

“The Wrong Side of the Tracks”: Territorial Rating and the Setting of Automobile Liability Insurance Rates in California

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I. Introduction

Territorial rating, or "redlining,"¹ is the practice of setting automobile liability insurance rates according to where a driver lives. Territorial rating causes drivers who live on the wrong side of the actuarial tracks to pay up to 100 percent more for automobile insurance. The financial impact of territorial rating is graphically illustrated by this letter written to Los Angeles County Supervisor Kenneth Hahn in 1984:

Dear Supervisor Hahn:

I recently read an article which you wrote in the local newspaper regarding the high cost of auto insurance in Los Angeles County. . . . As you know most of the companies rate by zip code.²

A small group of residents and business places in North East Torrance have an incorrect address and so we have to pay 40% (almost double) for our auto insurance because the Post Office clas-

1. See *infra* note 106 and accompanying text.

2. As far as the California Department of Insurance has ascertained, every insurer that writes automobile liability insurance in California sets its rates by territory. CALIFORNIA DEPARTMENT OF INSURANCE, RATE REGULATION DIVISION, STUDY OF CALIFORNIA DRIVING PERFORMANCE BY ZIP CODE (Phase 1), at 2 (1978) [hereinafter STUDY OF CALIFORNIA DRIVING PERFORMANCE BY ZIP CODE].

sifies us as Gardena, 90248, which is a much higher rate than if we had the correct address of Torrance, 90504. This is an area approximately five blocks long between Artesia Blvd. and 190th Street on Western Avenue. It is the people on the west side of the street on Western Avenue. . . .

Sincerely yours,
Arlene Gorske³

Territorial rating produces unjust price disparities between neighborhoods—often when they are literally next door to each other.⁴ The financial consequences of these disparities fall most heavily on the racial minorities and poor who inhabit the inner cities of California.⁵ This is graphically illustrated by Ms. Gorske's letter. Zip code 90504 covers part of Torrance, a predominantly white area of Southern California with a total minority population of 40 percent.⁶ In contrast, Gardena, the city located in zip code 90248, had a population that was 90 percent minority in 1990.⁷

Territorial rating as practiced in California violates a basic tenet of equal protection jurisprudence: that "burdens [imposed] should bear some relationship to individual responsibility or wrongdoing."⁸ Territorial rating imposes a substantial economic burden on drivers who choose to, or must, live in low income, predominantly minority, communities. The system has led to an inherently unfair economic result: those residents of urban areas of California with the lowest median income levels are charged the highest rates in the state for automobile insurance.⁹ While there may be some statistical support for these pricing disparities,¹⁰ it is indisputable that the burdens imposed on the poor and racial minorities by territorial rating bear no relationship to individual responsibility.¹¹

Part I of this Article documents the disparate economic impact of territorial rating on African-Americans, Latinos, and the poor in Califor-

3. Data collected by the California Department of Insurance in 1986 reveal that Ms. Gorske's description of the financial consequences of territorial rating on her life was accurate. The average insurance rate for zip code 90248 was \$548.67. For zip code 90504, the average rate was dramatically lower: \$358.67. CALIFORNIA DEPARTMENT OF INSURANCE, CONSUMER AFFAIRS DIVISION, COMPARATIVE PREMIUM SURVEY OF AUTOMOBILE INSURANCE FOR CALIFORNIA (1986) [hereinafter COMPARATIVE PREMIUM SURVEY].

4. *See id.* and accompanying text.

5. *See infra* Part I.

6. WESTERN ECONOMIC RESEARCH CO., UPDATED RACE AND ETHNIC ESTIMATES BY ZIP CODE 6 (1990).

7. *Id.* at 4.

8. Weber v. Aetna Casualty & Sur. Co., 406 U.S. 164, 175 (1972).

9. *See infra* Part I.

10. *See infra* Part IID.

11. *See infra* note 165 and accompanying text.

nia. Part II chronicles the history of the debate and litigation regarding territorial rating, describes the current state of California law on the subject, and outlines the statutes that govern the issue. Part III argues that state approval of territorial rating would violate the California Constitution. Part IV uses an analytical system developed by Professor Leah Wortham to reconcile the insurance industry's need to group risks with the mandates of Proposition 103¹² and the California Constitution.

I. The Disparate Impact of Territorial Rating on People of Color and the Poor

A. The Distribution of Insurance Rates in Los Angeles and the San Francisco Bay Area

In 1986, the California Department of Insurance published a comprehensive study of the financial consequences of territorial rating. That study, entitled "Comparative Premium Survey of Automobile Insurance for California,"¹³ examined liability insurance rates for automobiles using a standard policy type and automobile model.¹⁴ The *Comparative Premium Survey* lists the rates charged by ten major insurers for every county in California, for every zip code in the state.

The *Comparative Premium Survey* documents the distribution of automobile insurance rates. Comparison of the data from the *Comparative Premium Survey* with demographic and economic data compiled by the Census Bureau and other organizations¹⁵ documents the racial and economic impact of that distribution. This comparison reveals that almost

12. Proposition 103 is an initiative measure enacted by California voters in November 1988. It substantially revised the California Insurance Code. *See infra* notes 151-55 and accompanying text.

13. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

14. To conduct the study, the department created a standard driver. That theoretical driver was between the ages of 35 and 55 and married to a spouse of the same age. Both spouses were licensed for over five years, with no citations and no accidents. The standard automobile was a 1981 Buick Century. Policy limits were standardized as much as possible.

The department then collected data from each insurer surveyed about the rate(s) that would be charged for such a driver in each zip code area of the state. The average rate figures used throughout this Article are a composite of the rates charged by three major insurers doing business in the areas of the state discussed. The Southern California rates are a composite of the rates charged by State Farm, Farmers, and Allstate. For Northern California, the averages represent the rates charged by State Farm, Farmers, and either GEICO (Government Employees Insurance Company) or Allstate. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

15. The census data used throughout this Article are drawn from the publication, UPDATED RACE AND ETHNIC ESTIMATES BY ZIP CODE, *supra* note 6. The introduction to this publication explains that the data are an updated version of the statistics from the 1980 census. The updated data are created using a combination of census data, proprietary files, and Census Bureau state and county population estimates.

invariably,¹⁶ residents of areas of the Los Angeles Basin and San Francisco Bay Area that are identifiably African-American, Latino, Asian, and/or poor pay the highest rates for automobile insurance in California.¹⁷

1. *The Racial Impact of Territorial Rating.*

A hypothetical driver living in zip code 90220 in Compton paid an average premium of \$791.25 for liability insurance in 1986.¹⁸ If that same driver could afford to, or chose to live in zip code 90501 in Torrance, or zip code 90277 in Redondo Beach, predominantly Anglo communities located just 10 miles away from Compton, the driver would have paid an average premium of \$345.50.¹⁹ The racial impact of this price disparity is clear. The minority population of Compton, as of 1990, was 109%.²⁰ People of color comprise 47% of the populace of the area of Torrance covered by zip code 90501,²¹ while they make up only 16% of the population of Redondo Beach.²²

16. Those metropolitan areas with the lowest aggregate income levels were the highest rated territories in the Los Angeles Basin and the San Francisco Bay Area. The notable exception is the highest rated territory in California—Beverly Hills. In the Comparative Premium Survey, the average rate in zip codes 90211 and 90212, both located in Beverly Hills, was \$995.00. This result makes economic sense, given that those zip code areas in Beverly Hills have very high income levels. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

17. This result is not limited to California. A study done by the New Jersey Department of Insurance found that base rates there varied inversely with the gross income of the territory. While the report concluded that a case for a pattern of racial discrimination had not been made out, it acknowledged "the possibility of territorial boundaries doing the work of suspect or unlawful criteria" NEW JERSEY DEPARTMENT OF INSURANCE, HEARING ON AUTOMOBILE INSURANCE CLASSIFICATIONS AND RELATED METHODOLOGIES: FINAL DETERMINATION—MAJOR FINDINGS AND CONCLUSIONS, at 45 (1981).

18. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

19. *Id.*

20. The figures for zip code 90220 were:

Black - 72.43%
 Latino - 33.62%
 Asian - 2.98%

UPDATED RACE AND ETHNIC ESTIMATES BY ZIP CODE, *supra* note 6, at 4.

The numbers add up to more than 100% because of overlaps between Asian, Black, and Hispanic residents. The introduction to UPDATED RACE AND ETHNIC ESTIMATES BY ZIP CODE 1990 explains the reason for the statistical result: "[b]y a census definition, persons of a Hispanic origin can be of any race."

21. The 1990 population statistics for zip code 90501 in Torrance were:

Black - 3.18%
 Latino - 30.25%
 Asian - 14.48%

Id. at 6.

22. The minority population statistics for Redondo Beach, zip code 90277, in 1990 were:

Similar rate disparities affect Inglewood, another predominantly Black and Latino area of Los Angeles County. The Insurance Department Study's hypothetical driver, living in Inglewood, would have paid an average premium of \$703.00.²³ If that driver moved to El Segundo or Manhattan Beach, predominantly Anglo communities located adjacent to Inglewood, the driver's average premium cost would plunge to \$345.00.²⁴ Again, the racial impact of the disparity in rates is indisputable. Inglewood's population was 102% people of color.²⁵ Racial minorities made up a mere 11% of the population of El Segundo in 1990²⁶ and they comprised 10% of the population of Manhattan Beach in 1990.²⁷

A similar pattern of distribution of significant insurance rate disparities exists in the San Francisco Bay Area. The *Comparative Premium Survey* shows that the hypothetical driver residing in Oakland in 1986 paid an average liability premium of \$409.00.²⁸ If that same driver moved to Alameda, a community located just across a bridge from Oakland, the driver's average premium cost would have dropped to \$235.67 for the same coverage.²⁹ The contrast in the racial data for these communities is, again, striking. The racial make up of zip code 94601 in

Black - 2.04%
 Latino - 8.48%
 Asian - 5.76%

Id. at 5.

23. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

24. *Id.*

25. A representative Inglewood zip code area with those rates is 90301. Its population, as of 1990, was:

Black - 50.22%
 Latino - 47.08%
 Asian - 4.26%

UPDATED RACE AND ETHNIC ESTIMATES BY ZIP CODE, *supra* note 6, at 5.

