreover, the Court asserted that even infirmities in the method utilized would not render a rate order invalid. *Id.* at 602. Finally, Justice Douglas declared that because rate orders were the product of expert judgment, they were endowed with a heavy presumption of validity unless the party challenging the rates convincingly demonstrated unjust and unreasonable consequences. *Id.*

61 *Id.* at 603. Justice Douglas observed that investor and company interests demand revenue adequate to cover operating expenses, as well as the venture's capital costs, including stock dividends and debt service. *Id.*

bility of the venture.[62] The Court upheld the rate fixing scheme because the rate order at issue satisfied these criteria.[63]

In *Permian Basin Area Rate Cases*[64] natural gas producers challenged a rate structure that proscribed maximum rates for geographical areas, rather than setting rates based on a producer's individual situation.[65] The gas producers criticized the scheme for failing to provide adequate relief to individual producers who had been denied a reasonable return.[66]

In an opinion by Justice Harlan, the Court acknowledged that, traditionally, government agencies had been granted substantial latitude in setting rates for regulated classes.[67] Profits of

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62 *Id.* More specifically, the Court declared that the return should be sufficient to promote investor confidence in the endeavor in order to attract capital and maintain credit. *Id.* Justice Douglas asserted that even rates producing only minimal returns would be valid if they allowed the enterprise to operate successfully and to recompense investors for risks undertaken. *Id.* at 605.

63 *Id.* at 607. In analyzing whether the rate order would allow Hope to meet these criteria, the Court provided a lengthy analysis of Hope's recent financial history. *Id.* at 603-04. The Court stated that in setting Hope's return, the FPC had emphasized the significance of safeguarding the financial stability of the business. *Id.* at 604. Justice Douglas added that, based on an analysis of numerous fiscal criteria, the FPC had concluded that the new rates would not deter the operation from attracting capital on favorable terms. *Id.* at 605.

64 390 U.S. 747 (1968).

65 *Id.* at 754. The Natural Gas Act, 15 U.S.C. § 717 (1898), empowered the FPC to regulate natural gas sold interstate. *Permian*, 390 U.S. at 754. Originally, the FPC set rates based on each producer's operating costs. *Id.* at 756. This method ultimately proved unsuitable for independent producers, due to the erratic and unpredictable nature of their investments. *Id.* at 756-57. Additionally, the onerous administrative burden of determining individual rates of return induced the Commission to revise its approach. *Id.* at 757-58. In 1960, the Commission promulgated that individual cost of service determinations would no longer be employed, and that maximum rates would be established for each primary production area. *Id.* at 758. Pursuant to § 5(a) of the Natural Gas Act, a series of hearings was held to determine these rates. *Permian*, 390 U.S. at 758.

Between October 11, 1961 and September 10, 1963, the Commission conducted hearings, featuring 336 gas producers among the 384 total parties, which generated over 30,000 pages of transcripts. *Id.* at 755 n.4. The examiner issued a decision in September 1964, establishing rates and additional guidelines. *Id.* Applications for rehearing were denied in a supplementary opinion issued October 4, 1965. *Id.*

66 *Id.* at 770. The gas producers averred that as members of a class subject to rate regulation, they must be permitted to either retire from the subject activity or pursue special relief from regulations. *Id.* Under this scheme, the Commission permitted relief upon demonstration that a producer's "our-of-pocket expenses" exceeded revenues on a particular well. *Id.* at 770-71. The Commission further proclaimed that relief would be granted under certain conditions, but did not delineate those conditions. *Id.* at 771. The Commission placed the burden of justifying relief on a producer and stated that enforcement of the area rates would not be stayed pending resolution of individual claims. *Id.*

67 *Id.* at 769 (citations omitted). The Court noted that administrative agencies

gas producers could be radically curtailed, Justice Harlan averred, because the just and reasonable standard in the Natural Gas Act created a broad zone of reasonableness, with most rates enjoying a presumption of validity.[68] Evaluating the adequacy of rate relief provisions for individual class members denied a fair return, Justice Harlan acknowledged that the regulations did not explicitly set forth the conditions mandating relief.[69] The Court held, however, that the Commission's expansive guarantees of special relief were not unconstitutional.[70]

Several years later, in *FPC v. Texaco Inc.*,[71] the Court examined the validity of a natural gas price fixing regime which placed strict limits on the costs that large natural gas producers could pass through to customers.[72] Texaco, a large natural gas producer, challenged a Federal Power Commission rate order

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and legislatures had long been permitted to set rates for regulated classes without first examining the impact on each individual class member, provided there was "representative evidence" to support the regulation. *Id.*

[68] *Id.* at 770-71. The Court declared that investors' interests were but one facet of constitutional reasonableness and cautioned that the "power to regulate is not a power to destroy." *Id.* (quoting Stone v. Farmers' Loan & Trust Co., 116 U.S. 307, 331 (1886)). The Court concluded that the rates must be relevant to an appropriate legislative objective and must not be arbitrary or discriminatory. *Id.* at 769-70 (quoting Nebbia v. New York, 291 U.S. 502, 539 (1934)).

[69] *Id.* at 770-71.

[70] *Id.* at 772. The Court reversed a ruling by the United States Court of Appeals, which had found these provisions deficient due to vagueness. *Id.* at 771. The regulations permitted rate relief only in narrowly prescribed circumstances, with the burden of establishing the necessity of relief falling heavily on the producer. *Id.* at 771; *see also supra* note 66.

[71] 417 U.S. 380 (1974).

[72] *Id.* at 387. Federal Power Commission Order No. 428 (45 F.P.C. 454 (1971)) provided that sales by small producers were to be exempted from the direct rate regulation imposed on large producers and pipeline operators. *FPC v. Texaco*, 417 U.S. at 382. Small producers were identified as independent producers whose sales "did not exceed 10,000,000 Mcf at 14.65 psia during any calendar year." *Id.* at 383 n.1.

Pipelines and large producers were allowed to recover, through their rates, any reasonable expenses incurred in purchasing gas from small producers. *Id.* at 387. Large producers and pipeline operators were permitted to charge only just and reasonable prices, however, and were required to refund customer payments based on excessive purchased gas costs. *Id.* at 391.

Conversely, small producers were free to sell their gas at the best obtainable price and, theoretically, could contract with large producers at a price higher than the large producers could legally charge customers, without being required to refund the surplus. *Id.*

The Court noted that the risk of striking a bad deal and the burden of justifying costs rested on the large producers. *Id.* Effectively, large producers and pipeline operators were assigned the risk of making certain they struck a good bargain with small producers; if they did not, they could not pass through to customers the excessive cost of purchased gas. *Id.*

that permitted large producers to pass through only the reasonable costs of purchased gas.[73]

Justice White, writing for a unanimous Court, upheld the passthrough prohibitions on the large producers[74] but struck down the rate order as unduly vague.[75] Addressing the pass through limitations, the Court emphasized that the Commission should have the discretionary power to burden the large producers with the risks attendant to bargaining with small producers for reasonable prices.[76] Justice White discounted allegations that this scheme would have a confiscatory effect as premature because the full impact of the regulation could not be determined without examining future applications as well.[77] Accordingly, the Court upheld the Act's prohibition on cost passthroughs subject to judicial review of specific orders based on the indirect

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[73] *Id.* at 387. The Court emphasized that all regulated rates are governed by the just-and-reasonable standard, set forth in §§ 4 and 5 of the Natural Gas Act, 15 U.S.C. §§ 717c and 717d (1988). *FPC v. Texaco*, 417 U.S. at 386. Failing to delineate the method for determining just and reasonable rates, the Act permitted rate determinations via several methods, including the comparison of cost considerations of individual companies or the composite costs of area companies. *Id.* at 387. Justice White observed that the means used to ascertain precisely what those rates are was a matter properly left to the discretion of the Commission. *Id.* at 387-88 (quoting Wisconsin v. FPC, 373 U.S. 294, 309 (1963)). Finally, the Court reaffirmed the principle set forth in FPC v. Hope Natural Gas, 320 U.S. 591 (1944), requiring that just and reasonable rate determinations be based on results, not the method employed. *FPC v. Texaco*, 417 U.S. at 388.

