Journal of Consumer Attorneys Associations for Southern California
ADVOCATE
September 2016 Issue

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Insurance class action: Addressing the defenses

Abstention, Primary Jurisdiction and Exclusive Jurisdiction in insurance class

So you have just filed an insurance class action and you are very excited. You have substantial evidence that the defendant insurer has engaged in a practice of systematically denying benefits to thousands of policyholders in violation of an Insurance Code provision. (See, e.g., *Arce v. Kaiser Foundation Health Plan, Inc.* (2010) 181 Cal.App.4th 471 and *Ticconi v. Blue Shield of California Life & Health Ins. Co.* (2008) 160 Cal.App.4th 528.) What's more, the Department of Insurance has filed an enforcement action charging that the insurer violated the law to the detriment of policyholders as you allege.

But then in comes a demurrer. The insurer does not argue that there are insufficient allegations of wrongdoing or of a certifiable class. Indeed, the insurer essentially concedes the validity of those allegations. Instead the insurer contends that its systematic violation of policyholders' rights cannot be resolved in court because the conduct implicates an obscure "complex economic policy" or some undefined expertise that is better left to whatever action the regulator may take. After doing some research you realize that a court can decide to accept these arguments by simply reviewing the pleadings and exercising its "discretion" to have the matter dismissed or stayed pending possible review at some point by the regulator. How can this be?

Enter the doctrines of abstention, primary jurisdiction and exclusive jurisdiction. These related defenses focus on public-policy considerations for allowing an administrative body/regulator the exclusive or interim right to make decisions on issues within their jurisdiction and expertise. Because insurance class actions often concern issues that are the subject of an Insurance Code provision, a regulation, a regulatory function, or a regulatory proceeding, insurers frequently raise one or more of these defenses.

In addressing these arguments it is important to identify the particular defense being raised, because defendants often fail to spell out what particular doctrine they are relying upon in an effort to secure a dismissal instead of a stay. And, as the cases below demonstrate, courts often confuse the doctrines when applying them. Once a particular defense is identified, the public policy at issue can be addressed in light of the allegations of the complaint. Because prevention is the best medicine, these defenses should be understood and anticipated when drafting an insurance class-action complaint.

Abstention

An abstention defense can present a serious obstacle to the prosecution of a claim under Business & Professions Code section 17200 (the Unfair Competition Law, "UCL") because the doctrine: (1) is often based on obscure public-policy arguments; (2) is assessed by analyzing the allegations of the complaint; (3) is determined under an abuse-of-discretion standard; and (4) if determined to apply, ends the case.

The argument is that the UCL provides equitable remedies and that a court should abstain from employing those remedies when doing so "would drag a court of equity into an area of complex economic policy" (*Desert Healthcare District v. PacifiCare, FHP, Inc.* (2001) 94 Cal.App.4th 781, 795); "require a trial court to assume the functions of an administrative agency" (*Alvarado v. Selma Convalescent Hospital* (2007) 153 Cal.App.4th 1292, 1298); or when granting injunctive relief "would be unnecessarily burdensome for the trial court to monitor and enforce given the availability of more effective means of redress."

When a given issue will require a court to wade into "complex economic policy" or "assume the functions of an administrative agency" is not entirely clear. The cases on the subject appear to divide along the line of whether resolving the liability issue will require a court to delve into complicated financial issues typically performed under the supervision of the regulator or, despite some level of regulatory overlay, ask a court to decide contractual or statutory violations that are common in a consumer class action.

In *Desert Healthcare District*, *supra*, the economic policy at issue was the propriety of a health plan's patient-capitation rates, which resulted in the bankruptcy of a contracted medical group and its nonpayment to a hospital. The hospital brought suit alleging that the health plan's transfer of risk to the medical group violated the Knox-Keene Act and so the UCL. The court decided to abstain from hearing the dispute because, in order to fashion an appropriate remedy for such a claim, it would have had to determine the appropriate levels of capitation. The court's concern was that making this type of finding would "pull the court deep into the thicket of the health care finance industry, an economic arena that courts are ill-equipped to meddle in." (*Id.*, 94 Cal.App.4th at 796.)

