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May 27, 2003

Senator Michael Brennan, Senate Chair  
Representative Christopher P. O'Neil, House Chair  
Joint Select Committee on Health Care  
Augusta, ME 04333

Re: Legal Issues Relating to Assessments on Insurers in L.D. 1611

Dear Senator Brennan and Representative O'Neil:

By letter dated May 20, 2003, you have asked two questions concerning the provisions of L.D. 1611 that would establish assessments against health insurers, reinsurers, and third party administrators and that would prohibit this assessment from being incorporated in the rates charged by these insurers.<sup>1</sup>

Your first question is whether the State has the authority to impose and enforce the assessments that would be established by L.D. 1611, Sec. A-9 (proposed 24-A MRSA §6920). A variety of assessments are established by statute in order to raise funds for specified governmental purposes. There is no apparent reason why imposition of this particular assessment, which generates funds to be spent for a program that has a public purpose, should be viewed as somehow outside of the Legislature's authority.

In discussing the enforcement of the pass-through prohibition and the argument that its effects are unconstitutionally confiscatory, two points should be emphasized at the outset. First, the Superintendent of Insurance has substantial discretion in applying ratemaking and enforcement provisions of the Insurance Code (Title 24-A), and judicial review of administrative decisions made by the Superintendent will be given deference by the courts. Second, the Superintendent also has statutory responsibility for the solvency of the entities he regulates, and must take those provisions of the Insurance Code into account when regulating rates. In short, the enforceability of the pass-through

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<sup>1</sup>The time available to respond to these questions, given the Committee's time constraints, has been insufficient to prepare a formal opinion of the Attorney General. Accordingly, this letter does not attempt to discuss the law in more detail than necessary to address the pending questions. This is particularly true with respect to the discussion of takings case law, a complex area where the application of established principles depends on the totality of the circumstances.

prohibition is largely dependent on how the Superintendent applies the various statutes discussed below.

The means of enforcing the pass-through prohibition vary depending on the type of rates involved. Rates charged for policies of individual health insurance must be filed with the Superintendent, and are subject to disapproval if they are found to be excessive, inadequate, or unfairly discriminatory. 24-A M.R.S.A. § 2736(2). A violation of the pass-through prohibition for individual rates (found in § D-7 of LD 1611 at proposed § 2736-C(2)(B-1)) could provide the basis for a determination that the rates proposed are excessive, and consequently disapproval of those rates. General enforcement provisions of the Insurance Code (discussed below in connection with group rates) could also apply.

L.D. 1611 establishes a new rate review procedure for small group rates. The pass-through prohibition does not appear in this section of the bill (§D-8). If such a prohibition were to be inserted, the enforcement options would be the same as those for individual rates to the extent that the “excessive, inadequate, unfairly discriminatory” rating standard applies to small group rates.

Large group rates present a somewhat different situation because they are not regulated and therefore could not be disapproved based on a violation of the pass-through prohibition. However, each carrier offering large group policies must annually file with the Superintendent a certification by a member of the American Academy of Actuaries that the carrier has not reflected the cost of the assessment in its rates. L.D. 1611, § D-10, proposed 24-A M.R.S.A. § 2839-B(2). A violation of this requirement, like any violation of the Insurance Code, is subject to the enforcement authority of the Superintendent under 24-A M.R.S.A. § 211.

General enforcement options available to the Superintendent include those specified in § 12-A (civil penalties, cease and desist orders, restitution), § 215 (suspension or revocation of licensure), and referral to the Attorney General for prosecution in Superior Court (the § 12-A remedies as well as equitable relief and actual damages awarded to injured insureds). While these options are available in the case of individual and small group rates as well, rate disapproval is likely the more effective remedy in those areas.

This array of rating provisions is very relevant to the more complex analysis required to determine whether the pass-through prohibition results in an unconstitutional confiscation of insurers’ property in violation of the U.S. and Maine Constitutions. A legal claim that a regulatory measure results in an unconstitutional taking can be made in two ways: a facial challenge, and an “as applied” challenge. The viability of an as applied challenge depends on many facts not available at this time, including insurers’ rates and their profitability for the rating period at issue, the level at which the Dirigo assessments are set, and the savings to insurers generated by other initiatives in L.D. 1611. Accordingly, this discussion will focus on a challenge based on the relevant statutes on their face.

