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## CONSUMERS AND MARKETS SUFFER WHEN LAWYERS REGULATE INSURANCE

by

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The class action litigation procedures were designed to serve a socially beneficial purpose, in situations where meaningful legal recourse is not otherwise available. Contrary to this principle, certification of plaintiff classes is increasingly being sought with respect to the business practices of insurers. These lawsuits seek to undermine the ability of state insurance commissioners to follow a balanced and effective regulatory regime. As a result, both consumers and markets are harmed, and the solvency of insurers may even be threatened by exorbitant class action verdicts in so-called “bet the company” cases.

This LEGAL BACKGROUNDER analyzes instances where litigants have attempted to use the class action procedures to circumvent the authority of insurance commissioners. These efforts, which cut across all lines of insurance, have impacted consumers and markets not only within particular states, but also nationwide.

**Challenges to Insurance Regulatory Authority.** There have been a number of state court challenges to the regulatory authority of insurance commissioners that, while only impacting residents of a particular state, nevertheless detract from the ability of that state’s insurance regulator to apply the state’s insurance laws to that state’s residents.

For example, in four Ohio cases (*McDonald v. Westfield National Insurance Company*, *Baughman v. State Farm*, *Lazarus v. Ohio Casualty*, and *Mager, et al. v. Erie*), the plaintiffs asked an Ohio court to invalidate rates for uninsured/underinsured (UM/UIM) motorist coverage that had been approved by the Insurance Department. Ohio Insurance Director Lee Covington filed motions to intervene in these cases because: (1) pre-existing administrative procedures for aggrieved parties to request a hearing before the regulator were not used; (2) rate approval is under the exclusive jurisdiction of the Insurance Department, and the rates had been approved; and (3) retroactive modification of an approved rate by the courts would constitute an unlawful impairment of the Department’s exclusive authority to approve rates. In announcing his plans to intervene in these cases, Director Covington succinctly articulated the dire consequences of class actions that “sweep aside” the judgments of state insurance commissioners. He indicated that verdicts against the insurers in these actions (anticipated to be in the hundreds of millions of dollars) would affect his authority to regulate rates, which would in turn destabilize the insurance market.

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An even more drastic type of challenge to the regulatory authority of insurance commissioners is the filing of state court claims that could determine the rights and responsibilities of citizens in other states, inconsistent with insurance regulation in those states. Lax enforcement of certification rules by a few jurisdictions enables plaintiffs bringing national insurance class actions to shop around for the most favorable forum, even when that jurisdiction has little connection to the underlying dispute. The result is that a few states exercise a disproportionate influence over the venue of insurance class action filings. The danger is that these states preempt all other states' regulatory decision-making and authority, and simply impose their own rules on the rest of the states. Sometimes, the forum-shopping leads to a hunt for the most favorable statutory or decisional law by which to set a *de facto* national standard. Such a national standard would be imposed without a deliberative regulatory process and without basic due process rights in the other states.

***OEM Litigation in Illinois.*** State courts hearing nationwide class actions against insurers will almost always apply the law of the forum state to govern the claims of all class members, even when many members of the class live in other states whose laws differ dramatically. One example is *Avery, et al. v. State Farm*, a nationwide class action filed on behalf of all policyholders (in Illinois and nearly every other state) in Illinois state court. In *Avery*, an Illinois circuit court held that the insurer acted illegally in using non-original equipment manufacturer (“OEM”) parts in preparing estimates for repairs — even though other states (e.g., Hawaii and Massachusetts) in which the insurer issued auto policies permitted or even required the use of non-OEM parts. Regulators and legislators in these other states made this determination in order to benefit consumers by keeping down repair costs. The now-infamous \$1.8 billion judgment against the insurer — which the Illinois Supreme Court recently agreed to review — represents only the most immediate and visible fallout of the verdict in *Avery*, as the costs of some sheet metal parts rose by nearly 300% within a few months of the decision, and car companies were charging 60% more than distributors selling identical certified aftermarket parts. LIABILITY AND INS. WK., Apr. 24, 2000.

The National Association of Insurance Commissioners (NAIC) was keenly aware of the threat to market stability posed by the outcome in *Avery*. In its *amicus* brief supporting the insurer’s motion for direct appeal to the Illinois Supreme Court, the NAIC expressed concern about “the potential for erosion of the power of state insurance regulators to protect insurance consumers...” NAIC brief at 2, *Avery*. The NAIC also noted:

- ▶ For over 100 years, states have possessed the authority to regulate the language and substance of insurance policies. This authority is typically based upon the location of the property or risk insured within the regulating state. Instead of upholding this longstanding regulatory system, it appears that the trial court is taking for itself, and from state regulators and legislators, the responsibility for making policy judgments concerning non-OEM parts. State insurance policymakers face the previously inconceivable situation of having their judgments overruled by one Illinois trial court. This stands our national system of insurance regulation on its head.