Administrative entanglement and the complexity of the relief were at issue in *Alvarado v. Selma Convalescent Hospital, supra*. There the plaintiff brought a class action under the UCL to compel skilled-nursing facilities to comply with the limitations on nursing hours contained in Health & Safety Code section 1276.5, subdivision (a). The lower court sustained a demurrer without leave to amend based upon an abstention defense. The appellate court stated that although it would treat the demurrer as admitting all material facts properly pled, the standard of review was abuse of discretion in light of the equitable nature of the UCL remedies sought. (*Id.*, 153 Cal.App.4th at 1297.) In affirming, the appellate court determined that the Department of

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Health Services was to enforce the statute and that to fashion relief the court would have to calculate on class-wide basis numerous nursing work factors, a "task better accomplished by an administrative agency that by trial courts." (*Id.* at 1305-1306.)

In *Wolfe v. State Farm Fire & Casualty Ins. Co.* (1996) 46 Cal.App.4th 544, there was a mix of public policy and administrative detail that caused the court to abstain. The plaintiff brought a UCL action against 17 residential real-property insurers. He alleged that the insurers committed an unfair business practice by refusing to write policies in California in order to avoid issuing earthquake coverage after the Northridge earthquake. The insurers argued that their actions were necessary to comply with laws requiring they maintain adequate reserves to pay claims. The court affirmed the sustaining of a demurrer because "[d]etermining the validity of respondents' defense would necessarily involve the court in evaluating the potential risk being undertaken [by each insurer] and analyzing their respective financial conditions[.]" (*Id.* at 568.)

Samura v. Kaiser Foundation Health Plan, Inc. (1993) 17 Cal.App.4th 1284 presented a scenario where the injunctive relief ordered by the trial court usurped the functions of the regulator. The plaintiff brought a UCL action seeking to enjoin a health plan's enforcement of a third-party reimbursement provision. The trial court required the provision to be re-written to include a pro rata reduction of the lien amount for attorney fees expended in achieving the third-party recovery. The appellate court reversed, determining that the content of the policy form was subject to review by the health plan's regulator and "courts cannot assume general regulatory powers over health maintenance organizations through the guise of enforcing the [UCL]." (*Id*. at 1301-1302.)

The public policies proclaimed in these cases create a clear tension with the UCL, a broad remedial statute that is cumulative to all other California laws. "[E]ven were we to conclude [that other laws] are a comprehensive scheme for combating teen smoking, we would still confront the fact that in neither of these provisions is it "expressly provided" that remedies under the UCL and those statutes are not cumulative to each other." (*Stop Youth Addiction, Inc. v. Lucky Stores, Inc*. (1998) 17 Cal.4th 553, 573.) The existence of parallel enforcement mechanisms with regulatory oversight should not trump the UCL when it is being used to address specific wrongs against consumers that can be adjudicated like any other dispute.

For instance, in *Blue Cross of California v. Superior Court* (2009) 180 Cal.App.4th 1237, the issue was whether a court should abstain from addressing the city attorney's UCL action against a health plan, which alleged that the plan had engaged in the unlawful rescission of insurance contracts in violation of statute. The health plan argued that the abstention doctrine applied because its practices had come under scrutiny from its regulator that, pursuant to its enforcement authority, entered into a settlement with the health plan. The court noted the breadth of the UCL and the cumulative nature of its remedies, citing *Stop Youth Addiction, Inc. v. Lucky Stores*, *supra*. The court then determined that the city attorney's action was not seeking to interfere with actions of the regulator but "asking the court to perform an ordinary judicial function, namely to grant relief under the UCL and the FAL for business practices that are made unlawful by the statute." (*Id.* at 1258.)

This rationale was also applied in *Arce v. Kaiser Foundation Health Plan, Inc*. (2010) 181 Cal.App.4th 471. The plaintiff brought a class action against Kaiser alleging that it had breached members' contracts and violated the UCL by failing to provide certain types of treatment for children with autism in conformity with the Mental Health Parity Act, Health & Safety Code section 1374.72. The trial court dismissed the UCL claim because it concluded that relief sought would require it to engage in complex medical issues by determining which treatments were medically necessary. The appellate court rejected this argument, finding that resolution of the case merely required the trial court "to perform the basic judicial functions of contractual and statutory interpretation." (*Id.* at 499.) The *Arce* court also determined that section 1374.72 is not strictly a regulatory statute but also makes it unlawful to deny necessary treatment for autism – a right that private parties can enforce.

