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IN THE SUPREME COURT OF FLORIDA

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ROBERT P. SMITH, JR., et al.,

Appellants,

vs.

CASE NO. 69,551

STATE OF FLORIDA, DEPARTMENT OF INSURANCE, and BILL GUNTER, as Insurance Commissioner of the State of Florida, et al.,

Appellees.

REPLY BRIEF ON CROSS APPEAL OF APPELLEES DEPARTMENT OF INSURANCE AND BILL GUNTER

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TABLE OF CONTENTS

PAGE

TABLE OF AUTHORITIES ii

ARGUMENT:

CROSS APPEAL REPLY POINT

THE LOWER COURT ERRED BY HOLDING THAT THE SPECIAL CREDIT PROVISIONS OF CHAPTER 86-160, SECTIONS 66(1)-(3), VIOLATE THE IMPAIRMENT OF CONTRACT CLAUSE. 1

CONCLUSION 10

CERTIFICATE OF SERVICE 11

TABLE OF AUTHORITIES

PAGE

CASES CITED:

Case	Page
Department of Insurance v. Teachers Insurance Company, 404 So.2d 735 (Fla. 1981)	2,4,5,7
Energy Reserves v. Kansas Power and Light, 459 U.S. 400, 74 L.Ed.2d 569, 103 S.Ct. 697 (1983)	2,3,4,5
Estate of Conger v. Conger, 414 So.2d 230 (Fla. 3d DCA 1982)	2
Park Benziger and Co., Inc. v. Southern Wine and Spirits, Inc., 391 So.2d 681 (Fla. 1980)	9
Pomponio v. Claridge of Pompano Condominium, Inc., 378 So.2d 774 (Fla. 1979)	1,10
State, Department of Transportation v. Edward M. Chadbourne, Inc., 382 So.2d 293 (Fla. 1980)	8
State of Florida, Department of Transportation v. Cone Brothers Contracting Company, 364 So.2d 482 (Fla. 2d DCA 1978)	8
United States Fidelity and Guaranty Company v. Department of Insurance, 453 So.2d 1355 (Fla. 1984)	2,3,4,5,6,7,8
United States Trust Co. v. New Jersey, 431 U.S. 1, 97 S.Ct. 1505, 52 L.Ed.2d 92 (1977)	8
Yamaha Parts Distributors, Inc. v. Ehrman, 316 So.2d 557 (Fla. 1975)	1
Yellow Cab Co., etc. v. Dade County, 412 So.2d 395 (Fla. 3d DCA 1982), **pet. for rev. den.** 424 So.2d 764 (Fla. 1983)	2

TABLE OF CITATIONS CONTINUED

	PAGE
OTHER AUTHORITIES:	
FLORIDA STATUTES:	
Section 627.062	10
Section 627.062(a)	10
Section 627.062(b)(4)	10
Section 627.062(b)(11)	10
LAWS OF FLORIDA:	
Chapter 86-160	2,7,11
Chapter 86-160, Section 65	5
Chapter 86-160, Section 66	10
Chapter 86-160, Section 66(1)	1,9,10,11
Chapter 86-160, Section 66(2)	1,11
Chapter 86-160, Section 66(3)	1,9,10,11

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REPLY BRIEF ON CROSS APPEAL
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CROSS APPEAL REPLY POINT

THE LOWER COURT ERRED BY HOLDING THAT THE SPECIAL CREDIT PROVISIONS OF CHAPTER 86-160, SECTIONS 66(1)-(3), VIOLATE THE IMPAIRMENT OF CONTRACT CLAUSE.

CIGNA and AIA contend that the trial court's finding that the special credit provisions of Sections 66(1)-(3), Chapter 86-160, may not constitutionally be applied to contracts entered into before the effective date of the law should be upheld. They rely heavily upon the principle enunciated in Yamaha Parts Distributors, Inc. v. Ehrman, 316 So.2d 557 (Fla. 1975), that "virtually no degree of contract impairment has been tolerated in this state." CIGNA and AIA further contend that these special credit provisions will have a severe and dramatic impact upon insurers, while providing little or no benefit to consumers and businesses in this state. As a result, they argue, the law fails the balancing test set forth in Pomponio v. Claridge of Pompano Condominium, Inc., 378 So.2d 774 (Fla. 1979).

