IN THE SUPREME COURT OF THE STATE OF FLORIDA

CASE NO. 85,949

IN RE ADVISORY OPINION TO THE GOVERNOR -- REVENUE CAP STATE INSURANCE PREMIUMS

BRIEF OF INSURANCE CONSUMER ADVOCATE AS AMICUS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Florida Constitutional Provisions:

Statutes:

Other Authorities:

PREFACE

Unless specifically provided to the contrary, all section references herein are to the Florida Statutes, as amended through the 1995 Regular Session of the Legislature. References to "Article IV, Section 1(e)" are to Article IV, Section 1(e) of the Florida Constitution, as amended by referendum in the 1994 General Election.

Amendments to the Florida Insurance Code made during the 1995 Regular Session of the Legislature are contained in Laws of Florida 1995, Chapter 95-276.

References herein to the Florida Residential Property and Casualty Joint Underwriting Association shall be made as "Residential JUA". References to Article IV, Section 1(e) of the Florida Constitution shall be made as "the 1994 Constitutional Amendment".

STATEMENT OF THE CASE AND FACTS

The Insurance Consumer Advocate hereby adopts the Statement of the Case and Facts which appears in the brief filed on behalf of the Florida Residential Property and Casualty Joint Underwriting Association.

SUMMARY

The 1994 Constitutional Amendment at issue here does not act to limit the receivables or receipts of the Residential JUA. In concurrence with the opinions rendered by various governmental entities, the Amicus asserts that the Residential JUA was created as a private association to engage in the active trade or business of selling homeowners insurance. This result is founded upon the language of the Residential JUA's enabling legislation, as well as past state and federal governmental treatment of the Residential JUA.

The parties and the Amicus are before this Court seeking a favorable ruling as part of the process by which the Residential JUA may secure funding from banking institutions for catastrophic claims. Without the ability to borrow, the Residential JUA cannot pay claims in the event of a catastrophe, including claims for alternative living expenses. The effect on Florida's citizenry in such an event would tear at the very fabric of society.

DISCUSSION

I. The 1994 amendment to the Florida Constitution which limits the ability of the state to increase revenues does not apply to the Residential JUA's ability to fund claims and expenses.

In 1994, the citizenry of Florida passed an amendment to its Constitution, which reads in pertinent part:

> (e) Except as provided herein, **state revenues collected for any fiscal year shall be limited to state revenues allowed under this subsection** for the prior fiscal year plus an adjustment for growth.... For purposes of this subsection, "state revenues" means taxes, fees, licenses, and charges for services imposed by the legislature on individuals, businesses, or agencies outside state government.... (Emphasis added.)

Residential JUA Enabling Legislation

The issue to be disposed of in the instant case is uncomplicated: **whether funds owned by or owed to the Residential JUA have the character of state funds or revenues**. The briefs filed by the parties to this case concur that the Residential JUA has "state revenues" only if this Court holds that the Residential JUA is a "state instrumentality" of some sort; to wit, an agency, board, commission or other governmental body.

Since its origin in 1992, the Residential JUA's enabling legislation has contained substantially the following language:

> The Residential Property and Casualty Joint Underwriting Association is **not** a state agency, board, or commission[1].... (Emphasis added)

Concurring Opinions - JUA Status

The parties point out the numerous governmental entities which have reviewed this question for various purposes. Every governmental entity has uniformly determined that the Residential JUA is in fact **not** such a state instrumentality. In short, these officials are:

1. The Comptroller, which determined that the revenues and expenses of the Residential JUA need not be included in the financial statements of the State of Florida, on the ground that Residential JUA funds are not state revenues;

2. The Auditor General, which determined that the operations of the Residential JUA need not be audited by state auditors, inasmuch as the Residential JUA was not a state instrumentality;

3. The Department of Revenue, which has preliminarily determined that the Residential JUA may be liable for municipal premium taxes inasmuch as it was not exempt as

[1] §627.351(6)(j), FS

a state instrumentality from taxpayer status;

4. The Attorney General, which has issued an opinion that the Residential JUA is not a state instrumentality and does not possess state revenues; and

5. The Commissioner of Insurance, whose position on this issue is well-stated in his brief in the instant case.

Although each of the foregoing was examining the issue for different purposes, (and at different times), the concurrence among them is startling.