26. For El Segundo, zip code 90245, the population statistics in 1990 were:

Black - 0.74%
 Latino - 7.41%
 Asian - 3.09%

Id. at 4.

27. For Manhattan Beach, zip code 90266, the population statistics for 1990 were:

Black - 0.83%
 Latino - 4.51%
 Asian - 4.22%

Id. at 5.

28. COMPARATIVE PREMIUM SURVEY, *supra* note 3. This figure represents the average of rates charged by Allstate, Farmers, and State Farm. The COMPARATIVE PREMIUM SURVEY has no data for the Automobile Club in the Northern California communities covered in this Article.

29. *Id.*

Oakland in 1990 was 96% minority.³⁰ The racial make up of Alameda, zip code 94501, was only 33% minority.³¹

The city of Berkeley, California, presents a telling case study of the correlation between insurance rate disparity and racial composition. Zip codes 94702 and 94710 had the highest rates in Berkeley—the Insurance Department’s hypothetical driver paying an average rate of \$409.00.³² Move into zip codes 94705 or 94708 in Berkeley, and the average rate dropped to \$240.00.³³ The minority populace of zip code 94702 in Berkeley in 1990 was 69%,³⁴ and 77% for zip code 94710.³⁵ The figures for zip code 94705 in 1990 show a minority population of 23%,³⁶ while minorities comprised only 16% of the population of zip code 94708.³⁷

30. The 1990 figures for that zip code were:

Black - 48.63%
Latino - 39.16%
Asian - 8.59%

UPDATED RACE AND ETHNIC ESTIMATES BY ZIP CODE, *supra* note 6, at 55.

31. The 1990 census figures for Alameda:

Black - 5.93%
Latino - 9.41%
Asian - 17.25%

Id. at 52.

32. This average was paid for coverage with Allstate, State Farm, and Farmers Insurance. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

33. The rates quoted are attributed to Allstate and State Farm respectively. Farmers’ rate is not included because it is listed as having a “split rate, with no price quoted,” for these zip code areas. *Id.*

34. The figures in 1990:

Black - 45.36%
Latino - 7.04%
Asian - 15.37%

UPDATED RACE AND ETHNIC ESTIMATES BY ZIP CODES, *supra* note 6, at 56.

35. The figures for the 1990 minority population were:

Black - 38.12%
Latino - 20.96%
Asian - 17.44%

Id. at 56.

36. For zip code 94705, the minority population figures for 1990 were:

Black - 7.14%
Latino - 4.47%
Asian - 14.12%

Id.

37. For zip code 94708, the population figures were:

Black - 2.87%
Latino - 3.52%
Asian - 9.91%

Id.

The *Comparative Premium Survey* examined rates in 1986. A more recent study conducted by the Department of Insurance confirmed that insurers continue to charge the highest automobile insurance rates to neighborhoods in Los Angeles County that are identifiably African-American or Latino.³⁸ The lowest rated areas in California are rural communities where the presence of African-Americans and Asians is negligible, which enhances the discriminatory effect of territorial rating.³⁹

2. *The Future Racial Impact of Territorial Rating*

Territorial rating will continue to adversely affect people of color, due to the persistent nature of segregated housing in the United States. In 1944, Gunnar Myrdal, in his landmark study of African-Americans, noted that housing segregation was a major problem in the North and the South.⁴⁰ Myrdal identified four primary factors that led to residential segregation: the poverty of African-Americans, which consigned them to the cheapest housing accommodations; ethnic attachment;⁴¹ segregation enforced by white people; and segregation enforced by the poli-

38. A second study of territorial pricing conducted by the California Department of Insurance was published in June 1990. The AUTOMOBILE PREMIUM SURVEY 1990 surveyed the rates charged in different Southern California communities by various insurers. Although not as comprehensive as the 1986 survey, the 1990 study does demonstrate that the pricing pattern identified in 1986 continues today. The AUTOMOBILE PREMIUM SURVEY shows that a driver living in zip code 90220 in Compton, age 35, carrying a liability-only policy, paid an average premium price of \$701.00. That same driver, moving to zip code 90504 in Torrance, would immediately lower his or her premium to \$463.00.

39. Justice Broussard suggested in a concurring opinion that the economic and racial impact of these price disparities becomes even more pronounced as you leave the inner city and move to the suburbs, exurbs, and rural areas. *King v. Meese*, 743 P.2d 889, 902 n.8 (Cal. 1987) (Broussard, J., concurring).

40. Myrdal concluded that housing segregation was more important in the North than in the South, however, since the South had laws enforcing racial separation while the North had practically no such laws. 2 GUNNAR MYRDAL, *AN AMERICAN DILEMMA: THE NEGRO PROBLEM AND MODERN DEMOCRACY* 618 (Pantheon Books 1972) (1944).

41. Myrdal uses the term "ethnic attachment" to describe the tendency of immigrant groups to cluster together in colonies in the poorer sections of northern cities. He states that all national groups of immigrants, for reasons of economy and ethnic cohesion, formed such colonies upon arrival. *Id.* at 620. For Myrdal, African-Americans who migrated North were an immigrant group that followed this pattern. He concluded that African-Americans formed immigrant "colonies" for convenience and mutual protection. *Id.* at 619.

Myrdal documented one overriding difference between European immigrants and African-American immigrants. For the European immigrant groups, the colonies were not permanent—they dissipated as the immigrants became assimilated and more prosperous. For African-Americans, however, the colonies became permanent, due to economic, educational, and social obstacles, and housing segregation. In Myrdal's own words, "they [African-Americans] are kept as aliens permanently." *Id.* at 620.

cies of the federal government, particularly the FHA.⁴² Myrdal documented white citizens and the federal government enforcing housing segregation by using restrictive covenants, which prohibited the sale of properties in "white areas" to African-Americans and other minorities.⁴³ Private citizens and groups supplemented the restrictive covenants by resorting to extra legal activities ranging from "persuasion" to bombings to discourage African-Americans from moving into "white" neighborhoods.⁴⁴

Myrdal predicted that if the courts declared restrictive covenants illegal, housing segregation, at least in the North, "would be nearly doomed."⁴⁵ Unfortunately, Myrdal's prediction has not come to fruition. In 1948, the United States Supreme Court declared that enforcement of restrictive covenants violated the Fourteenth Amendment.⁴⁶ Yet housing segregation remains a persistent fact of American life.

In 1968, the Kerner Commission was appointed by President Lyndon Johnson to study the causes of the race riots then afflicting the country. The commission identified housing segregation as one major cause of racial unrest.⁴⁷ The Kerner Commission concluded that most black families remained in predominantly black neighborhoods because they were effectively excluded from white residential areas.⁴⁸ Citing a 1965 study of racial housing patterns, the commission noted that the patterns observed in 1944 by Myrdal continued unabated, with a high degree of racial separation present in virtually all American cities.⁴⁹

The commission cited three factors that contributed to the persistence of housing segregation after the elimination of restrictive covenants: threats of violence and actual violence against African-Americans who attempted to move into all-white neighborhoods; real estate agents' refusals to show homes in those areas to African-American customers; and the refusal of whites to move into predominantly black areas.⁵⁰

42. *Id.* at 348-49, 619.

43. *Id.* at 624. In the case of the federal government, Myrdal noted that the FHA instructed lenders and developers operating under its programs to prevent the "infiltration of . . . inharmonious racial groups." In addition, he noted that the FHA advised its property valuers that "effective restrictive covenants . . . provide the surest protection against undesirable encroachment. . . ." *Id.* at 349.

44. *Id.* at 624.

45. *Id.*

46. *Shelley v. Kraemer*, 334 U.S. 1 (1948).

47. ANGUS CAMPBELL & HOWARD SCHUMAN, SUPPLEMENTAL STUDIES FOR THE NATIONAL ADVISORY COMMISSION ON CIVIL DISORDERS 91 (1968).

48. *Id.* at 119.

49. *Id.* at 120-121. The commission relied on a statistical study of residential segregation. KARL AND ALMA TAEUBER, NEGROES IN CITIES (1965).

50. CAMPBELL & SCHUMAN, *supra* note 47, at 120-21.

In 1989 the National Research Council issued a new study of race relations in the United States.⁵¹ This study documents the present day persistence of residential segregation. The study concluded that whites hold three attitudes that help to explain the persistence of segregated housing. First, they believe that stable interracial neighborhoods are rare; once a few African-Americans move in, the neighborhood is bound to become predominantly black. Second, whites believe that property values will be lowered by the presence of blacks. Third, whites believe that crime rates are higher in black neighborhoods. As a result of these attitudes, 25% of white people surveyed in one study indicated that they would be uncomfortable if blacks composed 7% of the population in an area, while 40% said they would be uncomfortable if 20% of the neighborhood was composed of black residents.⁵²

Two social scientists, Douglas Massey and Nancy Denton, recently published a detailed study of segregated housing patterns in major cities in the United States. Denton and Massey coined the term "hypersegregation" to connote the fact that the isolation of African-Americans in identifiable racial enclaves within large urban centers of the United States is actually increasing.⁵³ Denton and Massey, using five categories or dimensions to define segregation, concluded that Los Angeles is one of the most segregated urban areas in the nation for both African-Americans and Hispanics.⁵⁴

3. *The Economic Impact of Territorial Rating.*

Comparison of the automobile liability rates documented in the *Comparative Premium Survey* with economic data compiled by the Census Bureau and other organizations⁵⁵ demonstrates that territorial rating also has an adverse impact upon the urban poor.

Consider the areas compared in the discussion of the racial impact of redlining. The median household income in Compton, zip code 90220, was \$26,224.00 in 1990.⁵⁶ Compton residents paid an average premium

51. See NATIONAL RESEARCH COUNCIL, A COMMON DESTINY: BLACKS AND AMERICAN SOCIETY (1989).

52. *Id.* at 141.

53. Douglas Massey & Nancy Denton, *Hypersegregation in U.S. Metropolitan Areas: Black and Hispanic Segregation Along Five Dimensions*, 26 DEMOGRAPHY 373 (1989).

54. *Id.* at 377, 384. The San Francisco Bay Area was classified as moderately segregated for African-Americans. *Id.* at 377-78.