The abstention doctrine appears to be more readily applied when the relief sought is less a matter of individual redress (albeit on a class basis) for some violation of contract or law and more of a broad-based attack on a public policy or a financial system where any remedy would be extremely difficult to assess or manage. Accordingly, an insurance class-action complaint should anticipate these arguments and allege a UCL violation and remedies that will cause a court to conclude that it is being asked "to perform an ordinary judicial function, namely to grant relief under the UCL" in ordering specific restitution and/or issuing a manageable injunction. (*Blue Cross of California v. Superior Court, supra,* 180 Cal.App.4th at 1258.)

Primary jurisdiction

Primary jurisdiction is often confused with the doctrine of exhaustion. Exhaustion comes into play when a dispute must first be presented to an administrative body before it can be presented in court. "[J]udicial interference is withheld until the administrative process has run its course." (*Farmers Ins. Exchange v. Superior Court* (1992) 2 Cal.4th 377, 390 quoting *United States v. Pac. R. Co.* (1956) 352 U.S. 59, 63-64.) In other words, it is jurisdictional in the sense that the administrative action is a prerequisite to a civil action. Primary jurisdiction, on the other hand, arises when a dispute may be filed in court but any action by the court should be suspended pending a decision by an administrative body. (*Farmers Ins. Exchange, supra,* at 390.)

Several primary-jurisdiction cases in the insurance area concern disputes over compliance with the provisions of Proposition 103, the landmark legislation requiring prior approval of property and casualty insurance rates. Perhaps the

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leading primary-jurisdiction case in California is *Farmers Ins. Exchange. v. Superior Court, supra*. There, the Attorney General brought an action on behalf of the People alleging that the insurer had violated Proposition 103's "Good Driver Discount" as set forth in Insurance Code section 1861.02 and the "discriminatory rates" provision of Insurance Code section 1861.05(a). The insurer argued that the allegations of impropriety in the insurer's rating practices were subject to an exhaustion of administrative remedies available under the Insurance Code.

After determining that exhaustion did not apply, the court turned to the issue of primary jurisdiction. It stated that application of the doctrine advances two related policies: "it enhances court decisionmaking by allowing courts to take advantage of administrative expertise, and it helps assure uniform application of regulatory laws." (*Farmers Ins. Exchange, supra*, 2 Cal.4th at 391.) There is no rigid formula for applying these policies and, like the abstention defense, application of these policies to a given case is within the court's discretion absent a law stating otherwise.

The court determined that the UCL action was subject to the primary jurisdiction of the Insurance Commissioner because it alleged that the insurer had violated the provisions of Insurance Code sections 1861.02 and 1861.05(a) and that:

> The resolution of these questions mandates exercise of expertise presumably possessed by the Insurance Commissioner, and poses a risk of inconsistent application of the regulatory statutes if courts are forced to rule on such matters without benefit of the views of the agency charged with regulating the insurance industry.

(*Id.*, 2 Cal.4th at 398.)

Noteworthy is that the court rejected the Attorney General's attempt to recharacterize the allegations of the complaint ("the complaint does not on its face allege the factual claim that the People now advance"). (*Id.*, 2 Cal.4th at 397.) As with the abstention defense, the nature of the violation alleged and the specificity of the relief sought will be paramount in defeating a primary jurisdiction defense.

The progression of a case through the primary jurisdiction process is displayed in *Donabedian v. Superior Court* (2004) 116 Cal.App.4th 968. An individual brought a UCL action alleging that the insurer used the absence of prior insurance in and of itself in determining entitlement to a Good Driver Discount in violation of Insurance Code section 1861.02. The trial court stayed the matter so the plaintiff could present it to the Insurance Commissioner. The Commissioner declined jurisdiction but expressed his agreement with the plaintiff's position. The trial court then dismissed the case based upon exclusive jurisdiction. The appellate court reversed, determining that the issue was one of primary jurisdiction and the referral to the Commissioner had satisfied the requirement of the regulator's initial assessment.