In addition, the Residential JUA sought (unsuccessfully) an exemption from federal income tax by filing a request for private letter ruling with the Internal Revenue Service. In the fall of 1993, a conference was held in consideration of this ruling request, in which the Service advised that it considered direct issuers of insurance coverage to be inherently private in their operations and subject to taxation. Furthermore, the Service also advised that the request would be denied on separate grounds if it were determined that state revenues were not used to support the operation. The request was subsequently withdrawn, due to the prohibition in Florida's Constitution against the use of state revenues to support private obligations[2].

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[2] Article VII, Section 10. Pledging credit.--Neither the state nor any county, school district, municipality, special district, or agency of any of them, shall become a joint owner with, or stockholder of, or give, lend or use its taxing power or credit to aid any corporation, association, partnership or person; but this shall not prohibit laws authorizing:

(a) the investment of public trust funds;

Residential JUA's Income and the 1994 Constitutional Amendment

The impetus for the 1994 Constitutional amendment was abundantly clear: the citizenry sought to control the growth of government by limiting its funding.

The premium income relative to property insurance in Florida has remained fairly constant over the past few years, and is expected to change concurrent with the expansion of the housing stock, implementation of rate increases, and other market factors.[3] It cannot be successfully argued that the 1994 Constitutional Amendment has in any way affected the rate-making methods or procedures developed under the Insurance Code -- the *premium* income of the Residential JUA will remain tied to policy number, expenses, claims and other factors just as it always has.[4] There simply is **no nexus** between the growth of personal income in Florida and the rate increases which may be granted to the Residential JUA or to any other homeowners insurance

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(b) the investment of other public funds in obligations of, or insured by, the United States or any of its instrumentalities;

(c) the issuance and sale by any county, municipality, special district or other local governmental body of (1) revenue bonds to finance or refinance the cost of capital projects for airports or port facilities, or (2) revenue bonds to finance or refinance the cost of capital projects for industrial or manufacturing plants to the extent that the interest thereon is exempt from income taxes under the then existing laws of the United States, when, in either case, the revenue bonds are payable solely from revenue derived from the sale, operation or leasing of the projects. If any project so financed, or any part thereof, is occupied or operated by any private corporation, association, partnership or person pursuant to contract or lease with the issuing body, the property interest created by such contract or lease shall be subject to taxation to the same extent as other privately owned property.

(d) a municipality, county, special district, or agency of any of them, being a joint owner of, giving, or lending or using its taxing power or credit for the joint ownership, construction and operation of electrical energy generating or transmission facilities with any corporation, association, partnership or person.

[3] Annual Report of the Department 1993, p. 138; Annual Report of the Department 1994, p. 194.

[4] See §627.062(2)(b), FS; the Department shall review a rate filing for actuarial soundness by reference to such factors as expenses, investment income, loss reserves, reinsurance expenses, and other factors.

company in this state.[5]

If *premium* income in the Residential JUA is controlled by the growth of the association's writings and the rate increases granted to it by the Department, what other revenues might be subject to the constitutional limitation? Apart from *premiums*, the Residential JUA receives income from investment of its cash on hand; sale of its manuals to agents; and other incidental income. No one can responsibly argue that the 1994 Constitutional Amendment limits the amount of *investment income* the Residential JUA may legally accrue.

This case concerns only one type of income which may accrue to the Residential JUA: *assessment income*. The Residential JUA is attempting to secure commitments from lenders which will allow it to access a billion or more of ready cash in the event of a catastrophe to pay claims, and these lenders are diligently seeking assurance that the flow of funds under Residential JUA assessment notices to insurers and policyholders will not be subjected to uncertainty on the basis of the 1994 Constitutional Amendment.

It is not clear that payment of an assessment notice to the Residential JUA gives rise to *income*. The Residential JUA is, by force of law, an association rather than a partnership, corporation, or other form of business entity. In Florida, such entities are regarded a creatures

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[5] The Residential JUA has market-driven growth patterns which the Legislature specifically recognized in the 1995 Regular Session. The provision of standard homeowners insurance for residences has never been a state function anywhere in the United States until the Residential JUA was formed in 1992. The structure of the Florida economy is such that no state entitlement program could replace the certificate of insurance with respect to mortgage lenders, builders, and others whose economic concerns are affected by the residential housing market. In other words, if Florida had experienced a crisis in health insurance, it would have been *possible* to open government-operated clinics and deliver medical care directly to sick and injured citizens. However, as to homeowners insurance, only a traditional, *private* delivery structure could accomplish the critical public purpose of averting failure to insure a third of Florida's residences.

of contract, obligating the members in several, but not joint liability.[6] While the association form of doing is business requires an act of the Legislature[7], other such entities are similarly private in character *even when engaged in matters of grave public concern.*[8] Furthermore, the public concerns of a non-profit corporation may be laudable, but that alone will not cause the organization to "take root" in the state's organizational chart.