55. The median income data used in this article are drawn from WESTERN ECONOMIC RESEARCH, CO., ANNUAL DEMOGRAPHIC ESTIMATES BY ZIP CODES (1991), which contains income estimates for the year 1990.

56. ANNUAL DEMOGRAPHIC ESTIMATES, *supra* note 55, at 4.

of \$791.25 for liability insurance.⁵⁷ The median income in Torrance, zip code 90501, was \$31,448.00,⁵⁸ while the median income in Redondo Beach, zip code 90277, was \$42,427.00.⁵⁹ The average liability insurance premium charged in those communities was \$345.00,⁶⁰ less than one half the rate charged in Compton.

For Inglewood, zip code 90301, the average premium was \$745.00.⁶¹ The median income for that community was \$25,720.00.⁶² In nearby El Segundo, zip code 90245, the median household income was \$41,763.00,⁶³ while the median income in Manhattan Beach, zip code 90266, was \$58,403.00.⁶⁴ Both communities paid an average liability insurance premium of \$345.00,⁶⁵ less than half the rate paid by Inglewood residents.

The inverse relationship between income and automobile liability insurance premium rates exists in urban Northern California as well. In a representative Oakland neighborhood, zip code 94601, the average liability premium was \$409.00.⁶⁶ The median household income in that community was \$21,681.00.⁶⁷ In Alameda, zip code 94501, the community across the bridge from Oakland, the average liability rate dropped to \$235.67⁶⁸ while the median household income rose to \$33,927.00.⁶⁹

The residents of the highest rated territories in Berkeley, zip codes 94702 and 94710, paid an average premium of \$409.00.⁷⁰ Those communities had median incomes of \$23,014.00 and \$20,606.00 respectively.⁷¹ Residents of the lowest rated territories in Berkeley, zip codes 94705 and 94708, paid \$240.00 for the same coverage.⁷² The median incomes in those areas were \$37,742.00 and \$66,528.00 respectively.⁷³

The inverse relation between automobile liability insurance rates and wealth is more pronounced than the preceding comparisons suggest.

57. COMPARATIVE PREMIUM SURVEY, *supra*, note 3.

58. ANNUAL DEMOGRAPHIC ESTIMATES, *supra* note 55, at 6.

59. *Id.* at 5.

60. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

61. *Id.*

62. ANNUAL DEMOGRAPHIC ESTIMATES, *supra* note 55, at 5.

63. *Id.* at 4.

64. *Id.* at 5.

65. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

66. *Id.*

67. ANNUAL DEMOGRAPHIC ESTIMATES, *supra* note 55, at 55.

68. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

69. ANNUAL DEMOGRAPHIC ESTIMATES, *supra* note 55, at 54.

70. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

71. ANNUAL DEMOGRAPHIC ESTIMATES, *supra* note 55, at 56.

72. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

73. ANNUAL DEMOGRAPHIC ESTIMATES, *supra* note 55, at 56.

Significantly lower automobile liability insurance rates are charged in some of the wealthiest communities in urban California. In Southern California, the median household income was \$65,646.00 in zip code 91105, a neighborhood in Pasadena.⁷⁴ The average liability insurance rate charged in that community was \$358.00.⁷⁵ In Palos Verdes, zip code 90274, where the median household income was \$75,000.01,⁷⁶ the average liability rate charged was \$358.67.⁷⁷ And in Playa Del Rey, zip code 90292, where the median household income was \$56,567.00,⁷⁸ the average automobile liability insurance rate was \$372.33.⁷⁹

In Northern California, even lower prices prevailed in some of that region's wealthiest communities. In Fremont, a community located south of Oakland, the median household income in zip code 94539 was \$56,344.00 in 1990.⁸⁰ The average automobile liability insurance rate charged in that community was \$230.66.⁸¹ In San Francisco, the average liability rate charged in zip code 94127 was a mere \$286.00,⁸² while the median income was \$60,737.00.⁸³ And in zip code area 94707 in Berkeley, the average liability insurance rate was \$269.33.⁸⁴ The residents of that community had a median income of \$60,000.00.⁸⁵

4. *The Future Economic Impact of Territorial Rating.*

These comparisons illustrate the inverse correlation between the wealth of neighborhoods and the liability insurance rates charged in urban California communities. The persistence of housing segregation, cou-

74. ANNUAL DEMOGRAPHIC ESTIMATES, *supra* note 55, at 10.

75. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

76. ANNUAL DEMOGRAPHIC ESTIMATES, *supra* note 55, at 5.

77. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

78. ANNUAL DEMOGRAPHIC ESTIMATES, *supra* note 55, at 5.

79. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

80. ANNUAL DEMOGRAPHIC ESTIMATES, *supra* note 55, at 53.

81. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

82. *Id.*

83. ANNUAL DEMOGRAPHIC ESTIMATES, *supra* note 55, at 48.

84. COMPARATIVE PREMIUM SURVEY, *supra* note 3.

85. ANNUAL DEMOGRAPHIC ESTIMATES, *supra* note 55, at 56. The information presented here is anecdotal. An insurance rating study conducted by the Stanford Research Institute (SRI) and funded by the insurance industry, however, acknowledged the existence of an inverse relationship between wealth and rates. The SRI study examined the relationship of wealth and rates in Illinois using data supplied by Allstate Insurance Company. The researchers discovered that disposable income is the highest on the average in medium rated territories, and drops significantly for the lowest rated territories (rural areas) and the highest rated territories (inner city areas). BARBARA CASEY, JACQUES PEZIER, AND CARL SPETZLER, *THE ROLE OF RISK CLASSIFICATIONS IN PROPERTY AND CASUALTY INSURANCE: A STUDY OF THE RISK ASSESSMENT PROCESS* (1976), at 97 (emphasis added). The SRI study, while bemoaning the lack of data available on the relationship of income to premiums, concluded that the available data "seem to suggest . . . a negative correlation." *Id.* at 96.

pled with the economic conditions that afflict people of color, guarantee that the burdens of territorial rating will always fall most heavily on the urban poor of California.

Housing segregation guarantees that most African-Americans will continue to live in areas of the state predominantly populated by blacks.⁸⁶ It is no surprise that these areas have significantly lower median income levels, since poverty and race have always been closely intertwined. In 1944, Gunnar Myrdal identified two causes of this relationship:

Nonagricultural Negro workers are, for the most part, either in low paid service occupations or have menial tasks in industry. Few are skilled workers. . . . The majority of manufacturing industries do not give jobs to Negroes. Neither in the South nor in the North are Negroes in professional, business or clerical positions, except in rare instances and except when serving exclusively the Negro public. . . . The unemployment risk of Negroes is extraordinarily high.⁸⁷

The concentration of African-Americans in low paid occupations and the unemployment lines has been a consistent characteristic of American society. The Kerner Commission concluded that the economic inequality identified by Myrdal in 1944 was extant in 1968.⁸⁸ The commission cited three factors responsible for the dismal economic status of African-Americans. Two of those factors were the problems identified by Myrdal—high unemployment⁸⁹ and the continued concentration of working African-Americans in the lowest levels of employment.⁹⁰ In ad-

86. See *supra* notes 40-54, and accompanying text.

87. MYRDAL, *supra* note 40, at 206. The high rate of unemployment risk was not surprising. Myrdal noted that economic progress generally worked against the economic interests of African-Americans:

When modern techniques transform old handicrafts into machine production, Negroes lose jobs in the former but usually do not get into the new factories, at least not at the machines. . . . When work becomes less heavy, less dirty, or less risky, Negroes are displaced.

Id.

88. CAMPBELL AND SCHUMAN, *supra* note 47, at 91-92. The commission cited economic deprivation as a prime cause of the racial unrest then buffeting the nation. *Id.*

89. The Kerner Commission noted that even in a good economic climate, the rate of African-American unemployment was double the rate of white unemployment in every category. *Id.*

90. The Commission observed that:

Negro workers are concentrated in the lowest skilled and lowest paying occupations. Those jobs often involve substandard wages, great instability and uncertainty of tenure, extremely low status in the eyes of both employer and employee, little or no chance for meaningful advancement, and unpleasant or exhausting duties. Negro men in particular are more than three times as likely as whites to be in unskilled or service jobs which pay far less than most[.]

dition to these impediments, the Kerner Commission identified a third factor responsible for the poor economic standing of African-Americans—chronic underemployment.⁹¹

While some African-Americans made significant educational and economic progress during the sixties, seventies, and eighties, most blacks remain trapped in the conditions described by Myrdal and the Kerner Commission.⁹² This is how one author described the situation in 1987:

a racial division of labor has been created due to decades, even centuries, of discrimination and prejudice [B]ecause those in the low wage sector of the economy are more adversely affected by impersonal shifts in advanced industrial society, the racial division of labor is reinforced. . . . [B]lacks have been severely hurt by deindustrialization because of their heavy concentration in the automobile, rubber, steel and other smokestack industries.⁹³

The coalescence of economic deprivation and housing segregation has created a self perpetuating cycle of poverty for poor African-Americans. In 1944, Myrdal theorized that poverty breeds the conditions that perpetuate poverty. He then observed that it is more difficult for African-Americans to escape this cycle of poverty because “in the case of Negroes, the deprecation (of poverty) is fortified by the elaborate system of racial beliefs”⁹⁴

Forty-five years later, the authors of *A Common Destiny* described the present operation of that cycle for African-Americans:

[P]oor blacks, to a much greater degree than poor whites, interact mainly with other disadvantaged people. Black poor children attend schools with other poor children, go to churches with improv-

Id. at 124.

91. Even among those urban African-Americans who were working, the Commission found that a high proportion were “underemployed.” “Underemployed” was defined to include part-time workers who were seeking full-time employment, full-time workers earning less than \$3,000 per year, and those who had dropped out of the labor force. The Labor Department estimated that the rate of “underemployment” was 2.5 times the rate of unemployment in urban ghettos. *Id.* at 126.

92. DOUGLAS GLASGOW, *THE BLACK UNDERCLASS* 5-6 (Vintage Books edition 1981) (1980). The National Research Council noted that black men with some college education earned 80-85% as much as their white counterparts. On the other end of the scale, black men who did not finish high school were victims of the stagnant economy of the seventies. Many of these men have dropped out of the labor force. *A COMMON DESTINY*, *supra* note 51, at 275.