These arguments ignore the case law, subsequent to Pomponio, construing and applying the balancing test. They also overlook the fact that the legitimate reforms contained in Chapter 86-160 have, as the Department demonstrated in its answer brief, changed the "playing field" on which the affected insurance contracts were drawn. The special credit provisions merely seek to assure that the benefits of these reforms are passed on to policyholders, while protecting the contractual expectations originally bargained for. Finally, the special credit is, in fact, related to the legislative goal of reducing the dramatically increasing and excessive costs of insurance and making it more affordable to a wide range of Florida consumers and businesses.

As pointed out in the Department's answer brief, it is clear that, at least since Pomponio, Florida courts have recognized that the State of Florida may exercise its police power to protect the public welfare, even where to do so might impact upon contractual relationships in existence at the time law is enacted. See, e.g., Yellow Cab Co., etc. v. Dade County, 412 So.2d 395 (Fla. 3d DCA 1982), **pet. for rev. den.** 424 So.2d 764 (Fla. 1983); Estate of Conger v. Conger, 414 So.2d 230 (Fla. 3d DCA 1982); Department of Insurance v. Teachers Insurance Company, 404 So.2d 735 (Fla. 1981); United States Fidelity and Guaranty Company v. Department of Insurance, 453 So.2d 1355 (Fla. 1984). These cases clearly adopt and apply the federal balancing test in state contract impairment analysis and allow the state to step in and protect its citizens from dramatic increases in the price of vital goods and services such as insurance.

In Energy Reserves v. Kansas Power and Light, 459 U.S. 400, 74 L.Ed.2d 569, 103 S.Ct. 697 (1983) (a case cited and relied upon by the Court in

United States Fidelity and Guaranty Company), the United States Supreme Court upheld a Kansas statute which retroactively placed limits on the amount of price increases natural gas producers were entitled to under contracts with public utilities. Specifically, Energy Reserves Group, Inc. (ERG) had a series of contracts with the Kansas Power and Light Company (KPL) concerning the long-term sale and purchase of natural gas. The contracts allowed ERG to increase the price of its natural gas under certain circumstances or, alternatively, if KPL was not able to pay the increased prices, to cancel the contract. The State of Kansas passed a statute restricting the terms and conditions under which ERG could exercise these options.

In upholding the statute against an impairment of contract clause challenge, the court applied the balancing test. The court first noted that "[o]ne legitimate state interest is the elimination of unforeseen windfall profits." Id., 459 U.S. 412. The court also stated that:

> On the other hand, state regulation that restricts a party to gains it reasonably expected from the contract does not necessarily constitute a substantial impairment.

Id., 495 U.S. 411

At the time ERG and KPL executed their contracts the price of natural gas was subject to federal price controls. When these prices were deregulated, the State of Kansas enacted legislation to limit the prospective increase. The court, therefore, found that:

> Thus, at the time of the execution of the contracts, ERG did not expect to receive deregulated prices. The very existence of the governmental price escalator clause indicates that the contracts were structured against the background of regulated gas prices. If deregulation had not occurred the contracts

> undoubtedly would have called for a much smaller price increase than that provided by the Kansas Act's adoption of the §109 ceiling.

Id., 459 U.S. 415.

The court found that, since ERG could not have had a reasonable expectation of deregulation and the resulting windfalls, it was, in essence, still getting the same benefit it had bargained for. Therefore, any contract impairment was outweighed by Kansas' legitimate interest in the elimination of unforeseen windfall profits.

Similarly, the Court in United States Fidelity and Guaranty Company v. Department of Insurance, supra, held that:

> What minimal impairment does exist is outweighed by the state's interest in eliminating unforeseen windfall profits. Section 627.066(13) specifically states that excess profits were realized in the years 1977-1979 due to statutory changes. These changes were made in response to escalating insurance costs in order to protect policyholders from paying exorbitantly high premiums. Changes were made to reduce the insurers' costs of doing business so that these savings could be passed on to policyholders in the form of lower premiums.

Id., at 1361.

The specific statutory changes were discussed in greater detail in Department of Insurance v. Teachers Insurance Company, supra. At pages 739-740, the Court identified a number of changes in the manner in which automobile insurance rates were to be regulated. In upholding the law against an impairment challenge, the Court stated at page 742:

> Clearly the legislature did not intend there be insurance company excess profits resulting from the tort and insurance law reform of 1976 and 1977. The intent was rather to have both policyholders and insurance companies benefit from the reform. We emphatically reject the assertion that windfall profits are protected by the impairment of contract clause.

As did the court in Energy Reserves v. Kansas Power and Light, supra, this Court in both United States Fidelity and Guaranty Company and Teachers recognized that the challenged law properly restricted the complaining party to the gains it reasonably expected from the contract. Insurers could not reasonably have expected at the time the contracts were executed the windfall benefits they will most assuredly receive from the tort reforms. These cases leave no doubt that the legislature is not prohibited by the contract clause from assuring that the benefits of tort and insurance reforms are passed on to policyholders and not retained by insurers.

