

## THE FILED RATE DOCTRINE: A TROJAN HORSE FOR INSURERS?

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"Be careful what you ask for, you may get it" is a dictum of special relevance to insurance companies as they continue carving out new defenses to fend off policyholder lawsuits. This is especially applicable to a new defense that is occurring with increasing frequency in litigation, the "filed rate doctrine." Originating in utility regulation, the filed rate doctrine "holds that any filed rate - that is, one approved by the governing regulatory agency - is per se reasonable and unassailable in judicial proceedings brought by ratepayers." (See *Wegoland Ltd. v. NYNEX Corp.*, 27 F.3d, 17, 18, 2d Cir. 1994.)

The insurance version of this is that if the rates insurers charge have been approved by regulators, plaintiffs are without standing to sue, even if they cloak their challenges in allegations of fraud, conspiracy, breach of contract, or some other basis common to insurance disputes. If applied as defense counsel often plead, the filed rate doctrine would exonerate insurers from a plague of challenges and force disgruntled policyholders to beg for mercy at the citadels of regulators and legislators.

Plaintiffs, on the other hand, are dumbfounded at having to face this novel defense. Plaintiffs' attorneys wonder how battles with phone, gas, and electric companies apply to insurance. Except for adopting the doctrine in a few cases (*Morales v. Attorneys' Title Insurance Fund*, U.S. District Court, Southern District of FL, 1997 LEXIS 18247; *N.C. Steel, Inc. v. National Council on Compensation Insurance*, North Carolina Supreme Court, Electronic Citation, March 6, 1998; *Uniforce Temporary Personnel, Inc. v. National Council on Compensation Insurance*, 11<sup>th</sup> Cir. 1996), the courts have made little effort in explaining how the filed rate doctrine and insurance rate regulation are marriageable partners. My view is that insurance rate regulation and filed rates for utilities are quite distinguishable. Furthermore, should courts continue applying the filed rate doctrine to insurance, insurers and regulators should prepare for a very different regulatory scheme in the future -- a regulatory scheme that may be inhospitable to insurers.

### FILED RATES AND INSURANCE RATES ARE DIFFERENT

Several factors distinguish utility rates from insurance rates. First, utility rates are user determined, insurance is based on risk. For example, I pay a set fee per minute or fraction thereof for long distance phone usage and so much per kilowatt hour for electricity. There is no risk element involved. Logically, then, the filed rate doctrine is not even of the same genre as insurance.

Second, utility rates are individualized while insurance risks are pooled. In a sense, utility services are community rated and guarantee issue services. One doesn't have to be an authority on insurance matters to know that these two principles are not popular among many insurers.

Third, utility rates are nontransferable; I do not pay a share of my neighbor's power bill, nor does he pay mine. The very essence of insurance, on the other hand, is a transfer of risk (Some prefer to say "sharing of risk" instead, nowadays) from the individual to the insurer, the ultimate objective of the insurer's risk selection process being to take advantage of the law of large numbers so that average loss is substituted for actual loss in projecting a rate structure.

Fourth, courts repeatedly hold that no property interest attaches to utility rates, whereas, insurance contracts are a chose in action (a right enforceable in court). So, policyholders, unlike ratepayers, have a property interest at stake in an insurance contract. Consistent with this view, it is noteworthy that insurance contracts are universally considered to be contracts of utmost good faith placing special burdens on the parties to it. Conversely, ratepayers have no contractual commitments or rights, other than those bestowed upon them by the public utility regulatory statutes.

Fifth, utility companies are usually licensed on the basis of "public convenience and necessity." Insurance companies are licensed on the basis of their ability to demonstrate sufficient capital and satisfy a few other regulatory tests, none of which require a showing that either the company or its products serves the public convenience or necessity. Theoretically, you can't have too many insurance companies or insurance products in the same market; however, the public might be inconvenienced by 300 utility wires strung along a suburban street.

Indeed, one reason for strict rate regulation of public utilities stems from the fact that utility services, until recently, have been considered natural monopolies; consequently, there is a strong public policy interest in closely monitoring their rates.