[74] *Id.* at 392.

[75] *Id.* at 395-96. The Justice held that the rate order was imperfect because it failed to ensure, as required by the Act, that all natural gas rates be just and reasonable. *Id.* at 396. Justice White averred that the rate order lacked the clarity required of an administrative order. *Id.* at 395-396. The Court declared that the ambiguous reliance on market prices was not sufficient to ensure that small producer rates met the just and reasonable statutory requirement. *Id.* at 396-97. Deferring to the legislative intent behind the Natural Gas Act, the Court invalidated the Commission's rate order. *Id.* at 400.

[76] *Id.* at 392. Justice White explored the implications of the Act's failure to impose a requirement that small producers refund excess profits on gas sold at rates subsequently deemed to have been unjust and unreasonable. *Id.* Justice White declared that the Commission did not abuse its discretionary power by exempting small producers from refund obligations because the small producers were engaged in an important exploratory enterprise and consumers were protected from excessive rates. In support of this reasoning, the Court noted that this decision involved a balancing of competing interests. *Id.*

The Court highlighted the considerable public interest in protecting the small producers to facilitate their exploration for new gas sources which could result in greater gas production and assure continued just and reasonable rates. *Id.*

[77] *Id.* at 392. The Justice added that although the regulatory scheme was admittedly experimental, the Commission had pledged to closely monitor the effects of the scheme. *Id.* at 392-93.

regulation.[78]

In *Helmsley v. Borough of Fort Lee*,[79] the New Jersey Supreme Court addressed a regulatory taking claim in the context of municipal rent control.[80] The owners of several multiple-family dwellings in Fort Lee challenged the general application of a municipal rent control ordinance that limited annual rent increases.[81] The ordinance restricted rate relief, by permitting landlords to pass through the increased cost of real estate taxes directly to tenants.[82]

Writing for the unanimous court, Justice Mountain determined that the ordinance would steadily decrease profits for a

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78 *Id.* at 393. In determining whether current regulations have a confiscatory effect, Justice White averred that courts must ascertain whether the regulations will allow the business to maintain its economic stability, "attract necessary capital, and fairly compensate investors for the risk they have assumed, and yet provide appropriate protection to the relevant pubic interests both existing and foreseeable." *Id.* at 393 (quoting Permian Basin Area Rate Cases, 390 U.S. 747, 792 (1968)).

Justice White also recognized the potential for the enhanced risk to large producers of incurring unrecoverable expenses if the Commission failed to provide adequate guidelines as to what rates would be deemed excessive. *Id.* This problem, Justice White declared, should be addressed on remand. *Id.*

79 78 N.J. 200, 394 A.2d 65 (1978), *appeal dismissed* 440 U.S. 978 (1979).

80 *Id.* at 204, 394 A.2d at 67. Ord. No. 74-32, enacted by Fort Lee on November 6, 1974, limited rent increases to corresponding Consumer Price Index percentage increases. *Helmsley*, 78 N.J. at 204, 394 A.2d at 67. This general rule, however, was subject to a significant condition, whereby no rent increase could exceed 2.5% of the prior year's rent. *Id.* at 204-05, 394 A.2d at 67.

81 *Id.* at 205, 394 A.2d at 67. The plaintiffs argued that the ordinance was not justifiable as an emergency response to a housing shortage and that it denied them a constitutionally adequate rate of return. *Id.* Two weeks after the ordinance was enacted, the trial court issued a temporary restraining order suspending the enforcement of the 2.5% increase limitation. *Id.* In July, 1975, the trial court upheld the facial validity of the limitation but left the restraining order in effect, and placed rent increases exceeding 2.5% in escrow. *Id.* at 205-06, 394 A.2d at 67. The New Jersey Superior Court, Appellate Division, affirmed the judgment of the trial court in March 1977. *Id.* at 206, 394 A.2d at 67. The New Jersey Supreme Court granted certification and consolidated the principle case with two other cases then pending in the Appellate Division. *Id.* at 206-07, 394 A.2d at 68. These three cases were remanded for a plenary hearing to determine what constituted a just and reasonable return. *Id.* at 207, 394 A.2d at 68. On March 1, 1978, the trial court declared the rent control scheme confiscatory and invalid. *Id.* at 208, 394 A.2d at 68.

After detailing this elaborate procedural history, the court pointed to the unique character of this challenge which involved the legislation's impact on an entire municipality, rather than simply a particular building or landlord. *Id.* at 208, 394 A.2d at 68-69. This posture eliminated the generally required and often cumbersome administrative relief process because Fort Lee's administrative agency did not possess the authority to review the general impact of the ordinance challenged. *Id.* at 208, 394 A.2d 69.

82 *Id.* at 205, 394 A.2d at 67. Additionally, Ord. No. 75-45 set forth guidelines governing hardship relief available to landlords to augment the automatic increases provided by Ord. No. 74-32. *Helmsley*, 78 N.J. at 205, 394 A.2d at 67.

significant segment of landlords in Fort Lee, eventually attaining confiscatory proportions.[83] According to the justice, the constitution required that an effective administrative relief mechanism must accompany a regulatory scheme if the scheme would have a predictable and extensive confiscatory impact.[84] After careful analysis, Justice Mountain held that the Fort Lee ordinance failed to provide an adequate conduit for swift and effective relief.[85] Noting the foreseeable confiscatory impact and ineffective administrative relief provisions, Justice Mountain concluded that the ordinance, as applied, violated the Constitution.[86]

The constitutional challenge in *Calfarm Insurance Company v.*

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[83] *Id.* at 222-23, 394 A.2d at 75-76. Justice Mountain began his analysis by considering the various methods for calculating a landlord's fair rate of return. *Id.* at 210, 394 A.2d at 70. Justice Mountain identified three approaches that had been employed in formulating a landlord's proper rate of return: return on market value, return on investment, and the fraction of gross income comprised by operating profits. *Id.* at 210-211, 394 A.2d at 70. Justice Mountain declared that the valuation method presented " 'difficult problems of proof' " *Id.* at 213, 394 A.2d at 71. (quoting Troy Hills Village v. Parsippany-Troy Hills Tp. Council, 68 N.J. 604, 624 (1975)), and that "a value-based criterion for confiscation under rent control is practically unworkable." *Id.* at 215, 394 A.2d 72. The court noted that the plaintiffs presented no evidence regarding their level of investment. *Id.* at 216, 394 A.2d at 72. The third method, adopted by this court, involved an analysis of the percentage of income allocated to operating expenses. *Id.* at 211, 394 A.2d at 70.