The appellants make much of the trial court's finding that the effect of tort reform on the insurance industry is "speculative" (Judgment at 42). However, the lower court's finding must be read in context. The court found:

> The Defendants argued that this 10% rebate will be offset by an anticipated 10% reduction in losses and expenses as the result of the Act's civil law reforms. This argument, however, is speculative and what effect tort reforms will have on the insurance industry remains to be seen.

(Judgment at 42; emphasis supplied.)

The Department respectfully submits that it cannot be seriously argued that tort reform will have no effect on reduction in losses and expenses for the insurance industry. Indeed, the trial court's finding was bottomed upon the premise that tort reform may not offset the 10% rebate. Nevertheless, one cannot in good faith question the fact that tort reform must, of necessity, have some favorable impact on losses and expenses.

CIGNA, at page 22 of its brief, contends that the lower court's finding was buttressed by expert testimony that the Sunset provision of Section 65 makes the task of "accurately quantifying savings" more difficult.

Admittedly, "quantification" of tort reform is, at this juncture, subject to a degree of uncertainty. Nevertheless, the legislature could properly, in its discretion, believe that tort reform would, at a minimum, offset the 10% rebate.

While CIGNA would suggest to this Court that the value of tort reform is "speculative," it is interesting to note testimony presented by CIGNA's trial representative on the tort reform issue. The CIGNA Group conducted an evaluation of the tort reform provisions of Chapter 86-160 in an effort to assess the relative value of the tort reform, particularly as it relates to similar statutes in other states (TR III - 411-413). The CIGNA Group concluded that the tort reform provided in this act was the third best in the country (TR III - 413). Thus, while CIGNA may not be able to quantify the effect of tort reform, it is abundantly clear by its own admission that Florida's tort reform is indeed valuable to the insurance industry.

Finally, in United States Fidelity and Guaranty Company, the Court was not troubled by the legislature's inability to place a specific value on the tort reforms enacted. The Court stated:

> Changes were made to reduce the insurers' costs of doing business so that these savings could be passed on to policyholders in the form of lower premiums. Since it was impossible to calculate in advance the precise impact the statutory changes would have on insurer's earnings, the legislature deemed it fit to require the insurers to file information on their earnings and expenses and authorized the Department of Insurance to calculate and order refunds of any excess profits. We do not find this method of protecting policyholders from paying exorbitantly high premiums to be unreasonable.

Id., at 1361.

The appellants also take issue with the Department's contention that insurance rates were perceived to be excessive. The appellants take solace with the trial court's finding that there had been no showing "that such

is the case or that any particular insurance company was charging excessive rates" (Judgment at 39). Because the insurers made an admittedly facial attack on Chapter 86-160, it is hardly surprising that there was no showing that any "particular" insurance company was charging excessive rates. Indeed, the lower court, upon objection by the insurers, refused to hear testimony bearing upon individual companies (TR V - 823-825). It is instructive to note, however, that the Florida Legislature made an express finding that the cost of liability insurance was, in fact, excessive. The legislature stated:

> WHEREAS, the Legislature finds that, in general, the cost of liability insurance is excessive and injurious to the people of Florida and must be reduced . . ."

CIGNA also attempts to distinguish United States Fidelity & Guaranty Company and Teachers by contending that the only reason that excessive profits in these cases were not protected by the contract clause was because the 1977 law put insurers on notice that they might have to refund such profits. This argument, however, misses the primary point of both cases. Certainly, the notice given by the 1977 law played an important role in the Court's decision. However, the overriding concern of the Court and the legislature was to assure that the benefits of the tort and insurance reforms were passed on to policyholders. It is the assertion that those unexpected windfall profits resulting from legislation are protected by the contract clause which the Supreme Court "emphatically" rejected.

CIGNA and AIA rely heavily on two cases which pre-date Teachers and United States Fidelity and Guaranty Company. These cases are distinguishable and would not control in this case.

State, Department of Transportation v. Edward M. Chadbourne, Inc., 382 So.2d 293 (Fla. 1980), should be distinguished from the instant case for two reasons. First, that case involved a private party which had a contract with the state. Under such circumstances, where the state is attempting to change the terms of a contract to which it is a party, a different inquiry is appropriate. United States Fidelity and Guaranty Company, supra, at 1361, citing United States Trust Co. v. New Jersey, 431 U.S. 1, 23-24, 97 S.Ct. 1505, 1518, 52 L.Ed.2d 92, 110-111 (1977). Here the state has intervened with a law that purports to affect a contract between private parties.