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The NAIC believes that the protection of insurance consumers is best achieved in an environment where the relationship between the policyholder and the insurer is regulated by each state. The underlying principle of state insurance regulation is that the regulatory decisions are best reached at the state level, through state regulators who possess intimate knowledge of the unique circumstances and situations of their state’s residents. NAIC brief at 3, *Avery*.

- ▶ Where one state’s insurance regulator has determined a particular regulatory course with respect to the business of insurance in his or her state, the NAIC believes effective regulation requires sister states to respect that decision. For example, the application of one state’s consumer fraud statute by that state’s court to a dispute concerning a policy issued in and risk located in another state threatens the other state’s ability to regulate effectively by overriding the considered judgments reached by regulators and legislators in that state. NAIC brief at 4, *Avery*.

***UM/UIM Litigation in Washington State.*** The damage done when one state’s lower court arrogates to itself the authority to determine the status of insurance regulation nationwide is also illustrated in the brief filed by the NAIC in *Busani v. United Services Automobile Association*, No. 70816-9, Wash. Sup. Ct. (2001). In *Busani* (which involves the duties of insurers with respect to underinsured motorist coverage), the Superior Court of Pierce County, Washington, certified a class of 20,000 people in 27 states, despite the fact that (i) the defendant was an out-of-state company; (ii) most of the putative class members resided outside of Washington; (iii) most of the automobile accidents occurred outside of Washington; (iv) most of the claims were filed and processed outside of Washington; and (v) the statutes, regulations and judicial opinions on the central legal issue varied significantly among the twenty-seven states.

In its *amicus* brief supporting review of the class certification by the Washington Supreme Court, the NAIC noted that:

- ▶ The superior court’s certification has the effect of applying Washington law to insurance policies of individuals residing in 27 states . . . the practical effect of the trial court certification reaches far beyond the borders of Washington in contravention of established principles of constitutional and regulatory law. Furthermore, it conflicts with the state-by-state nature of insurance regulation through which the questions of recoverability of IDV (implied diminished value) is appropriately evaluated. This conflict is significant. NAIC brief at 1, *Busani*.
- ▶ . . . The judgments of regulators and legislators in other states would be swept aside and replaced by the judgment of a Washington trial court . . . insurance contracts between insurers and policyholders, formed and to be performed under the laws of other states, potentially are subject to a Washington standard . . . Effectively, state legislators and regulators in 26 other states are held hostage to one trial court in one state. NAIC brief at 10, *Busani*.

***Modal Premium Litigation in New Mexico.*** This genre of nationwide class action litigation — now filed against some eighteen life insurers in New Mexico state courts since 1998 with “copy-cat” cases being filed in Alabama and Texas — revolves around the ability of the consumer to pay their insurance premiums in a variety of modes (hence the term “modal”): for example, annually, twice a year, quarterly, or monthly. In succeeding with these cases, plaintiffs’ lawyers are using the state judiciary to usurp the sovereign powers of the state insurance regulators. Moreover, these state court judges are refusing to recognize the primary jurisdiction of the state insurance regulator, resulting in regulation through litigation.

Notwithstanding the fact that the Insurance Departments in these states approved the policies for sale, the plaintiffs’ lawyers convinced state court judges that the policies themselves do not fully explain to the consumer how much more a consumer pays in premium if the consumer chooses to pay it in a mode other than annually. Inexplicably, these attorneys have also been able to shoehorn into insurance the concept of an APR (annual percentage rate). The APR is from the Truth in Lending Act (TILA) — a federal law which does not apply to insurance; the crux of TILA disclosures lie in collateralized debt. A policy of insurance is not collateralized debt, which is why TILA does not apply to insurance.

One such modal premium case is *Azar, et al. v. The Prudential Insurance Company of America*. Among the rulings made by the trial court was a refusal to stay the proceeding to permit New Mexico’s Superintendent of Insurance to determine whether Prudential’s policy language violated New Mexico’s Insurance Code or was misleading or ambiguous with respect to modal premiums. Currently on appeal to the New Mexico Court of Appeals (oral argument was held in late February 2002), this case awaits decision.