Justice Mountain declared that the plaintiffs had the burden of proving the ordinance would produce a sweeping confiscatory effect on efficient operations, not merely an adverse impact on select properties. *Id.* at 218, 394 A.2d at 73. Although the plaintiffs failed to prove a confiscatory effect before 1976, the court concluded that the financial data the plaintiffs had submitted demonstrated a foreseeable confiscatory effect after 1976. *Id.* at 220, 394 A.2d at 74-75. Justice Mountain based this conclusion on an inequality between operating expenses and rent increases. *Id.* at 222-23, 394 A.2d at 76. This disparity would engender a "steady erosion" of net operating income eventually attaining confiscatory proportions. *Id.*

[84] *Id.* at 226, 394 A.2d at 78. Justice Mountain professed that even exacting rent control ordinances would be permissible, as long as they included provisions for swift and equitable administrative relief. *Id.* at 242, 394 A.2d at 85. Justice Mountain also noted that if a municipality failed to provide an adequate administrative relief mechanism, the municipality must employ a regulatory scheme that was less apt to result in confiscatory rates. *Id.* at 242, 394 A.2d at 86.

[85] *Id.* at 228, 394 A.2d at 79. The court considered five factors in determining the effectiveness of the administrative relief available under this ordinance: the timeliness of relief, the inadequacy of relief attributable to "regulatory lag," the scheme's increased reliance on the "hardship mechanism," the vague hardship relief criteria, and the prescribed method of calculating a just and reasonable return. *Id.* at 228-31, 394 A.2d at 79-80.

[86] *Id.* at 233, 394 A.2d at 81. Although the 2.5% limitation was found unconstitutional, the court declared that the limitation was severable. *Id.* The Court therefore upheld the statutory prohibition against rent increases that exceeded the percentage growth of the Consumer Price Index. *Id.*

Deukmejian[87] focused on rate relief limitations in an automobile insurance regulation scheme.[88] Seven insurers and the Association of California Insurance Companies challenged the facial validity of Proposition 103, which required an immediate rate reduction by at least twenty percent and limited the availability of rate relief to only insurers substantially threatened with insolvency.[89]

Writing for a unanimous California Supreme Court, Justice Broussard asserted that in determining whether a particular statute was confiscatory, a court must focus on the effect of the regulation, rather than the method of fixing rates.[90] The justice remarked that because price fixing statutes often appeared facially valid, yet proved confiscatory when applied, courts have scrutinized these statutes to ensure the possibility of timely and effective relief.[91]

Applying this analysis to Proposition 103, Justice Broussard proclaimed that requiring insolvency before granting rate relief violated due process.[92] The court reasoned that an insurer with

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87 771 P.2d 1247 (Cal. 1989).

88 *Id.* at 1249-50. In November 1988, responding to rapidly escalating insurance rates, California enacted Proposition 103, a program designed to fundamentally alter the state's insurance industry. *Id.* at 1249. Beginning with a statement of findings and purpose, Proposition 103 declared that " '[e]normous increases in the cost of insurance have made it both unaffordable and unavailable to millions of Californians' and noted that 'existing laws inadequately protected consumers and allow[ed] insurance companies to charge excessive, unjustified and arbitrary rates.' " *Id.* at 1249-50 (quoting CAL. INSURANCE CODE § 1861.01 historical n. supp. 1992)).

The Supreme Court of California assumed original jurisdiction over the dispute, citing on the gravity of the matter and the need for a timely resolution. *Id.* at 1249. Some provisions of the act were applicable only in the first year. *Id.* Thus, the court decided to hear the case before that period expired. *Id.*

89 *Id.* at 1250 (citing CAL. INSURANCE CODE § 1861.01 (a), (b)). Section (a) required immediate reduction of insurance rates to a level at least twenty percent below the contemporary rates. *Id.* Section (b) dictated that rate relief would not be granted prior to November 8, 1990, unless an insurer was substantially threatened with insolvency. *Id.* Additionally, § 1861.04 -.10 set forth the procedures for rate increase applications. *Calfarm Insurance Company*, 771 P.2d at 1250.

90 *Id.* at 1252. Justice Broussard began by indicating that all statutes must be presumed valid unless undeniably unconstitutional. *Id.* at 1251. (citations omitted). The justice next declared that the court would find a statute facially invalid only if it "preclud[ed] avoidance of confiscatory results.' " *Id.* at 1252 (citation omitted).

91 *Id.* at 1252-53 (citing Birkenfeld v. City of Berkeley, 550 P.2d 1001 (1976)); *see supra* note 85 discussing factors relevant to the effectiveness of rate relief provisions.

92 *Id.* at 1255-56. The supreme court explained that insolvency may be ascribed numerous meanings. *Id.* at 1253. Justice Broussard stated that a business may be insolvent if liabilities exceed assets or if it is incapable of paying obligations as they arise. *Id; see also* U.C.C. § 1-201 (23) (1991) ("[a] person is 'insolvent' who either

significant assets could endure confiscatory rates on insurance lines without becoming insolvent.[93] Accordingly, the court held that the absence of adequate relief for insurers faced with confiscatory rates rendered the provision invalid.[94]

One year later, insurers questioned the constitutionality of a relief mechanism in a similar statutory plan in *Guaranty National Insurance Co. v. Gates*.[95] Eight insurance companies challenged a

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has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the federal bankruptcy law"); BLACK'S LAW DICTIONARY 797 (6th ed. 1990) (setting forth similar definitions, as well as defining 'technical' insolvency as a "situation in which a firm is unable to meet its current obligations as they come due, even though the value of its assets may exceed it liabilities").

Despite the variety of definitions for insolvency, the court declared that no interpretation of insolvency would permit the court to find subdivision (b) in conformity with the fair and reasonable return mandated by the Constitution. *Calfarm*, 771 P.2d at 1253.

In its discussion of the *Calfarm* decision, the *State Farm* court noted that although the *Calfarm* holding was based on a due process violation, the analysis used by that court was essentially a takings analysis. *State Farm*, 124 N.J. 32, 50, 590 A.2d 191, 200 (1991). These analyses often produce congruous results. *See supra* note 3 and for discussion of the correlation between takings and due process analysis.

[93] *Id.* at 1254. Insurers with substantial external sources of income, or considerable capital resources, could sustain tremendous losses without risk of insolvency. *Id.* The court noted that although the provision vested the commissioner with some discretion to determine whether an insurer was "substantially threatened with insolvency," this discretion was clearly limited, and would not safeguard constitutionally adequate relief for all insurers. *Id.* at 1254 n.1.

[94] *Id.* at 1255-56. In reaching this conclusion, Justice Broussard dismissed the assertion that a relief mechanism was not required because subdivision (b) was justified as a temporary emergency measure. *Id.* at 1255. Although some caselaw supported an absolute price freeze without furnishing a method to obtain relief, the justice distinguished those cases due to the twenty percent rate reduction mandated in the case at bar. *Id.* at 1254-55; *see also* Birkenfeld v. City of Berkeley, 550 P. 2d 1001 (1976) (rent control law struck down where procedures for securing relief from confiscatory rates were overly cumbersome).