This funding source may later be determined (at least for some purposes) to constitute a contribution to capital, rather than a receivable -- bearing in mind that all members of this association are severally liable to its policyholders to pay claims. The manner in which that liability is apportioned is provided for in the Residential JUA's enabling legislation, but the legal result of several liability remains unchanged. *Note that contribution to capital character is virtually impossible to attain for a transfer from a private person to a government operation.* While the government accepts gifts and bequests, and absorbs abandoned property, transfers to it which are compulsory in nature do not have the character of "contributions to capital". By contrast, the Florida Partnership Act and the Florida Corporations Code both provide ample mechanisms by which an entity may obligate a person to transfer consideration to it at a later time.[9] The Residential JUA may be able to take the position that assessment funds are not income on a federal income tax return filing or elsewhere because *the Residential JUA is a*

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[6] Sult v. Gilbert, 3 So.2d 729 (1941 Fla.), 7 C.J.S. Associations §1 et seq.

[7] Section 620.585(2), FS. A group of persons engaging in a trade or business, without an effort to incorporate, etc., would generally be regarded as having formed a general partnership. However, if the Legislature authorizes the formation of an association, these acts do not change the character of the entity.

[8] See, e.g., the Comptroller's determination as the Florida Windstorm Underwriting Association and Florida Property and Casualty Joint Underwriting Association, as to the status of these organizations under GASB 14.

[9] See e.g., subscription agreements; §607.0620. FS; shareholders' preemptive rights, §607.0630, FS; restrictions on transferability of shares, §607.0627, FS.

private organization, and the contractual or statutory obligations of its members, enforced against each by all, do ***not*** *have the force and effect of a government act*[10].

The Legislature which convened for the 1995 Regular Session was well aware of the 1994 Constitutional Amendment, and yet acted in great detail to modify the potential revenue sources of the Residential JUA. A new requirement was added that the Board seek reinsurance coverage where such coverage is available at a reasonable cost[11]. A limitation on the assessments on insurers was retained, and new language was added to permit insurers to recoup the expenses of assessments through rate increases[12]. While provisions related to bonding were retained, the Legislature also added emergency assessment authority[13], under which every Florida homeowners policyholder would pay a surcharge to reduce Residential JUA deficits or debt. Finally, a generalized provision authorizing borrowings of all types was added[14]. *It is axiomatic that the Legislature's acts are presumed to be constitutional unless no construction can be posited which will save the provision.* Here, there is no question that the Legislature was well aware of the growth of the Residential JUA, and of the enormous capital demands which policyholders would make in the event of a catastrophe.

II. The effect of a finding that the Residential JUA monies are subject to the limitations on state revenues would be disastrous for Florida homeowners and for Florida.

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[10] §627.351(6)(g)1., FS.

[11] §627.351(6)(c)9., FS.

[12] §627.3512, FS.

[13] §627.351(6)(b)3.d., FS.

[14] §627.351(6)(c)3., FS.

The scenario facing the Residential JUA today is this: not enough money to pay catastrophic claims due to an involuntary concentration of catastrophic risk in the association; potential recovery from the Florida Hurricane Catastrophic Fund limited due to the infancy of the Fund; predictions of 13 hurricanes for the 1995 hurricane season now underway; no reinsurance currently in place; no catastrophic reserves due to the huge growth and infancy of the Residential JUA; and insufficient assessment income from direct assessments on insurers. The banking industry is prepared to provide $1.5 billion of this cash immediately in the event of a storm, provided it can be assured that no legal defect will arise in the Residential JUA's ability to assess or impose policy surcharges from which this capital outlay may be repaid. Without this capital source, the policyholders of the Residential JUA will be effectively denied all catastrophic coverage.

In less than three years of operation, the Residential JUA has become the third largest homeowner insurer in the State of Florida. Following Hurricane Andrew, voluntary insurers attempted to quickly reduce claims exposure, leaving homeowners without insurance (at any cost), and thereby destabilizing Florida's very economy. In response to the threatened mass exodus of voluntary market insurers, the state limited the number of policies which could be cancelled by voluntary insurers and created an insurer of last resort, the Residential JUA.