93. WILLIAM WILSON, *THE TRULY DISADVANTAGED: THE INNER CITY, THE UNDERCLASS, AND PUBLIC POLICY* 12 (1987). Statistical studies conducted by the National Research Council for its 1990 report confirm Wilson’s observation. Analysis of employment data revealed that disproportionate numbers of African-Americans are employed in low wage jobs. The council concluded that workers holding such jobs remain more vulnerable to periods of temporary or permanent unemployment. *A COMMON DESTINY*, *supra* note 51, at 283, 294, 296.

94. MYRDAL, *supra* note 40, at 208-209.

erished congregations, and deal with merchants geared to do business with a poor clientele. *Racial segregation in residence reinforces the effects of economic separation.*⁹⁵

While some African-Americans have escaped this cycle of failure,⁹⁶ the majority have not. Those who remain are trapped in inner-city neighborhoods⁹⁷ where territorial rating allows insurers to charge the highest rates in the state.⁹⁸ Since the concentration of African-Americans in enclaves of poverty in California is increasing,⁹⁹ territorial rating will continue to impose the highest automobile insurance rates upon the state's poorest urban residents.¹⁰⁰

95. A COMMON DESTINY, *supra* note 51, at 283-84 (emphasis added).

96. The result of this confluence of poverty and segregation was deftly summarized by the Kerner Commission in 1967:

For residents of disadvantaged Negro neighborhoods, obtaining good jobs is vastly more difficult than for most workers in society. For decades, social, economic, and psychological disadvantages surrounding the urban Negro poor have impaired their work capacities and opportunities. The result is a cycle of failure—the unemployment disabilities of one generation breed those of the next.

CAMPBELL & SCHUMAN, *supra* note 47, at 124.

Even those African-Americans who have “escaped” from this cycle of failure have not achieved economic equality. In 1978 the Kerner Commission found that, given similar employment, African-American workers with the same level of education earned less than white workers. *Id.* at 126. Although the degree of separation has since narrowed for college-educated African-Americans, college-educated Black males still earn only 85% as much as their white counterparts. A COMMON DESTINY, *supra* note 51, at 275.

97. The National Research Council concluded that poor blacks are more likely than poor whites to live in central cities and in neighborhoods where a high proportion of residents are poor. A COMMON DESTINY, *supra* note 51, at 283.

98. See *supra* notes 17-39 and accompanying text.

99. See *supra* notes 111-12 and accompanying text.

100. Similar conditions affect the Latino population in California. While the connection between race and poverty is not as strong for Hispanics and Latinos, there is in fact a connection. Like African-Americans, California Latinos are concentrated in jobs at the low end of the economic scale. LOUIE WOOLBRIGHT AND DAVID HARTMANN, *THE NEW SEGREGATION: ASIANS AND HISPANICS, IN DIVIDED NEIGHBORHOODS* 146 (Gary Tobin ed., 1987); Roberto Suro, *Without A Ladder: The Mexican Immigrants*, NEW YORK TIMES, Jan. 19, 1992, section 1, at 1 (part 1). As a result, California Latinos, like African-Americans, are more vulnerable to the economic shift from manufacturing jobs to lower paying service industry jobs which is occurring in the United States. *Id.*, John Hendren and Louise Palmer, *1 Million Latino Children Entered Poverty in the 1980s, Study Says*, STATES NEWS SERVICE, August 27, 1991, available in Lexis, Nexis Library. Given the higher unemployment and lower wage levels which have resulted from that shift, the median income level among Mexican-Americans actually decreased during the eighties. In Los Angeles, 16.7% of Mexican-American families lived below the poverty level in 1969. In 1990, 28% were living below that line. Gloria Romero, *Perspective on the Chicano Uprising*, LOS ANGELES TIMES, August 31, 1990, at B7.

B. The Contribution of Financial Responsibility Laws to the Problems Caused by Redlining

The racial and financial impact of the territorial rating system is aggravated by the continuing trend in the states toward enactment of financial responsibility laws.¹⁰¹ California drivers are legally required to carry some form of automobile liability insurance. Because of this requirement, the contention that drivers who do not like, or cannot afford, the high premiums charged in inner cities can and should opt out of the insurance system, is becoming moot.¹⁰²

California's financial responsibility laws require virtually all drivers to carry liability insurance. California Vehicle Code section 16020 requires every driver to maintain in force some form of financial responsibility and to carry evidence of the form of that financial responsibility in the automobile. Vehicle Code section 16021 defines three forms of financial responsibility: a certificate of self-insurance, purchase of automobile liability insurance or a bond, or a deposit of \$50,000 with the Department of Motor Vehicles. The "alternatives" to the purchase of automobile liability insurance are illusory. Vehicle Code section 16053, which mentions the certificate of self-insurance, applies to fleet owners operating more than twenty-five vehicles. It is patently obvious that a person who cannot afford to pay the several hundred dollars required for minimum liability insurance will not be able to deposit the aggregate amount of \$50,000 with the Department of Motor Vehicles that section 16054.2(a) requires.¹⁰³

The state enforces these financial responsibility laws through an accident reporting requirement. Any time a driver is involved in an automobile accident, he or she must provide proof of financial responsibility. If the driver fails to produce the required proof, his or her driver's license may be suspended.¹⁰⁴

101. As of 1979, 25 states had some form of financial responsibility law. U.S. GENERAL ACCOUNTING OFFICE, ISSUES AND NEEDED IMPROVEMENTS IN STATE REGULATION OF THE INSURANCE BUSINESS 75 (1979). In 1982, that number rose to 32. *Compulsory Auto Insurance: How Well Does It Work?*, 1982 J. OF AM. INS. at 20. By 1990, 41 states had some form of mandatory liability insurance law. Clifford Meacham & Wayne Andersen, *Illinois' Mandatory Insurance Law*, 78 ILL. B.J. 298 (1990).

102. See, e.g., Kenneth S. Abraham, *Efficiency and Risk in Insurance Risk Classification*, 71 VA. L. REV. 403, 407 (1985).

103. CAL. VEH. CODE §§ 16021(d), 16054.2 (a), 16056, 16435.

104. *Id.* §§ 16000, 16000.1, 16070, 16430. The Legislature, dissatisfied with the efficacy of the accident reporting requirement, added a new enforcement mechanism in 1985. Vehicle Code § 16028 allowed any peace officer to demand proof of financial responsibility whenever a ticket was issued in connection with a moving violation. If the driver failed to produce proof of financial responsibility, she or he committed an infraction. If the driver in fact was not insured or otherwise financially responsible, she or he was subject to a substantial fine, and had

The existence of California's financial responsibility laws means that the purchase of liability insurance is not optional—each person who drives in California must carry liability insurance or risk losing the driving privilege (unless the person is extremely wealthy). The fact that drivers cannot legally opt out of the system, coupled with the fact that all insurers in California utilize territorial rating,¹⁰⁵ means that drivers living in redlined territories must pay the high rates charged in their communities or risk losing their driving privileges.

II. Historical and Statutory Background

The practice of territorial rating has been the subject of intense political and legal debate in California for over twenty years. In this debate, the opponents of territorial rating have defined the practice as "redlining." A group of advisory committees to the United States Commission on Civil Rights has defined insurance redlining as "canceling, refusing to insure or to renew, or varying the terms under which insurance is available to individuals because of the geographic location of a risk."¹⁰⁶

Territorial rating, as practiced by the insurance industry in California, clearly fits the definition of redlining. Insurers refuse to insure residents in low-income and predominantly minority areas of the state.¹⁰⁷ When insurers do agree to cover drivers in those areas, they vary greatly

to obtain insurance or otherwise prove financial responsibility within 60 days or his or her driver's license was suspended. The measure expired on December 30, 1990. So far, legislative efforts to revive the law have failed. S.B. 228, 1991-92 Regular Session (1991); A.B. 2078, 1991-92 Regular Session (1991).

105. *See supra* note 2.

106. ILLINOIS, INDIANA, MICHIGAN, MINNESOTA, OHIO AND WISCONSIN ADVISORY COMMITTEES TO THE UNITED STATES COMMISSION ON CIVIL RIGHTS, INSURANCE REDLINING: FACT, NOT FICTION 4 (1979).

Similar definitions have been developed in the home mortgage business. In that context, the term "redline" has been defined as: "To discriminate against economically, especially by refusing to grant mortgages or by charging [an] unreasonably high mortgage." FUNK AND WAGNALL'S NEW COMPREHENSIVE INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE (1982). In *Conference of Fed. Sav. and Loan Ass'n v. Stein*, 604 F.2d 1256, 1258 (9th Cir. 1979), the court defined redlining as "credit discrimination based upon the characteristics of the neighborhood surrounding the borrower's dwelling."

107. On May 15, 1991, the Insurance Commissioner of California issued proposed regulations to encourage insurers to serve "disadvantaged communities." The proposed regulations were preceded by findings that:

- 1) Insurance is more difficult to obtain in minority and low income and inner city communities in the State of California; and
- 2) that the difficulty in obtaining insurance in these communities is the result of insurers ignoring the needs of those communities, discouraging their personnel from serving those communities, withholding and canceling agency appointments in those communities, and failing to hire employees from those communities.

the terms under which automobile insurance may be purchased in those areas, by charging as much as 100 percent more than is charged in neighboring communities.¹⁰⁸

A. The Legislative Debate

Since 1973, the California legislature has considered numerous bills designed to modify or forbid the practice of territorial rating.¹⁰⁹ The Legislature has also held several hearings on the subject.¹¹⁰ In 1978 the Assembly directed the Insurance Commissioner to study the issue of territorial rating.¹¹¹ During that same year, the Legislature added to Insurance Code section 11628 the language that authorizes the current system of setting automobile insurance rates by zip code area.¹¹² While the

Notice of Proposed Action and Notice of Public Hearing, RH-292 (1991).

One insurance industry representative, Michael McCabe of Allstate Insurance Company, threatened in a public hearing that if the Insurance Commissioner eliminated or suppressed territorial rating, "the incentive that affects my behavior is to treat those customers [inner-city policyholders] as badly as the law allows. . . . It's an incentive to drive them away." Erik Ingram, *'Territorial' Rate Plan Draws Fire*, S.F. CHRON., June 23, 1989, at A1, A22.