The court acknowledged that "emergency situations may require emergency measures." *Calfarm*, 771 P.2d at 1255. Nonetheless, the court observed that " 'an emergency situation would have to be a temporary situation of such enormity that all individuals might reasonably be required to make sacrifices for the common weal.' " *Id.* (quoting Hutton Park Gardens v. West Orange Town Council, 68 N.J. 543, 567, 350 A.2d 1, 14 (1975)). Declaring the auto insurance quagmire a chronic situation requiring more than a quick-fix, the court held that subdivision (b) was not justified as an emergency measure. *Id.*

Justice Broussard therefore severed the unconstitutional provision from the corpus of the statute and upheld the initiative, based on other constitutional relief provisions that were originally intended to govern future years. *Id.* at 1259. These procedures for rate relief included "application to the commissioner, the opportunity to seek interim relief, a hearing in accordance with the Administrative Procedure Act, and judicial review." *Id.*

[95] 916 F.2d 508 (9th Cir. 1990). The insurers asserted that the statutory plan

state law mandating a fifteen percent rate roll back on auto insurance premiums, with a one year moratorium on rate increases.[96] The scheme allowed rate relief only for insurers substantially threatened with insolvency.[97]

The United States Court of Appeals for the Ninth Circuit found the statute unconstitutional.[98] Writing for the panel, and referencing the analysis set forth in *Calfarm*, Judge Leavy distinguished the Nevada law from the California provision.[99] The

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permitted Nevada to impose confiscatory rates, denied insurers a fair rate of return, and violated due process by failing to provide a relief mechanism to avoid confiscatory results. *Id.* at 509. The insurers also asserted that the plan was invalid as a temporary emergency measure. *Id.* at 512. The appellate court perfunctorily dismissed this claim despite the fact that it was the apparent basis for the district court's decision. *Id.* at 511, 516.

96 *Id.* at 509. Subsection 1 of the statute provided, in pertinent part, that "every insurer shall reduce its charges for motor vehicle liability insurance to levels which are at least 15% less than the charges for the same coverage which were in effect on July 1, 1988." *Id.* at 509-10 (quoting NEV. REV. STAT., Chapter 784, § (1) (1989)).

97 *Id.* at 510. Subsection 2 stated that:

> Between October 1, 1989, and October 1, 1990, rates and premiums reduced pursuant to this subsection may only be increased if the commissioner of insurance finds, after a hearing, that an insurer is substantially threatened with insolvency. The commissioner of insurance shall consider the profitability of all lines of insurance transacted by an insurer licensed to do business in this state in determining whether the insurer is substantially threatened with insolvency. For purposes of this subsection, "insolvency" means the financial condition wherein the sum of the insurer's debts is greater than all of the insurer's property, at fair valuation.

Id. at 510 (quoting NEV. REV. STAT., Chapter 784, § 1 (2) (1989); *see also supra* note 92 for a general discussion of the various definitions of insolvency.

98 *Id.* at 512. In earlier proceedings, the United States District Court for the District of Nevada had granted the Insurance Commissioner's motion for summary judgment, and found the regulatory plan justified as a temporary emergency moratorium. *Id.* at 510-11. The insurance companies appealed, and the appellate court delayed the statute's application awaiting resolution of the appeal. *Id.* at 511. On appeal, the appellate court first examined the issues of subject matter jurisdiction and held that federal jurisdiction was appropriate because the constitutional right to due process was at stake. *Id.* at 512.

99 *Id.* at 514-15. Judge Leavy observed that both the *Calfarm* plan and the Nevada statute required a rate reduction and a one year rate freeze. *Id.* at 513. In *Calfarm*, the statute limited relief during the first year of the plan to insurers threatened with insolvency but permitted relief for inadequate rates in future years. *Id.* at 514. The California Supreme Court severed the insolvency provision and determined that when the insolvency provision was stricken, the regulation as to future years would apply to the first year, guaranteeing the insurers a constitutionally fair rate of return. *Id.* at 514 (citing *Calfarm Ins. Co. v. Deukmejian*, 771 P.2d 1249, 1257-59 (Cal. 1989)).

Judge Leavy stated that although both plans proscribed "inadequate" rates, the California plan did not include a definition of this term. *Id.* at 515. The Nevada Insurance Code did, however, define the term, providing that "[r]ates are inadequate if they are clearly insufficient, together with the income attributable to them,

judge determined that the statutory scheme's legislative context and extant provisions precluded severance of the unconstitutional insolvency requirement.[100] Accordingly, the appellate court invalidated the scheme as unconstitutional.[101]

THE NEW JERSEY SUPREME COURT'S PRONOUNCEMENT

Utilizing the principles gleaned from the various takings cases and applying the *Nebbia* due process standard, the New Jersey Supreme Court considered whether the surtaxes and assessments imposed by the Reform Act would necessarily produce confiscatory results.[102] The court determined that the Reform Act neither precluded insurers from receiving a fair rate of return nor violated due process.[103] Accordingly, the court deemed the Act facially constitutional.[104]

Writing for a unanimous court, Justice Handler examined the legislative history, statutory language, and administrative interpretation of sections 75, 78 and 2g of the Reform Act.[105] Considering both the insurers' and the state's interpretations of the section 78 passthrough restrictions,[106] the justice concluded that

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to sustain projected losses and expenses in the class of business of which they apply." *Id.* (quoting NEV. REV. STAT. § 686B.050(3) (1989)). This definition, Judge Leavy reasoned, fell short of the constitutional mandate of a fair and reasonable return because it merely assured that insurers would break even. *Id.* Consequently, Judge Leavy concluded that severing the invalid insolvency provision would not save the statue because the rates generally required by Nevada law would nonetheless result in a facially confiscatory scheme. *Id.*

100 *Id.* at 516.

101 *Id.* Judge Leavy also disposed of an ancillary issue, declaring that the Insurance Commissioner's power to grant discretionary relief regarding rates voluntarily set at "unreasonably low" levels could not be applied with respect to statutorily set rates. *Id.* at 575.

102 *State Farm*, 124 N.J. 32, 63, 590 A.2d 191, 207 (1991). The court pronounced that resolution of the primary issue depended on adjudication of two ancillary issues: first, whether the cost pass through prohibitions in §§ 75 and 78 were absolute, and second, whether the Insurance Commissioner had been granted overriding authority to establish rates providing a reasonable rate of return. *Id.* at 51, 590 A.2d at 201.

103 *Id.* at 62-63, 590 A.2d at 206-207.

104 *Id.* at 63, 590 A.2d at 207.

105 *Id.* at 51-52, 590 A.2d at 201; *see also supra* notes 27, 28 and 31, and accompanying text for a discussion of these provisions.

106 *State Farm*, 124 N.J. at 52, 590 A.2d at 201. The insurers insisted that the prohibition in § 78 was absolute and required the insurance commissioner to ensure that policyholders did not pay for the surtaxes. *Id.* The insurers added that § 75 absolutely precluded cost passthroughs for assessments by foreclosing the only mechanism for transferring the burden of these assessments to policyholders. *Id.* Conversely, the state maintained that while § 75 banned surcharges, it did not preclude consideration of surtaxes and assessments in the ratemaking process. *Id.*

the passthrough prohibition in section 78 was absolute.[107] Furthermore, Justice Handler held that although the section 75 restrictions were not as broad as those in section 78, the provisions indicated a legislative intent to prohibit shifting the surcharge burden to consumers.[108]

Justice Handler next considered the legislative history, noting its value in divining legislative intent.[109] The justice focused on several unsuccessfully proposed amendments to the questioned provisions, explaining that the reasons for the amendments' failure were relevant in discerning the intended effects of the legislation.[110] Justice Handler explained that two sets of amendments to the Reform Act had been proposed to bolster passthrough prohibitions.[111] Noting the defeat of both sets of

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The State asserted that §§ 75 and 78, tempered by § 2g's guarantee of a fair rate of return, did not foreclose the possibility of relief through the ratemaking process. *Id.* at 53, 590 A.2d at 202.