Although depopulation plans are being considered and implemented, the Residential JUA currently insures more than Seven Hundred Thousand (700,000) homeowners in this state. These homeowners are not insured by the Residential JUA through choice, but because no voluntary insurer would issue a homeowners policy. The Residential JUA currently has no surplus or reserves. Each homeowner with a Residential JUA policy depends not on the financial strength

of the Residential JUA to pay claims, but on monies secured from voluntary insurers via assessments. The availability, and advisability, of reinsurance is likewise uncertain. Clearly the **only** solution at the current time is securing a line of credit utilizing the Residential JUA's ability to assess insurers as collateral.

Current Residential JUA expenses exceed income, and the Residential JUA has run a deficit each year since inception. Administrative expenses, adjusting costs and non-catastrophe claims payments currently exceed income. Hence, the Residential JUA would not be able to pay even living expenses for impacted insureds in the event of a catastrophe, absent accessing unearned premium, which is illegal.

A reasonable estimate of probable catastrophic loss is between $1.5 and $2 billion. Florida has not experienced a hurricane of any note since Andrew. Each day that passes the likelihood of a significant hurricane impacting Florida increases. Each day that passes the Residential JUA is less likely to be able to pay claims resulting from a significant hurricane.

The vast majority of Residential JUA insureds are homeowners in our most heavily populated counties. If the Residential JUA cannot, due to a characterization of assessments as "state revenues," access a line of credit, the unwilling Residential JUA insureds **almost certainly** will not get claims paid in the event of a disaster. In an Andrew scenario (which is not unlikely), living expense monies would be required -- **Residential JUA funds are insufficient to pay living expenses in the event of a disaster.** Living expense monies and funds to repair damaged homes would not be available until insurers had been not only assessed, but had paid the assessments. Further damage to homes as a result of untimely claims payments would exacerbate the problem, and would greatly increase the ultimate amount needed to repair damaged homes.

In addition, the entire first year assessment amounts to approximately $250 million, a small portion of the likely Residential JUA liability. The balance of Residential JUA liability would be paid by assessments **collected in future years**[15]. These future assessments are the assets which will be used to secure the proposed line of credit **to assure payment of claims today**. The Cat Fund liability would kick in at about $500 million, and would in any event be only 75% of claims above that amount. In real life then, a $1 billion storm would result in $250 million being paid, plus whatever the Cat Fund reinsurance would provide after $500 million in claims had been incurred. Therefore, $250 million **plus** 25% of remaining claims exposure **would simply not be paid**. An inability to timely pay claims (or perhaps pay claims at all), would result in a citizenry in disarray, with the vast majority unable to secure housing, food, clothing or other basic life necessities.

The image of devastated homes and dazed citizens unable to secure shelter from their insurance company is shocking enough. However, as each day passes without access to capital markets, the reality of destroyed cities, populaces returning to a state of nature, as well as a bankrupt state comes ever closer.

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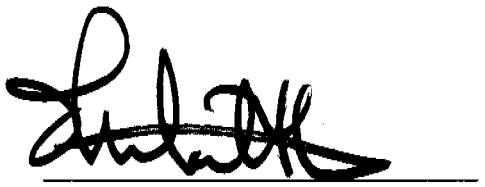
[15] The Bureau of Industry Coordination has requested legal action to collect over 30 unpaid start-up assessments originally imposed in 1993. These assessments were de minimis in amount -- $1000 per company -- and it is expected that deficit assessments in significant amounts would prove more difficult to collect.

CONCLUSION

For the reasons stated herein, the Amicus joins the parties in their respectful submission that this Court should issue an advisory opinion to Governor Chiles that assessments, policy premiums, and policy surcharges owned by or owed to the Residential JUA pursuant to §627.351(6), FS, are not state revenues within the meaning of Article VII, Section 1(e), Florida Constitution.

Respectfully submitted this 5th day of July, 1995.



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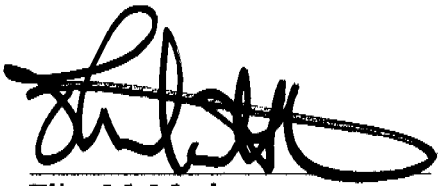
ATTORNEY FOR THE INSURANCE CONSUMER ADVOCATE -- AMICUS

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been provided by U.S. Mail to the Honorable Lawton Chiles, Governor of the State of Florida, The Capital, Tallahassee, Florida 32399 this 5th day of July, 1995.



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