Prior to the passage of Proposition 103, the refusal of insurers to issue policies in African-American and Hispanic communities was widely known. See, e.g., Kenneth Reich, *Territorial Rating Attacked; Reforms Could Put State Into Auto Insurance Business*, L.A. TIMES, Nov. 24, 1986, at A1.

108. See *supra* Part I.

109. Two bills introduced in the Assembly during 1985 are illustrative of these efforts. Assemblywoman Gwen Moore introduced Assembly Bill 654 that would have made the entire state one territory. Assemblywoman Gloria Molina introduced Assembly Bill 2214 that would have prohibited the use of any factor other than driving record in setting automobile insurance premiums. Both measures were defeated in the Assembly Finance Committee in January 1986. Charley Roberts, *Redlining Bills Trounced; Highway-Liability Measure Expires*, L.A. DAILY J., Jan. 22, 1986, at 2.

Previous bills to outlaw or ameliorate the practice of territorial rating were introduced in 1973 (A.B. 753), 1975 (A.B. 2755, 2953), and 1978 (A.B. 60, 146 and 282). Assembly Bill 753, from the 1973-74 session of the legislature, was killed in committee on September 14, 1973. Assembly Bills 2755 and 2953, introduced during the 1975-76 session of the legislature, both died in committee on November 30, 1976. Assembly Bills 60, 146, and 282 were all killed in committee on January 1, 1978.

110. CALIFORNIA LEGISLATURE, ASSEMBLY COMMITTEE ON FINANCE, INSURANCE AND COMMERCE, TRANSCRIPT ON THE SUBJECT OF DISCRIMINATION IN INSURANCE (1976). CALIFORNIA LEGISLATURE, SENATE COMMITTEE ON INSURANCE AND FINANCIAL INSTITUTIONS, AUTOMOBILE INSURANCE RATES AND TERRITORIAL RATING (1977). CALIFORNIA LEGISLATURE, ASSEMBLY AD HOC COMMITTEE ON AUTO INSURANCE PRICING, SYNOPSIS OF PUBLIC HEARING OF THE AD HOC COMMITTEE ON AUTO INSURANCE PRICING (1977). CALIFORNIA LEGISLATURE, SENATE COMMITTEE ON INSURANCE, CLAIMS AND CORPORATIONS, THE INSURANCE CRISIS: A CASE OF LEGISLATIVE REFORM (1986).

111. Assembly Con. Res. 100 (stats. 1978).

112. A.B. 3596 (1978). The bill amended § 11628 of the Insurance Code. The statute now reads as follows:

No admitted insurer, licensed to issue and issuing motor vehicle liability policies as defined in Section 16540 of the Vehicle Code, shall fail or refuse to accept an applica-

legislature's intent may have been laudable,¹¹³ this amendment has allowed insurers to draw lines that discriminate between insurance applicants on the basis of race and wealth.¹¹⁴

The inability, or unwillingness, of California regulators and legislators to remedy the racial and economic impact of redlining is attributable to three factors. First, insurers form a powerful lobby in Sacramento. Over the years, insurers have given tremendous amounts of money to the governor and California legislators.¹¹⁵ Those contributions give insurers access to the Insurance Commissioner and legislators when measures they view as inimical, such as attempts to outlaw or modify territorial rating, come up for hearing.¹¹⁶

Second, insurers have convinced the public and government that the elimination of territorial rating will cause a substantial increase of rates for two-thirds of the state's residents.¹¹⁷ Insurers have used this allega-

tion for that insurance, to issue that insurance to an applicant therefor, or issue or cancel that insurance under conditions less favorable to the insured than in other comparable cases, except for reasons applicable alike to persons of . . . the same geographic area Differentiation in rates between geographical areas shall not constitute unfair discrimination.

113. Ironically, it appears that the sponsors of A.B. 3596 intended to help consumers by forcing insurers to draw territories that were more contiguous and homogeneous. See STUDY OF CALIFORNIA DRIVING PERFORMANCE BY ZIP CODE (Phase I), *supra* note 2, at 59-60.

114. *King v. Meese*, 743 P.2d 889, 906 (Cal. 1987) (Broussard, J., concurring).

115. Kenneth Reich, *Insurance Lobby Gives Lawmakers \$1.6 Million*, L.A. TIMES, September 16, 1986, at A3; Kenneth Reich, *Insurance Firms' Gifts to Governor, Legislators Told*, L.A. TIMES, May 17, 1988, at A3. The latter article reported that, between 1985 and 1987, insurers gave former Governor Deukmejian \$460,645.00 and California legislators \$2,713,489.00. The contributions to the governor are significant because, prior to the passage of Proposition 103, the Insurance Commissioner was appointed by the governor. Former Cal. Ins. Code § 12900.

116. Two observers of California politics wrote that "Legislators and lobbyists alike assert that contributions 'buy' access, not votes." LARRY GERSTON & TERRY CHRISTENSEN, CALIFORNIA POLITICS & GOVERNMENT: A PRACTICAL APPROACH, 33 (1991). See also Daniel Lowenstein, *On Campaign Finance Reform: The Root of All Evil is Deeply Rooted*, 18 HOFSTRA L. REV. 301, 306-335 (1989); CHARLES BELL & CHARLES PRICE, CALIFORNIA GOVERNMENT TODAY: POLITICS OF REFORM?, 120-121, 128 (3d ed. 1988).

117. Former Insurance Commissioner Roxani Gillespie, for example, announced in 1989 that if territorial rating were eliminated as a rating factor, rates would increase for two-thirds of the state's drivers. Memorandum from Roxani Gillespie, Insurance Commissioner (August 1989) 2, and chart 1. This is undoubtedly true in a gross sense—the commissioner would have to allow insurers to raise rates elsewhere to compensate for the lower rates that insurers could charge drivers in redlined communities.

However, the creation of the good-driver discount policy (CAL. INS. CODE § 1861.02(b)-(d)(West 1988)) by Proposition 103 gives the Insurance Commissioner one mechanism by which he can minimize the economic impact of the change in rating practices.

The commissioner might further minimize the economic impact of eliminating redlining by carefully structuring the new rates. This is illustrated by the approach taken in New Jersey. While the Department of Insurance did not eliminate territorial rating, it significantly lowered its impact. This was accomplished by "tempering" the significance of territorial rating, and changing the way in which insurers could use territory in calculating rates. NEW JERSEY

tion to pit other areas of the state against redlined communities.¹¹⁸ This tactic was used in the insurance industry's campaign against Proposition 103.¹¹⁹

Third, redlining is perceived as a "minority" issue. Most of the organizations that have actively opposed territorial rating are civil rights organizations.¹²⁰ The measures that have been introduced to eliminate or ameliorate territorial rating have, with a few exceptions, been introduced by legislators who represent predominantly African-American or

DEPARTMENT OF INSURANCE, AUTOMOBILE INSURANCE RATE CLASSIFICATION: AN OVERVIEW OF FINDINGS, CONCLUSIONS AND REMEDIES at 21, 27-28, 31-32 (April 9, 1981). In short, New Jersey simply ordered a different, and broader, spreading of the risk. Massachusetts, studying a similar approach, concluded that the increase in rates caused would be minimal. STATE RATING BUREAU, MASSACHUSETTS DIVISION OF INSURANCE, AUTOMOBILE INSURANCE RISK CLASSIFICATION: EQUITY AND ACCURACY, at 100 (1978).

California's Insurance Commissioner could examine the actions taken in New Jersey and Massachusetts and come up with a plan that would minimize the impact of the elimination of territorial rating by ordering insurers to spread the risk of loss more broadly (and fairly) among California drivers.

118. When former Insurance Commissioner Kinder held hearings on territorial rating in 1976, he reported receiving "more than 40,000 cards and letters . . . from San Diego County residents alone in support of the present territorial rating system." AUTOMOBILE INSURANCE—TERRITORIAL CLASSIFICATIONS—EFFECT ON RATES, RH 207, 26 (California Insurance Commissioner 1979). Professor Wortham has noted that one of the difficulties inherent in any discussion of rate reform is the fact that it inevitably pits groups against one another. Leah Wortham, *The Economics of Insurance Classification: The Sound of One Invisible Hand Clapping*, 47 OHIO ST. L.J. 835, 838 (1986).

119. In areas outside of Los Angeles County, the insurance industry campaign claimed that Proposition 103 would "raise your rates." Kenneth Reich, *Insurers Seek to Keep Territorial Rating; Prop 103 Hearing Warned Change Could Hike Costs In Suburban, Rural Areas*, L.A. TIMES, June 20, 1989, at A3. The tactic was almost successful. The initiative received 51.17% of the vote—a bare majority. It carried in only eight counties—Los Angeles, Orange, San Francisco, Alameda, San Mateo, Santa Clara, Marin, and Solano. *The State*, L.A. TIMES, December 12, 1988, at A2.

120. Organizations that have been actively opposed to redlining include United Neighborhood Organization (a predominantly Latino organization), the Black Businessmen's Association of Los Angeles, the Southern Christian Leadership Conference (a predominantly African-American organization), Merchants 4 Community Improvement (a predominantly African-American group), and the Committee Against Discrimination in Automobile Insurance (a predominantly African-American organization). CALIFORNIA LEGISLATURE, SENATE COMMITTEE ON INSURANCE AND FINANCIAL INSTITUTIONS, AUTOMOBILE INSURANCE RATES AND TERRITORIAL RATING, at 3 (1977); CALIFORNIA LEGISLATURE, ASSEMBLY COMMITTEE ON FINANCE, INSURANCE AND COMMERCE, DISCRIMINATION IN INSURANCE at 147 (1976); Ray Estrada, *Citizens, Leaders Join Insurance Redlining Fight*, THE WAVE, November 27, 1985, at 1. It should be noted that the American Civil Liberties Union litigated *Compton v. Bunner*, 243 Cal. Rptr. 100 (Ct. App. 1988), and Public Advocates litigated *King v. Meese*, 743 P.2d 889 (Cal. 1987). Voter Revolt, the organization which sponsored Proposition 103, and Consumers Union have also actively opposed redlining in hearings before the Insurance Commissioner.