Additionally, the state trial court recognized a duty on the part of the insurer to disclose to its prospective insureds both the dollar amount by which modal premiums will exceed the annual lump sum premium and that amount expressed as an APR. In recognizing a duty — *without citation to a single supporting legal authority* — the trial court departed from the traditional rule that there is no affirmative duty of disclosure between parties dealing at arms length in a business transaction. That deviation finds no support in either of the two possible sources of a duty to disclose and, indeed, places the law of New Mexico at odds with the law of other states and settled common law principles.

Finally, the trial court inexplicably refused to invoke the doctrine of primary jurisdiction to allow the Insurance Division in New Mexico to review Prudential's policies for adequacy of disclosure and compliance with the insurance code. The Division not only had the authority to engage in such a review, but is uniquely well-situated to do so. Unlike the courts, the Insurance Division is well-versed in insurance law and policy and would be able to resolve uniformly the issue of whether modal premium rates must be disclosed in the form of APRs. By referring the issue of Prudential's disclosures to the Division, the court would have retained jurisdiction to resolve the litigation before it — and would have decided this case after receiving the expert advice of the executive branch. Refusing to invoke the doctrine was thus inconsistent with standard practice in other states, and also inconsistent with the New Mexico Supreme Court's instruction to the courts of New Mexico to defer to the appropriate expert agencies.

***Who is Best Qualified to Regulate Insurance?*** Given the highly specialized nature and broad public policy ramifications of these and other insurance regulatory issues, state insurance commissioners are equipped with a variety of tools that uniquely qualify them to render decisions that impact the entire marketplace. While juries are tasked with resolving narrowly-defined individual disputes between specific parties, regulators must ensure the stability of insurance markets by balancing the interests of numerous stakeholders. Regulators are given this authority precisely because they have “knowledge of the insurance industry.” IND. STAT. ANN., § 27-1-1-2. Whether appointed or elected, regulators have the burden of demonstrating that they have specialized expertise enabling them to perform this critical responsibility in a professional manner.

When making determinations that impact insurance markets, a decision-maker must have access to as much relevant information as possible. While regulators are authorized to independently obtain a wide range of information from a variety of sources, juries are required to passively receive evidence. Jurors receive only the information deemed admissible and relevant by a judge, and even relevant evidence may be excluded if its probative value is “substantially outweighed” by the danger of (among other things) unfair prejudice or confusion. FED. R. EVID. 403. Jurors are also prohibited from considering the implications of their decisions outside the facts and the law. Even in jurisdictions where jurors are permitted to ask questions, only questions that survive review by the parties and the judge may be asked. In addition, judges may instruct juries to view certain evidence in a particular light and to “. . . accept as conclusive any fact that is judicially noticed.” *Id.* at 105, 201. Further, the court gives general instructions to the jury regarding how they should conduct their deliberations. FED. R. CIV. P. 51. While effective in individual disputes, the jury system is not designed to balance the broad public policy considerations that are a necessary part of an insurance regulatory regime.

Regulators, on the other hand, generally have the ability to consider all information they deem relevant before making a determination. For example, the Illinois Director of Insurance is empowered “to conduct such examinations, investigations and hearings in addition to those specifically provided for, as may be necessary and proper for the efficient administration of the insurance laws of this State.” 215 ILCS 5/401(c). This enhanced ability to gather information, taken in combination with their knowledge of the industry, enables state insurance commissioners to appreciate the potentially broad ramifications of any regulatory decision.

***Regulatory and Legislative Solutions.*** The equitable and responsible regulation of the business of insurance is vital to the interests of consumers and insurers alike. In view of the broad and complicated array of factors bearing upon the appropriate resolution of insurance issues, state insurance commissioners must be permitted to exercise their statutory authority to regulate the industry. Their intimate knowledge of the factors bearing upon consumer protection, market stability and the very solvency of insurers must not be circumvented or overridden by either statewide or nationwide class actions that are appropriately addressed by a duly constituted regulatory process.

Accordingly, insurers support efforts to preserve the primary jurisdiction of insurance regulators, which include requiring the exhaustion of administrative remedies before class actions may be brought. In order to address situations where insurance issues are nevertheless litigated, the authors' organizations also strongly support federal and state legislative efforts — particularly H.R. 2341, the “Class Action Fairness Act of 2002” — to establish federal court jurisdiction over multi-state class actions by applying minimal diversity principles. Federal courts are best equipped to handle these actions, and by doing so would reverse the alarming trend of one state court taking upon itself the authority to dictate the law to other states.