In addition, while in Chadbourne there were, as the Court noted, some individual contractors who received windfall profits, there were also contractors who lost money as a result of the legislative changes. The majority opinion in Chadbourne specifically adopted the views and reasoning expressed by Judge Grimes in his dissenting opinion in State of Florida, Department of Transportation v. Cone Brothers Contracting Company, 364 So.2d 482, 490 (Fla. 2d DCA 1978). Therein, Judge Grimes made the following observations:

> If a contractor chose to accept this method of price calculation he was bound to it regardless of whether he ultimately received more or less than his original contract price. While the asphalt index price did go up as everyone expected, there were instances in which by virtue of having accepted the new formula some contractors were paid less than they would have been under their original contracts. This occurred with respect to one of the three contracts in issue in State of Florida, Department of Transportation v. Edward M. Chadbourne, Inc., supra.

In the instant case the litigation reforms work only to the insurers' advantage by reducing their losses. These gains are unbargained for and

unexpected. The concerns expressed by Judge Grimes are not present in the instant case.

In the second case, Park Benziger and Co., Inc. v. Southern Wine and Spirits, Inc., 391 So.2d 681 (Fla. 1980), there was no unexpected windfall gain. It appeared that the legislature simply sought to rewrite existing contracts between manufacturers and distributors of liquors to prohibit exclusive or "tied-house" arrangements. It is, therefore, distinguishable from the case at bar.

Finally, since the test set forth by the aforementioned impairment cases is a "balancing" test, the effect of Section 66(3) of Chapter 86-160 must be considered in the weighing. This provision, which serves to limit the amount and impact of any insurer's required refund or special credit, clearly tips the scales in favor of validity and constitutionality.

Specifically, Section 66(3) provides with respect to the refunds referred to in Subsection (1), as follows:

> (3) Any insurer which contends that implementation of the special credit provided for in subsection (1) will result in a rate which is clearly inadequate under the provisions of s. 627.062, Florida Statutes, may elect, by September 1, 1986, not to apply the special credit required by subsection (1). Any such insurer shall submit a special filing to the Department of Insurance on or before October 1, 1986 containing all data and information which it believes justifies its contention. An insurer may supplement its own loss and loss adjustment expense data with loss and loss adjustment expense data from an authorized statistical agent if it has relied upon such data to establish its rates and if use of such data is necessary to achieve reasonable actuarial credibility. The department shall review the filing and any other relevant data or information for that insurer pursuant to s. 627.062, Florida Statutes, and determine the appropriate special credit to be applied and order that such special credit be implemented, with interest at the rate of 12 percent per annum from the date the credit should have otherwise been implemented. (Emphasis supplied.)

Reference to Section 627.062 readily demonstrates that in review of any alternative rate filed by an insurer under the above-quoted subsection (3), the Department must approve rates which "allow the insurer a reasonable rate of return" [§627.062(a); §627.062(b)(4)] and allow a "reasonable margin for underwriting profit and contingencies" [§627.062(b)(11)].

Thus, in application of the "balancing" test, the most which would be required of any insurer under Sections 66(1) and (3) would be to refund that portion of 1986 premiums in excess of a reasonable rate of return. If, as contended by appellant insurers, 1986 rates were not excessive and the litigation reforms effective in mid-1986 are inconsequential, then presumably actual required refunds will, likewise, be inconsequential in amount or even nonexistent. If, on the other hand, significant refunds are required, it will be because the insurers' premiums and rates in 1986 significantly exceed a "reasonable rate of return."

It is respectfully submitted that the lower court erred in failing to fully recognize the purpose and operation of Subsection (3) as to pre-July 1, 1986, contracts, and its limitation of required refunds to sums which exceed a reasonable rate of return. When this provision is properly considered, Sections 66(1)-(3) must be upheld under the dictates of Pomponio v. Claridge of Pompano Condominium, Inc., 378 So.2d 774 (Fla. 1979), and subsequent decisions.

CONCLUSION

The special credit provisions of Chapter 86-160, Section 66, clearly reduce the cost of insurance to citizens and businesses in the State of Florida by passing on some of the benefits of the law's reforms to policy-holders of insurers. The law does not unconstitutionally impair insurers'

contract obligations or expectations. The holding of the trial court that Chapter 86-160, Sections 66(1)-(3) should not be applied to policies in effect before 86-160 was enacted should, therefore, be reversed.

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