Latino communities.¹²¹ The main political spokespeople against territorial rating in Los Angeles County have been either minority politicians or representatives of districts with substantial minority populations.¹²² Minorities and the poor have a difficult time getting favorable legislative action because of a lack of money, influence, and power.¹²³

B. The Legal Debate

Three lawsuits have challenged territorial rating. In *County of Los Angeles v. Farmers Insurance Exchange*,¹²⁴ the County of Los Angeles sued the Insurance Commissioner of California and several insurance companies. The lawsuit alleged that the territorial rating practices of insurance companies discriminated against poor and minority residents of Los Angeles County by causing residents of inner-city communities to pay substantially more for automobile liability insurance coverage than other residents of the state.¹²⁵ The Superior Court ruled that the county was required to exhaust its administrative remedies before it could litigate the issue.¹²⁶ Following that ruling, the County of Los Angeles petitioned the Insurance Commissioner for relief. The Insurance Commissioner held a series of hearings in response to the petition and issued an opinion stating that territorial rating was "actuarially valid."¹²⁷ Following the issuance of the commissioner's finding, the County of Los Angeles filed suit a second time, alleging that it had now exhausted the remedies available under the Insurance Code.¹²⁸ Despite the presence of a clear indication from the Insurance Commissioner that he was unwill-

121. The bills attempting to outlaw or ameliorate territorial rating have been carried by Assemblywoman Gloria Molina (Latina), Assemblywoman Gwen Moore (African-American), Assemblyman Richard Montoya (Latino) (A.B. 753, 1973), Assemblywoman Teresa Hughes (African-American) (A.B. 2953, 1976; A.B. 2755, 1976), and Assemblyman Art Torres (Latino) (A.B. 2953, 1976; A.B. 2755, 1976). The notable exceptions to this pattern in the measures researched were Assemblymen Terry Goggin and William Thomas.

122. Los Angeles County Supervisor Kenneth Hahn and California Assemblywoman Maxine Waters (African-American), whose districts include large portions of South Central Los Angeles, have been longstanding opponents of territorial rating. Estrada, *supra* note 120, at 1; *Rights and Remedies of Insurance Policyholders: Hearings Before the Subcomm. on Citizens and Shareholders Rights & Remedies of the Senate Judiciary Comm.*, 95th Cong., 2d Sess. 410 (1978).

123. "Not surprisingly, well-organized, well-financed, prestigious groups . . . have always found ready access in Sacramento; disorganized poor, low-status groups frequently have more difficulty gaining a serious hearing." BELL & PRICE, *supra* note 116, at 114.

124. 182 Cal. Rptr. 879 (Ct. App. 1982).

125. *Id.* at 880.

126. *Id.* at 881.

127. *Id.* at 883; AUTOMOBILE INSURANCE—TERRITORIAL CLASSIFICATIONS—EFFECT ON RATES, RH 207, 37 (Cal. Ins. Comm'r 1979).

128. *Farmers Ins. Exchange*, 182 Cal. Rptr. at 881.

ing to grant any relief, the trial court again dismissed the suit. The trial court ruled that the county's failure to exhaust administrative remedies barred the lawsuit.¹²⁹ The County of Los Angeles appealed that ruling. The Second District Court of Appeal affirmed, agreeing that the county had failed to exhaust its administrative remedies.¹³⁰ Following that ruling, the Board of Supervisors decided to drop the lawsuit, even though its complaint against the Insurance Commissioner was not dismissed.¹³¹

In 1985, the City of Compton, the Southern Christian Leadership Conference, and several individual plaintiffs sued the Insurance Commissioner and Farmers Insurance Group. The plaintiffs alleged that redlining violated the equal protection clauses of the California Constitution and the Unruh Civil Rights Act¹³² because it discriminated against racial minorities and the poor.¹³³ The suit claimed that territorial rating violated the equal protection clauses of the California Constitution because section 11628 of the California Insurance Code specifically sanctioned the practice of redlining.

The trial court dismissed the suit for failure to exhaust administrative remedies.¹³⁴ The Court of Appeal agreed that plaintiffs were required to exhaust administrative remedies by petitioning for relief before the Insurance Commissioner.¹³⁵ At the same time, the court ruled that Insurance Code section 11628 prohibited an insurer from charging higher rates in some territories unless that insurer had in effect a substan-

129. *County of Los Angeles v. Farmers Ins. Exchange*, Nos. C 210895 and C 309260 (Superior Court of Los Angeles County, Vernon G. Foster, Judge.)

130. *Farmers Ins. Exchange*, 182 Cal. Rptr. at 882. The court stated that the Notice of Public Hearing issued by the Department of Insurance did not indicate that the Commissioner intended to review all of the allegations of unlawful practices as they related to the insurance company defendants. The court concluded that, because the county failed to move to compel the Commissioner to resolve those specific issues, administrative remedies as to Farmers were not exhausted. *Id.* at 882-83.

131. *Id.* at 879. The Board of Supervisors voted to dismiss the litigation on December 7, 1982.

132. CAL. CIV. CODE § 51-52 (West 1992).

133. *City of Compton v. Bunner*, 243 Cal. Rptr. 100, 106 (Ct. App. 1988).

134. *Id.* at 107.

135. *Id.* at 108-09. The plaintiffs claimed, *inter alia*, that exhaustion was not required. This argument was premised on declarations of the Insurance Commissioner and the Department of Insurance that they would not change the system because territorial rating was "actuarially sound." *Id.* at 109, 115-17.

The court observed in its opinion that the Insurance Commissioner and the Department of Insurance had continually failed to address and resolve the claims of racial and economic discrimination despite their "sophisticated bodies of expertise in this field." *Id.* at 116. The court opined that, should the claims be presented again and the commissioner and the department have failed to resolve those claims, "we can presently envision no argument which would overcome a claim that the futility exception should be applied . . ." *Id.* at 116.

tial number of policies within the adversely affected areas.¹³⁶ The court held that the equal protection clauses of the California Constitution required this construction of section 11628.¹³⁷ While the court ruled that the Unruh Civil Rights Act did not apply to the business of insurance,¹³⁸ it concluded that section 11628 should be construed to prohibit insurance company discrimination in the same manner as does the Unruh Civil Rights Act.¹³⁹ A group of insurance trade organizations petitioned the state supreme court to depublish the *Bunner* opinion,¹⁴⁰ and the supreme court complied.¹⁴¹

The third lawsuit mounted a flank attack on territorial rating. In *King v. Meese*,¹⁴² the plaintiffs sought a preliminary injunction suspending the operation of Vehicle Code section 16028.¹⁴³ They alleged that redlining, in effect, made it impossible for residents of inner-city areas to purchase the liability insurance required by the financial responsibility laws.¹⁴⁴ The plaintiffs argued that enforcement of the financial responsibility laws therefore violated their right to procedural due process.¹⁴⁵

The trial court denied the plaintiffs' request for a preliminary injunction,¹⁴⁶ and the supreme court affirmed.¹⁴⁷ It held that the acts of private insurers were not converted to state action by the state law requiring drivers to buy insurance from them.¹⁴⁸ The high court did conclude that the decision to impose a fine or suspend a license due to a lack of insurance is state action. The court held that the state does, as a result, have a limited constitutional duty to make the required liability in-

136. *Id.* at 127.

137. *Id.*

138. *Id.* at 124. The Court relied upon the language of § 1860.1 of the Insurance Code, which provides:

No act done, action taken or agreement made pursuant to the authority conferred by this chapter shall constitute a violation of or grounds for prosecution or civil proceedings under any other law of this State heretofore or hereafter enacted which does not specifically refer to insurance.

City of Compton, slip op. at 31.

139. *City of Compton v. Bunner*, 243 Cal. Rptr. at 128.

140. Letter from Susan Popik of Rogers, Joseph, O'Donnell & Quinn to the California Supreme Court (June 9, 1988).

141. Depublication was ordered on July 21, 1988.

142. 743 P.2d 889 (Cal. 1987).

143. *See supra* note 104.

144. *King*, 743 P.2d at 893.

145. *Id.* at 894.

146. *Id.*

147. *Id.* at 901.

148. *Id.* at 896.

insurance available in a manner that is neither arbitrary nor capricious.¹⁴⁹ But the court determined that the state had met that burden through its creation of the California Automobile Assigned Risk Plan.¹⁵⁰

C. The Effects of Proposition 103

In 1988, a new factor was injected into the debate when California voters approved Proposition 103. Proposition 103 was an initiative measure that radically altered the law concerning automobile insurance rate setting and the regulation of the business of insurance.¹⁵¹

Proposition 103 significantly changed the law concerning the use of territorial rating. The initiative did not repeal Insurance Code § 11628. Nevertheless, it did declare that automobile insurance premium rates shall be set using three primary rating criteria: the individual insured's driving record, the number of miles driven by the insured annually, and the number of years of driving experience of the insured.¹⁵² Before any other rating factor may be used by an insurer, the Insurance Commissioner must approve its use. The Commissioner may approve the use of an additional factor only if it has "a substantial relationship to the risk of loss."¹⁵³

149. *Id.* at 897.

150. *Id.* The majority wrote that there was "some persuasive force" to the plaintiffs' concern that the lack of procedural safeguards leads to a feeling of helplessness among those unable to afford or obtain private insurance. They stated that the plaintiffs had to make their case for relief to the Legislature. *Id.* at 900. In light of the long, futile history of attempts to gain legislative relief from redlining, *see supra* notes 109-121, this was truly an empty observation.

151. Proposition 103 was an initiative measure approved by a majority of California voters in November 1988. Initiatives are proposed laws or constitutional amendments voted on by the electorate. Proposition 103 was placed on the ballot by presenting a petition to the Secretary of State. The petition contained the language of the proposed law, and the signatures of five percent of the state's registered voters. CAL. CONST. art. II, § 9.