The considerable body of United State Supreme Court case law on confiscation (or "takings") is applied to insurance ratemaking in two fairly recent state court cases relevant to the instant question: *Calfarm Insurance Company v. Deukmejian*, 771 P.2d 1247 (Calif. 1989)(hereafter "*Calfarm*"), and *State Farm Mutual Automobile Insurance Company v. State of New Jersey*, 590 A.2d 191 (N.J. 1991)(hereafter "*State Farm*"). For purposes of this discussion, the controlling principles of takings law, as described in *Calfarm* (see pp. 816-818) and *StateFarm* (see pp. 198-201) can be summarized as follows.

Legislative enactments are presumed to be valid, and the burden of a challenge is heavy. Price controls are unconstitutional only if arbitrary, discriminatory, or demonstrably irrelevant to the policy the Legislature is free to adopt, and holdings of facial unconstitutionality are rare in cases dealing with the validity of price control statutes. The state and federal constitutions are concerned not so much with the way in which initial rates are set, but whether rates resulting from regulation are confiscatory or fair. Regulated parties are entitled to the opportunity to earn a just and reasonable rate of return, taking into account both the interests of investors (the return on capital for comparable risks), the interests of consumers, and the interests of the general public sought to be advanced by the Legislature. A regulation will be invalidated on its face only if those who challenge it can show that the law is so restrictive as to facially preclude any possibility of a just and reasonable return.

In *Calfarm*, the California Supreme Court reviewed various provisions of Proposition 103, an initiated measure making various changes in the regulation of automobile and other insurance rates. The challenged provisions required a twenty percent rollback of auto rates from the level in effect approximately one year prior to the effective date of the law, permitted rate increases during the first year after the rollback only if the Insurance Commissioner found an insurer to be "substantially threatened with insolvency," and required that all rate increases be approved by the Commissioner applying the standard that rates not be excessive, inadequate, unfairly discriminatory, or otherwise in violation of the initiative.

Applying the principles described above, the *Calfarm* Court concluded that by limiting rate increases to cases where evidence demonstrated that an insurer was threatened with insolvency for a period of a year following a twenty percent rollback rendered the statute confiscatory on its face. However, having struck that limitation and considering the remaining provisions as a whole, the Court concluded that the rollback requirement survived a facial challenge because the standard that rates not be inadequate afforded protection to insurers sufficient to avoid confiscation.

In the *State Farm* case, the New Jersey Supreme Court upheld surtaxes and assessment on automobile insurers designed to retire debts of a failed assigned risk mechanism, notwithstanding a prohibition on passing these charges on to ratepayers. The Court expressly concluded that the pass-through prohibitions were intended by the

Legislature to be absolute in their application. However, language added to the act by amendment that provided that insurers were entitled to earn an adequate rate of return was found sufficient to permit rate relief in the event that application of the pass-through prohibitions resulted in confiscatory rates. The relevant statutes were upheld. Of interest here is the following statement of the Court:

In particular, government price controls do not have to allow pass-throughs of particular cost increases in order to assure a constitutionally adequate rate of return. See, e.g., *FPC v. Texaco Inc.*, 417 U.S. 380, 41 L.Ed. 2d 141 (1974)...

*State Farm* at 200.

Applying the *Calfarm* and *State Farm* decisions to the pass-through prohibitions in L.D. 1611, the requirement that rates not be inadequate provides a basis for the Superintendent to grant rate relief if confiscatory rates would otherwise result. As noted above, the general standard that rates not be inadequate, excessive or unfairly discriminatory applies to individual and small group rates. While this standard does not apply to large group rates in L.D. 1611, the overall rates are unregulated and could thus be adjusted by the unilateral action of an insurer in order to preserve an adequate return.

I hope this information is helpful. Please let me know if we can be of further assistance.

Sincerely,

A handwritten signature in black ink, appearing to read "L. Pistner", with a long horizontal flourish extending to the right.

Linda M. Pistner  
Chief Deputy Attorney General