In addition to these contentions about the passthrough prohibitions, the parties also proffered disparate views as to the efficacy of other relief mechanisms incorporated into the Reform Act. *Id.* at 54, 590 A.2d at 202. The State noted that if an insurer experienced an "unsound financial condition," the commissioner may suspend the entity's obligation to pay the premium surtax and PLIGA assessments. *Id.* at 54-55, 590 A.2d at 202-03. The State further claimed that numerous cost-saving provisions in the legislation would augment the insurers' profitability by including ceilings on health care provider fees, personal injury award caps, storage and towing charge limits and the establishment of a fraud deterrence program. *Id.* at 55, 590 A.2d at 203. In rebuttal, the insurers protested that the savings "attribute[d] to the foregoing provisions [was] problematic and unrealistic." *Id.*

107 *Id.* at 53, 590 A.2d at 202.

108 *Id.* at 53, 590 A.2d at 202. The express language of § 75 prohibits only surcharges on premiums in response to PLIGA assessments. *Id.* at 52, 590 A.2d at 201. Thus, the passthrough of these costs by other means, such as inclusion of the assessments in the rate making process, could be interpreted as permissible; at that time, however, surcharges were only prescribed method by which insurers could recover the cost of PLIGA insolvency assessments. *Id.* at 53, 590 A.2d at 202. In light of this, the Court determined that the Legislature, by barring recovery for the JUA assessments through the only existing avenue, had intended to preclude recovery for these assessments altogether. *Id.* Interestingly, prior to a 1979 amendment, PLIGA insolvency assessments were recouped through inclusion of the assessments in the rate setting process. *See* N.J. STAT. ANN. 17:30A-16 historical n. (West 1988).

109 *State Farm*, 124 N.J. at 55-56, 590 A.2d at 203 (citing Lloyd v. Vermeulen, 22 N.J. 200, 125 A.2d 393 (1956)).

110 *Id.* at 56, 590 A.2d at 203. The court noted that newspaper reports and Assembly floor statements made up the bulk of the information submitted as legislative history. *Id.* Acknowledging the dubious value of the sources, the justice explained that the records did offer valuable information regarding the fate of the proposed amendments which contributed to an understanding of §§ 75, 78 and 2g. *Id.*

111 *Id.* The first proposed amendments were introduced by Assemblyman Kamin while the Assembly Appropriations Committee was reviewing the Reform Act. *Id.* Kamin's proposed amendment to § 75 explicitly provided that "insurers could not

amendments, the justice opined that the Assembly deemed the proposed amendments redundant due to the absolute prohibitions already in place.[112] Supporting that conclusion, the court cited a parallel interpretation of the passthrough prohibitions espoused in regulations promulgated by the Commissioner of Insurance.[113]

Continuing to analyze the legislative history, Justice Handler addressed the addition of section 2g to the Reform Act.[114] The justice observed that the legislature introduced this section contemporaneously with the proposed amendments to sections 75 and 78.[115] Section 2g, according to Justice Handler, recognized and guaranteed the constitutional requirement that insurers be allowed an adequate rate of return.[116] Justice Handler opined that the legislature's rejection of reinforcements on the passthrough prohibitions made clear that relief in the form of direct passthrough of Reform Act charges had already been absolutely prohibited.[117] Nonetheless, the Commissioner of Insurance had been granted implied authority by section 2g to guarantee insurers a fair rate of return.[118] Justice Handler noted that the Department of Insurance had reconciled these apparently conflicting

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add a surcharge to premiums to compensate assessments paid into the fund [for the PLIGA loans to the Auto Fund] or include any amount of the assessments . . . as an expense in any insurance rate filing." *Id.* (quoting Amendments proposed by Assemblyman Kamin to Assembly, No. 1, 204th Leg., 1st Sess. (1990) (Kamin Amendments), p. 11). Assemblyman Kamin's proposed amendment to § 78 provided: "No insurer or rating organization shall include as an expense in any insurance rate filing any amount paid for the surtax imposed pursuant to section 76." *Id.* [Kamin Amendments, pp. 11-12.]

112 *Id.* at 57, 590 A.2d 204. The court also noted that although the prohibitions in the proposed amendments were more specific than those ultimately adopted, the provisions in the statute could nonetheless be absolute. *Id.* (citing Holmdel Builders Ass'n v. Township of Holmdel, 121 N.J. 550, 575, 583 A.2d 277, 289 (1990)).

113 *Id.* In a contemporary report, the commissioner made clear that the prohibitions contained in §§ 75 and 78 proscribe the inclusion of assessments and surtaxes in "the expense base for determining rates." *Id.*

114 *Id.* Justice Handler noted that § 2g was not included in the Reform Act as originally drafted but was proposed during the Assembly Appropriations Committee's consideration of the statute. *Id.*

115 *Id.* at 57-58, 590 A.2d at 204.

116 *Id.*

117 *Id.* at 58, 590 A.2d at 204.

118 *Id.* at 58, 590 A.2d 204. Justice Handler later voiced concern over whether these regulations may only permit, but not require, the Commissioner to grant rate relief. *Id.* at 62, 590 A.2d at 207. Nonetheless, the justice posited that "[i]t is reasonable to conclude that the Legislature conferred on the Commissioner of Insurance the necessary implied authority to satisfy the constitutional standard that it expressly acknowledged in the statute." *Id.* at 58, 590 A.2d at 204. Justice Handler stated that the court's "obligation to presume the constitutionality of legislation"

provisions in regulations governing rate relief.[119] Justice Handler declared that this administrative interpretation of the Act, guaranteeing an adequate rate of return, substantiated the interpretation suggested by the antecedent legislative history.[120]

The court acknowledged that although the regulations absolutely prohibited passthrough of surtaxes and assessments in *conventional* rate-making,[121] the Insurance Department regulations instituted a *special* rate-increase filing procedure for insurers alleging denial of a fair rate of return.[122] If an insurer demonstrated that it would be denied a constitutional rate of return, Justice Handler explained the regulations empowered the Commissioner to grant rate relief.[123] Furthermore, Justice Handler declared that when rate relief was warranted, the Commissioner could determine whether such relief would be granted immediately or over time.[124]

In conclusion, the court determined that the addition to the Reform Act of section 2g evidenced the Legislature's recognition

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required that the court assume that the commissioner would properly use this power to protect insurers' rights. *Id.* at 62-63, 590 A.2d at 207.

119 *Id.* at 58, 590 A.2d at 204.

120 *Id.* at 58, 590 A.2d at 204. The court explicated that an administrative interpretation is persuasive evidence in ascertaining legislative intent with regard to a regulatory scheme. *Id.*

121 *Id.* at 59, A.2d at 205; N.J. ADMIN. CODE § 11:3-16.10 (b) (8) (1991).

122 *State Farm*, 124 N.J. at 61, 590 A.2d at 206; *see also* N.J. ADMIN. CODE § 11:3-16.11 (1991) (establishing special filing requirements for insurers seeking to modify rates due to the surtaxes and assessments).

The regulations set forth, at great length and with specificity, the procedures required for a special rate-increase filing. *See id.* (listing the requirements for a filing). The New Jersey Administrative Code required insurers seeking relief to submit a special rate filing, independent of any previously approved rate filing. N.J. ADMIN. CODE § 11:3-16.11 (a) (1991). The new filing must include all the information provided in ordinary rate filings (as set forth in N.J. ADMIN CODE § 11:3-16.6) (1991), as well as a host of additional information. N.J. ADMIN. CODE § 11:3-16.11 (b) (1991). Among the additional data required are: a schedule of operating premiums, operating expenses, and losses incurred for New Jersey lines of business; a report on the insurer's internal accounting; and a description of the company's cost allocation methodologies; and an explanation as to why the assessment should be included in the ratemaking process. *Id.* The regulations also provide that the Commissioner may request any additional information deemed necessary in evaluating a request for rate relief. *Id.*

123 *State Farm*, 124 N.J. at 60, 590 A.2d at 205-6. In rendering this determination, the Commissioner must appraise an insurer's operational efficiency, the insurer's allocation of expenses for New Jersey operations, the insurer's total experience on all lines of business in New Jersey, and the synergistic effect of mandatory auto insurance on other insurance lines written by the insurer. *See* N.J. ADMIN. CODE § 11:3-16, 11(d)(1)-(4) (1991).