152. CAL. INS. CODE §§ 1861.02(a)(1)-(3)(West Supp. 1992).

153. CAL. INS. CODE § 1861.02(a)(4)(West Supp. 1992). Insurance companies have argued vigorously that the Insurance Commissioner should reinstate the practice of territorial rating under this provision. The issue has taken a series of perilous turns. On October 2, 1989, former Insurance Commissioner Roxani Gillespie announced that she intended to ban the use of territorial rating. Kenneth Reich, *Auto Insurance Rate Hikes Frozen; 6-month Ban Sparked by 'Chorus' of Proposed Increases, Gillespie Says*, L.A. TIMES, October 3, 1989, at A1. Following a storm of insurance industry protest, Commissioner Gillespie reversed that decision, announcing proposed regulations that allowed the use of territorial rating in a modified form. CAL. CODE REGS. tit. 10, ch. 5, sub. 4.7, § 2632.6(c) (proposed December 5, 1989). Despite Commissioner Gillespie's action, several insurers successfully sued to enjoin the enforcement of those regulations. While that litigation was pending John Garamendi took office as Insurance Commissioner. Commissioner Garamendi allowed the regulations proposed by former Commissioner Gillespie to lapse. On January 22, 1992 the Court of Appeal issued its opinion in *Allstate Ins. Co. v. Garamendi*, No. B050439, 1992 Cal. App. Lexis 72 (January 22, 1992). The court dismissed as moot the appeal from that portion of the injunction restraining imple-

Proposition 103 also made an important change in the regulatory structure for insurance. California was an "open rating" state, meaning that insurance rates did not have to be approved by the Insurance Commissioner.¹⁵⁴ With the passage of Proposition 103, all insurance rates must be approved by the commissioner before they may go into effect.¹⁵⁵

D. The Insurers' Defense of Territorial Rating

Insurers and their allies have mounted a spirited defense of territorial rating in legislative, administrative, and public debates. The defenders of territorial rating concede that neighborhoods do not cause accidents.¹⁵⁶ In making their case, proponents of territorial rating have never denied that the practice adversely affects racial minorities and the poor.¹⁵⁷ Instead, they have based their defense exclusively on the premise that territory is an accurate predictor of expected losses.

The California Department of Insurance and each of the three Insurance Commissioners who preceded John Garamendi in office¹⁵⁸ have defended redlining on this basis. A study issued by the Rate Regulation

mentation of the regulations announced by Commissioner Gillespie. *Id.* at 44. The case was then remanded to the trial court with instructions to vacate the remainder of the preliminary injunction in view of Commissioner Garamendi's intention to adopt new regulations. *Id.*

154. CAL. INS. CODE § 1850 (repealed 1988).

155. CAL. INS. CODE §§ 1861.05-.09 (West Supp. 1992).

156. *Public Hearings of the Insurance Commissioner Relating to Automobile Insurance*; CALIFORNIA DEPARTMENT OF INSURANCE, RATE REGULATION DIVISION, STUDY OF CALIFORNIA DRIVING PERFORMANCE (Phase II), at 193 (1979). Territory is really a surrogate, an easily administered substitute for a complex of factors which actually explain the risk of loss within different neighborhoods. The California Department of Insurance summarized those factors:

The factors tied closely to geographic location which have an impact upon automobile liability insurance costs include the following: topography; climate; street and highway design; road repair; traffic density and traffic flows; economic conditions, such as wage levels, the cost of hospital and medical services, and the cost of automobile repairs; etc.

CALIFORNIA DEPARTMENT OF INSURANCE, RATE REGULATION DIVISION, STUDY OF CALIFORNIA DRIVING PERFORMANCE (Phase II), at 194 (1979). *See also Public Hearings of the Insurance Commissioner Relating to Automobile Insurance*, *supra* note 156; AUTOMOBILE INSURANCE RISK CLASSIFICATION: EQUITY & ACCURACY, *supra* note 117.

157. *See, e.g.,* Kenneth Reich, *Territorial Rating Attacked: Reforms Could Put State into Auto Insurance Business*, L.A. TIMES, November 24, 1986, at A1. The article quotes George Tye, executive manager of the Association of California Insurance Companies: "A lot of people that are being charged \$2,000 are the lower economic strata. They simply can't afford that. It's a problem that's been brewing for years. We're trying to do something about it." In the same article John McCann, a California spokesperson for the Insurance Information Institute, conceded in his interview that "[i]t's too expensive for people to operate an automobile in the inner city and actually pay for the insurance." *Id.*

158. Garamendi is the first Insurance Commissioner elected pursuant to the provisions of Proposition 103. CAL. INS. CODE § 12900 (West Supp. 1992).

Division of the California Department of Insurance in 1979 concluded that driving performance “appears to vary significantly by geographic area.”¹⁵⁹

Pursuant to the initial trial court ruling requiring exhaustion of administrative remedies in *County of Los Angeles v. Farmers Insurance*, the County of Los Angeles filed a petition with the Insurance Commissioner seeking relief from territorial rating.¹⁶⁰ Insurance Commissioner Wesley Kinder held administrative hearings in response to that petition. Following those hearings, Commissioner Kinder concluded: “If territorial distinctions can be found to have predictive value, then the use of such a standard must be deemed ‘fair’ and reasonable.”¹⁶¹ Commissioner Kinder further stated:

[E]ven if it could be shown that territorial boundaries have been deliberately or even accidentally drawn to reflect racial or ethnic concentrations, that fact alone would not explain existing premium differences, which are the result of differences in loss costs.”¹⁶²

In line with these observations and the conclusions of the Study of Driving Performance, the commissioner found that territorial rating was “actuarially valid.”¹⁶³

In 1985, then-Insurance Commissioner Bruce Bunner and Everett Brookhart, the Chief of Consumer Affairs for the Department of Insurance, publicly reiterated that territorial rating was “justified.”¹⁶⁴ And before she left office, Commissioner Roxani Gillespie defended the practice of territorial rating, stating that “all the experts at our hearing, including those from the consumer groups, recognize that ‘territory’ is a valid rating factor.”¹⁶⁵

The insurance industry has vehemently defended the practice of territorial rating. During hearings on the implementation of Proposition 103, insurance industry executives urged the Insurance Commissioner to allow territorial rating to be used as a prime factor in setting rates, de-

159. CALIFORNIA DEPARTMENT OF INSURANCE, RATE REGULATION DIVISION, STUDY OF CALIFORNIA DRIVING PERFORMANCE BY ZIP CODE (Phase II) 210 (1979).

160. *County of Los Angeles v. Farmers Ins. Exchange*, 182 Cal. Rptr. 879 (Ct. App. 1982).

161. *In The Matter of the Public Hearings of the Insurance Commissioner Relating to Automobile Insurance—Territorial Classifications—Effect on Rates*, RH 207, 35 (Cal. Ins. Comm’r 1979).

162. *Id.* at 18.

163. *Id.* at 37.

164. Kenneth Reich, *Agency Favors Car Insurance Rates Change*, L.A. TIMES, March 5, 1986, at A1. Bunner and Brookhart did change their position after the *Comparative Premium Survey* was published. *Id.*

165. Notice Accompanying Proposed Regulations, Dec. 5, 1989, at 2.

spite the express language of Proposition 103.¹⁶⁶ In the course of those hearings, one industry representative claimed that the elimination of territorial rating would usurp the economic process in the interest of "socially based pricing."¹⁶⁷

The industry has funded two studies that defend the practice of territorial rating. The most extensive was a study published by the Stanford Research Institute (SRI) in 1976.¹⁶⁸ The SRI study acknowledged that geographical divisions are correlated with factors such as income level and race, due to forced segregation and natural aggregation.¹⁶⁹ Nevertheless, the SRI researchers concluded that insurance companies should be free to use territorial rating if territory is an accurate predictor of loss.¹⁷⁰ A second study, completed in 1980, concluded that approximately half of all automobile accidents involving injury occur within five miles of home, while approximately ninety percent of all accidents occurred within thirty miles of home.¹⁷¹

III. Territorial Rating and the Equal Protection Clauses of the California Constitution

Under the California Constitution, "[t]he concept of the equal protection of the laws compels recognition of the proposition that persons similarly situated with respect to the legitimate purpose of the law receive like treatment."¹⁷² A decision by the Insurance Commissioner to sanction the continued use of territorial rating would violate this fundamental proposition of law because residents of poor and minority communities do not receive like treatment. The California Constitution should be construed to prohibit state approval of territorial rating because the practice imposes additional burdens on those communities.

166. Kenneth Reich, *Insurers Seek to Keep Territorial Ratings*, L.A. TIMES, June 20, 1989, at A3. See *supra* notes 151-55 and accompanying text.

167. Erik Ingram, "Territorial" Rate Plan Draws Fire, S.F. CHRON, June 23, 1989, at A1 (quoting Michael McCabe, Vice President of Allstate Insurance).

168. BARBARA CASEY, JACQUES PEZIER, CARL SPETZLER, STANFORD RESEARCH INSTITUTE, *THE ROLE OF RISK CLASSIFICATIONS IN PROPERTY AND CASUALTY INSURANCE: A STUDY OF THE RISK ASSESSMENT PROCESS* (1976).

169. *Id.* at 91.

170. *Id.*

171. ANN DURAND, ALL-INDUSTRY RESEARCH ADVISORY COUNCIL, *AN ANALYSIS OF ACCIDENT LOCATION IN RELATION TO AREA OF RESIDENCE 1, 3* (1980). This study was undoubtedly commissioned to respond to the argument that the territorial rating system, which is based on where a car is garaged, is unfair because urban residents are forced to pay for accidents caused by suburban commuters driving into their communities for work, thereby adding to the congestion and the number of accidents.

172. *Purdy & Fitzpatrick v. State*, 456 P.2d 645, 653 (Cal. 1969).

A. The Problem of State Action

1. State Action under the Federal Constitution

Automobile insurance is sold by private companies. Thus the initial obstacle to the application of equal protection analysis to the problem of territorial rating is satisfying the requirement of state action.¹⁷³

The state action doctrine, such as it is,¹⁷⁴ evolved in decisions interpreting the language of the Fourteenth Amendment to the federal constitution.¹⁷⁵ The Fourteenth Amendment forbids "only such action as may fairly be said to be that of the States."¹⁷⁶ When a claim of constitutional violation is based on the activities of private parties, the determination of whether their conduct is state action must be made on a case-by-case basis, by "sifting facts and weighing circumstances."¹⁷⁷

The conservative majority on the present Supreme Court has narrowed the range of cases where state action will be found.¹⁷⁸ Two of the cases decided by the Supreme Court during that narrowing process are particularly pertinent to this discussion. In *Jackson v. Metropolitan Edison Co.*,¹⁷⁹ the Court held that extensive regulation of an industry does not, by itself, convert the actions of a private entity into state action.¹⁸⁰ The plaintiff must show a sufficiently close "nexus" between the state and the challenged action before the action of the private party may be treated as state action.¹⁸¹

In an attempt to show that the required nexus was present in *Jackson*, the plaintiff advanced three arguments relevant to the discussion of

173. In *King v. Meese*, *supra* notes 142-50, the California Supreme Court held that the state requirement that drivers purchase automobile insurance does not convert the actions of private insurers into state action. 743 P.2d 889, 896 (Cal. 1987).