Sixth, utility rates are based upon anticipated costs and usage along with lesser factors; insurance rates are based upon projected losses and expenses.

Ironically, given the current thrust toward deregulation of utility industries, utility rate regulation is likely to move more in the direction of traditional insurance regulatory practices at the same time that insurers are relying upon antiquated notions of utility regulation to defend their rating practices.

#### CAN YOU GET JUST HALF A LOAF?

Insurers strongly defend their rates against attack with the armor of the filed rate doctrine. But if insurers insist that a doctrine drawn from utility practices is a defense for their rates, why can't plaintiffs insist that insurers play by the same rules as utilities with respect to the rate approval process and how utilities are regulated in the interest of public convenience and necessity? Is it equitable for insurers to adopt part of what underlies the filed rate doctrine while omitting parts they adjudge unpalatable? These questions call attention to a few other rate-setting guides for utilities that are not common to insurance rate regulation. For example, utility regulators examine the quality of the service to be

provided in licensing and rate setting decisions. If such a principle (quality of service or product) were applied in insurance regulation, how many whole life insurance policies could pass the test? Long term care policies? Home service products? Any product with an investment component?

Utility regulators may reduce rate increase proposals because of imprudent management practices of the utility; indeed, some states even mandate a periodic management audit of utilities. Think about that as a principle for regulating insurance companies. In addition to financial and market conduct exams, insurance management might have its own separate scrutiny under a filed rate system. Perhaps this would be the best means of preventing future Executive Life, Mutual Benefit Life, Confederation Life, and vanishing premium scandals (assuming that the vanishing premium policies could get past the Product Quality regulator). Furthermore, would insurance regulators permit executives of poor performing companies to enjoy the salaries and perks now common in the industry, or would the filed rate doctrine be applied to punish incompetent management?

Utilities have been forced into providing life line services subsidized by the wealthier ratepayers to assure service for the poor. Applying this principle to insurance, the filed rate doctrine could require everyone above a certain income to pay more for insurance so the less fortunate could have adequate health, auto, dwelling, and other insurance. Consequently, risk bearing insurers might eventually become means of redistributing the wealth of policyholders, substantially altering the nature of insurance as we know it while, nevertheless, satisfying reformers who believe insurers should aid the less fortunate.

Most states authorize a consumer advocate, public utility rate counsel, or some other public official to represent the public in utility rate setting matters, an idea that is almost universally condemned by insurers (Texas is one exception to the pattern and California's Proposition 103 mandated public participation in rate proceedings). In fact, the *Morales* case cites the public's right to participate in the rate setting process in Florida as a major advantage of utility regulation. Is the filed rate doctrine the consumer advocate's solution to gaining more meaningful participation in insurance regulation? If a state does not involve the public in insurance rate setting, is it legally appropriate to permit use of the filed rate doctrine as a defense?

Ultimately, the filed rate doctrine may result in insurance regulatory adoption of another utility concept that is anathema to insurers, i.e., limiting insurers to a fair rate of return. Insurance rate setting statutes usually specify that rates can not be "excessive, inadequate, or unfairly discriminatory," so one may argue that regulators already have the authority to cut insurer profit. The problem is that "excessive" has little objective reference and even if rates are declared to be excessive, regulatory ability to provide remedies is limited. However, if reference could be made to the "fair rate of return" standard in utility law, a much different result might emerge. Possibly, regulators, policyholders, and legislative oversight committees would be emboldened considerably if they are handed a filed rate standard with more concrete foundations to justify rate controls.

## CONCLUSION

While both determine the final bill we will pay for services and products, utility and insurance rate setting are quite different phenomena and it is way past the time when courts should recognize appropriate distinctions. Furthermore, repeated reliance upon filed rate doctrine defenses may be a Trojan Horse for insurers who may eventually discover, as we Southerners sometimes say, "The fleas come with the dog." I'm not quite sure that insurance executives have thought far enough beyond their lawyers' briefs to consider the size of the fleas hiding under the fur of the filed rate doctrine.