The doctrines of exhaustion and primary jurisdiction in the context of an individual lawsuit alleging common law claims were addressed in *Jonathan Neil & Associates, Inc. v. Jones* (2004) 33 Cal.4th 917. There the issue was whether exhaustion or primary jurisdiction applied to a trucking company's premium dispute with its insurer. The insurance was provided through an assigned risk program run under rules promulgated by the Insurance Commissioner. The court determined that exhaustion did not apply because the Insurance Commissioner did not have the authority to decide the common law claims "but can only make a determination regarding some of the issues in the case." (*Id.* at 933.) The court, however, did find that "the case for the primary jurisdiction of the Insurance Commissioner is compelling" because an interpretation of the assigned risk program premium rules was at the heart of the controversy. (*Id.* at 934.)

Unlike abstention, primary jurisdiction is not a death-blow to a UCL claim because it calls for a referral to the regulator for input while the court action is stayed. If there is a pending regulatory proceeding, the court action is stayed until the proceeding is completed. (*Wise v. Pacific Gas & Electric Co.* (1999) 77 Cal.App.4th 287, 296.) If there is no pending proceeding, the stay may accompany a "referral" calling for the regulator to act. (*Farmers Ins. Exchange, supra*, 2 Cal.4th at 378.) If, however, the regulator renders an opinion, the trial court will be guided by that decision. (*Jonathan Neil & Associates, Inc. v. Jones, supra,* 33 Cal.4th at 937.)

Exclusive jurisdiction

A successful exclusive-jurisdiction defense is, like abstention, fatal to a case but should be limited to the infrequent circumstance where the Insurance Commissioner has been expressly given exclusive authority to resolve an issue.

For instance, in *State of California v. Altus Finance, S.A.* (2005) 36 Cal.4th 1284 the Attorney General sought restitution, injunctive relief and penalties under the UCL against an entity it alleged acted as a front for other businesses in the takeover of an insolvent insurer. The court determined that Insurance Code section 1037(f) gave the Insurance Commissioner the exclusive authority to recover lost property on behalf of creditors and policyholders of an insolvent insurer precluding any claim for restitution. The court also found that the Attorney General could pursue penalties as well as injunctive relief to the extent that relief implicates core law enforcement functions as opposed to duplicating the role played by the Commissioner as conservator of the insolvent company.

In *McKay v. Superior Court* (2010) 188 Cal.App.4th 1427 an issue was again raised regarding the propriety of an insurer's reliance on an insured's lack of prior insurance in calculating premiums in compliance with Insurance Code section 1861.02. The insurer moved for summary judgment on the basis the Department of Insurance had approved the rate. The court determined that Insurance Code section 1860.1 exempts from other California laws, acts done and actions taken pursuant to the ratemaking authority conferred by the ratemaking chapter, "*including the charging of a*

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preapproved rate" (*Id.* at 1443, emphasis in original.) Accordingly, the court granted summary judgment for the insurer.

On the other hand, in *Bell v. Blue Cross of California* (2005) 131 Cal.App.4th 211 the appellate court rejected an exclusive jurisdiction defense where the regulator (the Department of Managed Health Care) was authorized to enforce the statutory scheme at issue (the Knox-Keene Act) with no parallel authorization for suits brought by individuals. The court determined that a class action brought by emergency room physicians seeking full reimbursement from a health plan under a law requiring physicians to provide emergency services could proceed as a UCL unlawful claim. Nothing in the Knox-Keene Act granted the regulator exclusive jurisdiction to enforce its provisions or precluded a UCL action.

Conclusion

The defenses of abstention, primary jurisdiction and exclusive jurisdiction can defeat or delay an insurance class action when the case implicates insurance statutes, regulations or functions of the regulator. Care must be taken to plead the violations and relief requested with enough specificity to support arguments that the claims concern the type of issues regularly decided in court. In particular, UCL remedies that would infringe on an existing compliance system or will require a court to resolve complex issues best reserved for a regulator will likely result in a court exercising its discretion to dismiss or stay the case for regulatory review.

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