124 *State Farm*, 124 N.J. at 60, 590 A.2d at 206 (quoting N.J. ADMIN. CODE § 11:3-16.11 (f)).

and accommodation of the constitutional imperative that insurers be allowed an adequate rate of return.[125] Justice Handler added that courts favored such a construction when a contrary interpretation would render a statute unconstitutional.[126] The justice stressed that the legislature had delegated to the Department of Insurance the authority to determine what constituted a fair rate of return and that the Commissioner had established an adequate rate relief mechanism.[127] Justice Handler declared that section 2g prevented the Reform Act from unconstitutionally depriving insurers of an adequate rate of return.[128] Accordingly, the court held that the prohibitions in sections 75 and 78 did not work a confiscatory taking and were facially constitutional.[129]

Justice Handler summarily disposed of the auto insurers' claim that the Reform Act, as applied in 1990, precluded those insurers from earning an adequate rate of return.[130] The justice averred that challenges based on the experience of particular insurers were more properly raised in the administrative ratemaking process established by the Department of Insurance.[131] Should this relief prove inadequate, Justice Handler opined, insurers could pursue a remedy in the courts.[132]

Turning to the insurers' due process claim, Justice Handler held that because the Reform Act was not facially confiscatory, by implication, it did not violate substantive due process.[133] The

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125 *Id.* at 61, 590 A.2d at 206.

126 *Id.*

127 *Id.*; *see also supra* note 122 discussing the rate relief process established by N.J. ADMIN. CODE § 11:3-16.11.

128 *State Farm*, 124 N.J. at 61, 590 A.2d at 206. The court noted that the options for relief available under the regulations had not yet been utilized. *Id.*

129 *Id.* at 62, 590 A.2d at 206.

130 *Id.* Justice Handler noted that the targeted profit of 3.5% of premiums was subject to adjustment if constitutionally mandated and that a takings claim was not established based merely on those income percentages presented. *Id.* at 62, 590 A.2d at 206-07.

131 *Id.* at 62, 590 A.2d at 207; *see also supra* note 122 for an overview of the ratemaking process set forth in N.J. ADMIN. CODE § 11:3-16.11.

132 *Id.* at 63, 590 A.2d at 207. The court conceded that the Act potentially allowed the commissioner to deny relief because the statute did not explicitly require the insurance commissioner to grant rate relief to insurers denied an adequate return. *Id.* The court also acknowledged that because the rate application process was fairly complex, timely rate relief might be elusive. *Id.* Concurring Justice Garibaldi reiterated these concerns. *See infra* notes 144-49 and accompanying text.

133 *State Farm*, 124 N.J. at 63, 590 A.2d at 207. Several commentators have examined the nexus between due process and takings jurisprudence. *See also* Strong, *supra* note 3, at 593, (whether a taking has occurred turns on application of due process analysis); Frank Michelman, *Takings, 1987*, 88 COLUM. L. REV. 1600, 1612-14 (1988) (analyzing implications of Justice Scalia's proposition that takings claims

justice explained that because the Reform Act empowered the Commissioner of Insurance to impart rate relief to avoid a confiscatory taking, the Act was not arbitrary, unreasonable or capricious.[134] Justice Handler also indicated that because the Act had a rational relation to the legislative objective, the statutory scheme satisfied substantive due process requirements.[135]

Justice Handler tersely dismissed two additional constitutional claims addressed in the lower courts, and held that the Act did not violate the Contract Clause[136] and was not a bill of attainder.[137] Appraising the relationship between the insurers and the JUA, Justice Handler declared that no contractual relationship existed and therefore no contract was violated.[138] Additionally,

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may trigger more rigorous judicial scrutiny than mere economic due process claims); *see also supra* note 3 for discussion of the evolution of takings jurisprudence.

134 *State Farm*, 124 N.J. at 63, 590 A.2d at 207 (citing *Nebbia v. New York*, 291 U.S. 502, 525 (1934)).

135 *Id.* The legislative objectives of the Reform Act included reducing auto insurance rates, abolishing the JUA, and establishing a means of paying of the JUA debt. N.J. STAT. ANN. § 17:33B-1 (West Supp. 1991); *see also supra* note 26 and accompanying text for a discussion of the Act's purpose.

136 *Id.* at 64, 590 A.2d at 207. The Contract Clause provided, in pertinent part, that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts." U.S. CONST. art. I, § 10.

The Contract Clause was designed to prevent states from passing laws, particularly debtor relief legislation, that would interfere with the private contractual obligations of citizens. NOWAK, *supra* note 2, at 461-62. This clause, however, does not impede a state's autonomy to alter contracts involving the state's inherent police powers. *Id.* at 461.

The importance of the Contract Clause diminished during the "due process era" of the early twentieth century. *Id.* at 467. In 1978, however, the Supreme Court revived the Contract Clause in Allied Structural Steel Co.v. Spannaus, 438 U.S. 234 (1978) (Court recognized that legislation reasonably and narrowly aimed at protecting a basic societal interest would be sustained and therefore invalidated a Minnesota law that failed to satisfy the reasonableness and narrowness criteria of the Contract Clause).

137 *State Farm*, 124 N.J. at 65, 590 A.2d at 208. The Constitution simply proclaimed that "[n]o State . . . pass any Bill of Attainder" U.S. CONST. art. I, § 10.

Historically, a bill of attainder was a legislative act that mandated the death penalty for serious crimes without providing standard judicial proceedings. NOWAK, *supra* note 2, at 478-80. The prohibition against bills of attainder precluded legislation intended to punish specifically named individuals or readily identifiable entities without a proper trial. *Id.*

The bill of attainder clause has also been credited with safeguarding the separation of powers by preventing legislatures from making laws addressing specific individuals. TRIBE, *supra* note 2 § 10-5, at 491-92. Professor Tribe noted: "By restricting the legislative process to the formulation of general rules, the bill of attainder clauses would guarantee an institutional fractionalization of power." *Id.*; *see also infra* notes 141-42 and accompanying text for the court's analysis of the insurers' bill if attainder claims in *State Farm*.

138 *State Farm*, 124 N.J. at 64, 590 A.2d at 208. The court observed that the insur-

Justice Handler argued that the contracts clause is not a wooden provision, and when applied, it must be applied flexibly.[139] The justice concluded that even if, *arguendo*, a contractual relationship could be established, the impairment of an existing contract under these circumstances would nonetheless be warranted based on the Reform Act's substantial and legitimate public purpose.[140]

Adjudicating the bill of attainder claim, Justice Handler delineated the traditional characteristics of bills of attainder[141] and found that none existed in the Reform Act.[142] Finally, Justice Handler declined ruling on several peripheral claims that had been raised, but not fully developed, in the lower courts.[143]

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ance industry, like other highly regulated industries, may make use of a "potentially transient" regulatory scheme such as the JUA without assuming liability for the unjustified reliance of industry participants. *Id.* at 64-65, 590 A.2d at 208.

139 *Id.* at 64, 590 A.2d at 208 (citing Allied Structural Steel Co. v. Spannaus, 438 U.S. 234 (1978)). In *Allied Structural Steel*, the Court declared that "[t]he [Contract] Clause is not . . . the Draconian provision that its words might seem to imply. As the Court has recognized, 'literalism in the construction of the contract clause . . . would make it destructive of the public interest by depriving the State of its prerogative of self-protection.' " *Allied Structural Steel*, 438 U.S. at 240 (1978) (quoting W. B. Worthen Co. v. Thomas, 292 U.S. 426, 433 (1934)).

140 *Id.* at 65, 590 A.2d at 208. Auto insurance reform was, at this time, a top priority of both the legislative and executive branches. *Id.* at 42, 590 A.2d at 196.

141 *Id.* at 65, 590 A.2d at 208. Justice Handler cited the United States Supreme Court's enumeration of three characteristics of bills of attainder in Selective Service Syst. v. Minnesota Public Interest Research Group, 468 U.S. 841 (1984). The Supreme Court in *Selective Service* required "[t]hree necessary inquiries" before holding statute invalid as a bill of attainder: "(1) Whether the challenged statute [fell] within the historical meaning of legislative punishment; (2) whether the statute, 'viewed in terms of the type and severity of burdens imposed, reasonably [could] be said to further non-punitive legislative purposes'; and (3) whether the legislative record 'evinces congressional intent to punish.' " *Selective Serv.*, 468 U.S. at 852 (1984) (quoting Nixon v. Administrator of Gen. Serv., 433 U.S. 425, 473, 475-76, 478 (1977)).

142 *State Farm*, 124 N.J. at 65-66, 590 A.2d at 208-09. Justice Handler noted that of the traditional forms of legislative punishments ("death sentences, imprisonment, banishment, confiscation of property, and barring the attainted properties from specified employment or vocations"), the only category conceivably applicable to the insurers' claims was confiscation of property. *Id.* at 65, 590 A.2d at 208. Relying on antecedent confiscatory takings analysis, Justice Handler determined that the legislation was "not a punitive confiscation." *Id.* Referencing the court's preceding substantive due process scrutiny, Justice Handler averred that because the Act addressed a legitimate and substantial legislative purpose, the Act failed to meet the second prong of the bill of attainder test. *Id.*

Justice Handler also asserted that because the legislature was "clearly much more concerned" with resolving the car insurance crisis than punishing the insurers, the Reform Act did not meet the third requirement of a bill of attainder. *Id.* at 65-66, 590 A.2d at 208.

143 *Id.* at 66, 590 A.2d at 209. These claims included assertions that the "pro-

Justice Garibaldi, writing separately and concurring in the judgment, stressed that the Reform Act was still vulnerable to an as-applied challenge.[144] The concurring justice also expressed misgivings about the capacity of the Insurance Commissioner to provide adequate rate relief under the existing regulations.[145] Tempering these concerns, Justice Garibaldi opined that the regulations adopted by the Department of Insurance might prove more serviceable than anticipated, and noted the impropriety of prospectively arrogating the regulatory expertise of the Commissioner of Insurance.[146]

Justice Garibaldi added that her consternation was amplified by the prevailing economic doldrums,[147] and emphasized the imperative that insurers be granted relief in a timely manner.[148] Justice Garibaldi concluded that the insolvency or extinction of auto insurers in New Jersey would be even more devastating than the deplorable JUA deficit.[149]

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ducer assignment program" was violative of due process, that the Act imposed an extraterritorial tax on mutual insurers and that the Act violated the Commerce Clause of the United States Constitution. *Id.* In refusing to review these claims, the court noted that they could be raised in subsequent proceedings. *Id.*

144 *Id.* at 66, 590 A.2d at 209. (Garibaldi, J., concurring).

145 *Id.* at 66-67, 590 A.2d at 209 (Garibaldi, J., concurring). Justice Garibaldi pointed to the complexity of the current ratemaking mechanism and opined that the implementation of a special filing procedure would only exacerbate existing delays. *Id.* at 67, 590 A.2d at 209 (Garibaldi, J., concurring). Justice Garibaldi also noted that a delay in providing relief from confiscatory rates, without more, may not render a regulatory plan unconstitutional, but that a realistic prospect for relief must be present. *Id.*; *see also* Helmsley v. Borough of Fort Lee, 78 N.J. 200, 223, 394 A.2d 65, 76 (1978) (effective administrative relief mechanism was constitutionally mandated if a regulatory scheme would have a predictable and extensive confiscatory impact); Calfarm Ins. Co. v. Deukmejian, 771 P. 2d 1247, 1253 (1989) (absent adequate relief for insurers faced with confiscatory rates a provision would be invalid).

146 *State Farm*, 124 N.J. at 67, 590 A.2d at 209 (Garibaldi, J., concurring).

147 *Id.* at 67-68, 590 A.2d at 209 (Garibaldi, J., concurring). Justice Garibaldi explained that insurance companies are no longer the "financial bulwarks" they once were. *Id.* at 67, 590 A.2d at 209.

148 *Id.* at 67-68, 590 A.2d at 210 (Garibaldi, J., concurring). The justice reiterated that where there is a realistic possibility of adequate relief, " 'the effect of a delay must be judged in hindsight, and it cannot be reliably predicted to amount to constitutional interdiction.' " *Id.* at 68, 590 A.2d at 210 (Garibaldi, J., concurring) (citation omitted).

149 *Id.* at 68, 590 A.2d at 209-210 (Garibaldi, J., concurring). Justice Garibaldi's concerns proved prophetic when Allstate Insurance Company, the largest auto insurer in New Jersey, announced its withdrawal from the New Jersey market a mere four months after the *State Farm* decision. *See* Joe Donohue et al., *Allstate is Pulling Out as Insurer in Jersey*, THE STAR-LEDGER, September 17, 1991, at 1; Eric N. Berg, *Largest Insurer in New Jersey, Allstate, Seeks to End Coverage*, NEW YORK TIMES, September 17, 1991 at A1; *see also* Robert Schwaneberg, *Regulator Calls Shaky Fiscal Position*

CONCLUSION

In *State Farm v. State*, the New Jersey Supreme Court judiciously deferred to a legislative pronouncement that was, at times, nebulous and difficult to cipher. Faced with several statutory provisions apparently at loggerheads, the *State Farm* court engaged the Reform Act to exhume a constitutionally viable construction. In dismissing the insurers' challenge to the new insurance scheme, the court validated an unmistakable legislative intention to place a significant measure of the JUA debt burden on the oft elusive shoulders of the auto insurance companies.

The *State Farm* court justifiably refrained from a prospective determination of the validity of the ratemaking relief provided in section 2g. As established in *Helmsley v. Borough of Fort Lee*, however, [150] a protracted and arduous administrative process, precluding timely and effective relief, may justify invalidating a statutory scheme.[151] In *State Farm*, this alternative received only cursory consideration. Given the exigency of replacing the JUA and arresting the concomitant runaway deficit, and recognizing that the challenge was couched as a facial attack on the statute, the wisdom of the New Jersey Supreme Court's decision cannot be questioned.[152]

Tangible relief for New Jersey drivers, in the form of lower insurance rates, may prove illusory. Section 2g grants insurers the right to seek relief through a special ratemaking process, in order to ensure a fair rate of return.[153] While imperative for con-

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the Real Reason for Allstate's Exit, THE STAR-LEDGER, September 23, 1991, at 1 (arguing that financial problems linked to Allstate's parent company, Sears, Roebuck and Co. were the cause of Allstate's withdrawal, not New Jersey insurance regulations).

150 78 N.J. 200 (1978).

151 *See supra* notes 79-86 and accompanying text for a discussion of *Helmsley*.

152 The majority alluded to the complexity of the Reform Act's rate application process and the potential that this process might stymie realization of an adequate rate of return. *State Farm*, 124 N.J. at 62, 590 A.2d at 207. Despite this caveat, the court acknowledged the presumption of constitutionality traditionally granted legislation and assumed that the Commissioner would uphold his statutory duty to provide rate relief in a timely fashion. *Id.*

Concurring Justice Garibaldi voiced concern for the timeliness of rate relief under the Reform Act and observed that "[a]lthough the length of time before rate relief is granted may not, alone, make the scheme constitutionally defective, the possibility for relief from confiscatory rates must be realistic." *Id.* at 67, 590 A.2d at 209 (Garibaldi, J. concurring).

153 The court declined application of an emergency takings analysis, an alternative that does not appear viable, and certainly was not necessary. The court determined that it was not faced with a *Helmsley* type situation, and, although the effectiveness of the relief mechanism was not a certainty, the court properly adopted a wait-and-see approach. *Id.* at 63, 590 A.2d at 207.

stitutional validity, this provision seriously undermines the Reform Act's effectiveness in making insurers accountable for perceived abuses under the JUA. Insurers threatened with diminished profits will undoubtedly claim the rates are confiscatory; employing the statutory relief mechanism, the insurers will pass their increased costs through to the helpless consumer. The passthrough proscriptions in sections 75 and 78, designed to insulate New Jersey drivers from the onus of the JUA bailout, may be reduced to mere hollow rhetoric.

Despite the questionable effectiveness of these passthrough prohibitions, the Reform Act does erect some barriers between the insurers and the unfettered profits earned under the previous regime. The statutory procedures for rate-increase filings are time-consuming and complex, and require disclosure of operating expenses and internal accounting methods.[154] Certain insurers, particularly those employing creative bookkeeping techniques, may opt to forego a rate-increase filing in order to avoid making the requisite disclosures.[155]

Nevertheless, the Reform Act will likely be subject to numerous as-applied challenges, based on insurers' individual experiences.[156] Although the *State Farm* court, particularly concurring Justice Garibaldi, expressed profound doubts as to the scheme's serviceability, final victory for the auto insurers is not a foregone conclusion.

Perhaps anticipating a deluge of litigation in the wake of this decision, the *State Farm* court emphasized that the notion of a fair rate of return is based on the profits earned by an *efficient* operation.[157] Inefficient operations are not entitled to the revenue

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154 *See supra* note 31 for the text of § 2g; *see also supra* note 122 and accompanying text for a discussion of the rate increase filing process.

155 *See supra* note 122 for discussion of the special rate filing process; *see also* N.J. ADMIN. CODE § 11:3-16.11 (setting forth requirements of the filing process).

156 Disputes over accounting methods are not foreign to the auto insurance arena. For example, when Allstate Insurance Company opted to withdraw from the New Jersey insurance market, citing economic exigencies, a debate developed over exactly what Allstate's profits had been. Questions arose as to proper allocation of business expenses. Schwaneberg, *supra* note 149, at 1.

Additionally, a separate debate arose as to calculating the deficit incurred by the Market Transition Facility (MTF) that succeeded the JUA but did not succeed. *See* Donohue, *supra* note 22, at 1 (although several studies undertaken at the time indicated that the Market Transition Facility was operating at a deficit approaching $400 million, Insurance Department "denied any deficit exist[ed] and remained adamant in their insistence that the pool will break even by 1994.")

157 *See* Allstate Ins. Co. v. Fortunato, 248 N.J. Super. 153, 590 A.2d 690 (1991) (insurer challenged constitutionality of order compelling the issuance of policies to

earned by proficient businesses. This issue will surely serve as the focal point of future litigation, and may prove the deathknell for New Jersey auto insurers' takings claims. Insurers must be compelled to demonstrate a heightened level of vigilance in combatting fraud, identifying false and inflated claims, and thwarting the graft and chicanery which have pushed the industry to the eve of destruction.

Courts must not permit inefficient enterprises to charge excessive rates to an essentially captive consumer market, merely because these businesses lack the acumen to ferret out meritless claims, or properly supervise their operations. Correlating the insurers' returns to the constitutional efficiency standard will force insurers to bear the substantial burden arising from their own failings.

The New Jersey auto insurance industry, long plagued by the pestilence of inefficiency, requires extensive transformation to achieve a system where premiums are commensurate with risks and where inefficiency is not condoned.[158] When faced with as-applied challenges to the Reform Act, New Jersey courts must

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insured formerly covered through the JUA); *In re* Aetna Casualty & Surety Co. 248 N.J. Super. 153, 591 A.2d 631 (1991) (insurers filed complaint against Commissioner of Insurance for failure to take action on rate increase filings).

[158] Admirably, the State of New Jersey has stepped to the forefront in combatting fraud in its many guises, particularly in padded bills for auto body repair shops. Herb Jaffe, *Probers Say Some Body Shops Find Ways to "Pad" Repair Bills*, THE STAR-LEDGER, October 29, 1991, at 1; Herb Jaffe, *Insurance Investigations Uncover Growing Web of Auto Shop Fraud*, THE STAR-LEDGER, October 28, 1991, at 1; Herb Jaffe, *Auto Body Repair Shops Feel Sting of Fraud Probe*, THE STAR-LEDGER, October 27, 1991, at 1; *see also* Sue Epstein, *Fortunato Stresses Fraud Detection as a Way to Reduce Insurance Rates*, THE STAR-LEDGER, October 24, 1991, at 21 (detailing fraud detected in all areas of auto insurance). The positive effect of this crackdown has already been realized, with many unlawful operations being subject to fines and forced to obtain licenses. Tom Hester, *Sweeps Finds 143 'Illegal' Car Repair Shops in State*, THE STAR-LEDGER, March 7, 1992, at 1. Division of Insurance Fraud Prevention Director Lou Parisi declared: "Once an unlicensed business submits to the regulatory process, we are in a much better position to monitor that business for fraud." *Id.*

Other efforts aimed at remedying the ailing New Jersey auto insurance industry include a program to identify and punish out-of-state drivers unlawfully obtaining New Jersey insurance. Guy Sterling, *100 Paying Up, 200 Refuse as Rate Evader Fight Heats UP*, THE STAR-LEDGER, February 28, 1992, at 1; Angela Stewart, *State Launches Crackdown on Car Rate Evaders*, THE STAR-LEDGER, January 3, 1992, at 1; Angela Stewart, *Jersey Taking Aim at Auto Rate Evaders*, THE STAR-LEDGER, January 1, 1992, at 1.

Finally, New Jersey has begun targeting uninsured drivers. Joe Donohue, *State Putting Squeeze on Uninsured Drivers*, THE STAR-LEDGER, February 5, 1992, at 1. The State has also successfully prosecuted for fraudulent claims which had increased insurance costs exorbitantly. Joseph D. McCaffrey, *36 Cited in Big Bilk That Boosted Cost of Jersey Insurance*, THE STAR-LEDGER, April 3, 1992, at 1.

give close scrutiny to the efficiency of the challenging insurers, to ensure that the rate of return is commensurate with the efficiency of their operations. It is only through identifying and addressing the specific evils plaguing the industry, and holding the auto insurers accountable for the efficiency of their operations, that meaningful reform will be realized.

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