174. The "doctrine" of state action has been described as "a conceptual disaster area." Charles L. Black, Jr., *The Supreme Court, 1966 Term—Foreword: "State Action," Equal Protection, and California's Proposition 14*, 81 HARV. L. REV. 69, 95 (1967). See generally LAURENCE TRIBE, *AMERICAN CONSTITUTIONAL LAW*, § 18-1 (2d ed. 1988); 2 RONALD D. ROTUNDA ET AL., *TREATISE ON CONSTITUTIONAL LAW: SUBSTANCE AND PROCEDURE*, § 16.1 (1986).

175. The relevant language of the Fourteenth Amendment provides:

No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

U.S. CONST. amend. XIV.

176. *Shelley v. Kraemer*, 334 U.S. 1, 13 (1948).

177. *Burton v. Wilmington Parking Auth.*, 365 U.S. 715, 722 (1961).

178. Henry C. Strickland, *The State Action Doctrine and the Rehnquist Court*, 18 HASTINGS CONST. L.Q. 587, 644-45 (1991).

179. 419 U.S. 345 (1974).

180. *Id.* at 350.

181. *Id.* at 351.

the problem of redlining. The Court rejected the plaintiff's contention that the monopoly status of the defendant utility created the required nexus.¹⁸² The Court also rebuffed plaintiff's claim that the nexus was present because the utility performed a public function by providing an essential service.¹⁸³ Finally, the Court rejected the plaintiff's assertion that the required nexus was created by the state's authorization of the termination practice that was the subject of the lawsuit.¹⁸⁴ The Court held that approval by the state of the utility's request for approval of its business practices did not constitute state action, reasoning that the approval did not place the imprimatur of the state on the practice.¹⁸⁵ The Court contrasted the situation in *Jackson* with the facts in *Public Utility Commission v. Pollack*,¹⁸⁶ where the government investigated the proposed practice, and approved it after finding that the practice was "not inconsistent with public convenience, comfort and safety."¹⁸⁷

The second state action case decided by the United States Supreme Court that is relevant to this discussion is *Flagg Bros., Inc. v. Brooks*.¹⁸⁸ In *Flagg Bros.*, the Court rejected the contention that a statute authorizing warehousemen to seize and sell a bailor's property for unpaid storage charges constituted state action.¹⁸⁹ Citing *Jackson* and *Moose Lodge No. 107 v. Iris*,¹⁹⁰ Justice Rehnquist wrote:

These cases clearly rejected the notion that our prior cases permitted the imposition of Fourteenth Amendment restraints on private action by the simple device of characterizing the State's inaction as "authorization" or "encouragement."¹⁹¹

Based on this premise, the Court held that the enactment of the statute did not create the necessary nexus because the state was in no way responsible for Flagg Brothers' decision to take the plaintiff's property.¹⁹²

182. *Id.* at 351-52.

183. *Id.* at 352-54.

184. *Id.* at 356-57. Although not the focus of this discussion, the Court also rejected the argument that the utility shared a symbiotic relationship with the state. *Id.* at 357-58.

185. *Id.* at 357.

186. 343 U.S. 451 (1952).

187. *Jackson*, 419 U.S. at 356-57.

188. 436 U.S. 149 (1978).

189. *Id.* at 164.

190. 407 U.S. 163 (1972).

191. *Flagg Bros.*, 436 U.S. at 164-65.

192. *Id.* at 165. The Court had noted earlier in its opinion that there were no state officials as defendants in the action. *Id.* at 157.

2. *State Action under the California Constitution*¹⁹³

Unlike the Fourteenth Amendment to the federal constitution, the equal protection clauses of the California Constitution do not contain language requiring state action.¹⁹⁴ The California Supreme Court has noted this textual distinction.¹⁹⁵ Nevertheless, the California court has consistently held that state action is required to invoke the equal protection guarantees of the California Constitution.¹⁹⁶

The task of establishing state action under the California Constitution is less daunting than it is under the current federal standard.¹⁹⁷ The California Supreme Court has stressed that its interpretation of the state equal protection clauses is independent of the federal courts' state action analysis:

[A]lthough our court will carefully consider federal state action decisions with respect to the federal equal protection clause insofar as they are persuasive, we do not consider ourselves bound by such decisions in interpreting the reach of the safeguards of our state equal protection clause.¹⁹⁸

California courts have used three state action theories that are applicable to analysis of the use of territorial rating: 1) state authorization or encouragement of private activity; 2) pervasive state regulation of private entities; and 3) symbiotic relationship.

193. While the problem of territorial rating has received some attention in scholarly quarters, most of that attention has been focused on the federal equal protection issues raised by the practice. *See, e.g.,* Regina Austin, *The Insurance Classification Controversy*, 131 U. PA. L. REV. 517 (1983); and Leah Wortham, *Insurance Classification: Too Important to Be Left to the Actuaries*, 19 U. MICH. J.L. REF. 349 (1986) [hereinafter *Insurance Classification*]. That is a subject worthy of continued examination, despite the substantial state action barriers posed by current federal constitutional law.

194. Article I, § 7(a) of the California Constitution provides, in pertinent part, that "A person may not be . . . denied equal protection of the laws." The relevant portion of Article I, § 7(b) provides that "A citizen or class of citizens may not be granted privileges or immunities not granted on the same terms to all citizens." Article IV, § 16(a) provides that "All laws of a general nature have uniform operation."

195. *Kruger v. Wells Fargo Bank*, 521 P.2d 441, 449-50 (Cal. 1974); *Gay Law Students' Ass'n v. Pacific Tel. & Tel. Co.*, 595 P.2d 592, 598 (Cal. 1979).

196. *See, e.g., Gay Law Students*, 595 P.2d at 598; and *Kruger*, 521 P.2d at 450.

The California Supreme Court has held that the state constitutional guarantees of the right to privacy, the right to freedom of speech, and the right to petition the government apply to certain actions of private parties. *Robins v. Pruneyard Shopping Ctr.*, 592 P.2d 341 (Cal. 1979) (freedom of speech, petition); *see also Porten v. University of S. F.*, 134 Cal. Rptr. 839, 842 (Ct. App. 1976) (privacy); *Chico Feminist Women's Health Ctr. v. Scully*, 256 Cal. Rptr. 194, 200 (Ct. App. 1989) (privacy). These decisions are based upon the absence of language referring to the "state" in the relevant constitutional provisions. *See Jennifer Friesen, Should California's Constitutional Guarantees of Individual Rights Apply Against Private Actors?*, 17 HASTINGS CONST. L.Q. 111 (1989).

197. *See supra* notes 174-92 and accompanying text.

198. *Gay Law Students Ass'n v. Pacific Tel. and Tel. Co.*, 595 P.2d at 598.

a. State Encouragement of Territorial Rating

The first theory on which a finding of state action could be premised in California is properly characterized as an authorization or encouragement analysis. *Adams v. Department of Motor Vehicles* exemplifies this approach.¹⁹⁹ In *Adams*, plaintiffs challenged the constitutionality of the garagemen's labor and materials lien law.²⁰⁰ The lien law authorized an unpaid garageman to retain and sell vehicles that had been repaired. The law required the Department of Motor Vehicles to transfer registration to the purchaser, but did not require the department to conduct a hearing before transferring the registration.²⁰¹ The California Supreme Court found that this system entailed state action.²⁰² The *Adams* opinion listed the factors leading to this conclusion:

The vehicle service lien and the procedures for its enforcement are created and governed by statute. The procedure is administered by the Department of Motor Vehicles, and transfer of title to the lien sale purchaser is ultimately recorded by the department. "Thus, although a private individual retains and sells the car, his power to do so arises from and is subject to specific provisions of state statute and his exercise of that power is supervised by the department."²⁰³

Adams clearly rejects the reasoning utilized by the United States Supreme Court in *Flagg Bros.*²⁰⁴ The California Supreme Court found specifically that the fact that the seizure and sale were conducted without the aid of state personnel was not dispositive. The court held that since the ability to perform these acts was permitted only by statute, the state's involvement in the imposition and enforcement of the garageman's liens constituted state action.²⁰⁵

The practice of territorial rating is authorized by section 11628 of the Insurance Code.²⁰⁶ Insurance Code section 1861.01 does not allow insurers to use territorial rating without the approval of the Insurance Commissioner.²⁰⁷ Thus, although private entities sell the insurance, their ability to use territorial rating will arise from the specific provisions of those statutes. Moreover, since the Insurance Commissioner must approve of the use of territorial rating, and of the rates set under that sys-

199. 520 P.2d 961 (Cal. 1974)

200. Then codified in CAL. CIV. CODE §§ 3068-3074 (West Supp. 1974, 1992).

201. *Adams*, 520 P.2d at 963.

202. *Id.* at 965.

203. *Id.* (citations omitted).

204. 436 U.S. 149, 164 (1978).

205. *Adams*, 520 P.2d at 965.

206. See *supra* note 112 and accompanying text.

207. See *supra* notes 153-55 and accompanying text.

tem,²⁰⁸ the insurers' use of that rating criteria will be created and supervised by the commissioner and the Department of Insurance.²⁰⁹ The combination of these facts and actions would constitute state action under the encouragement theory.²¹⁰

There is, however, an objection to a finding of state action under this theory. Territorial rating was a practice of the insurance industry prior to the enactment of Insurance Code section 11628.²¹¹ Powers that a private entity already possesses do not become state action merely because they are codified. A leading California case articulating this principle is *Kruger v. Wells Fargo Bank*.²¹² In *Kruger*, the bank deducted money from the plaintiff's checking account to satisfy an overdue credit card payment.²¹³ The plaintiff challenged the constitutionality of the bank's exercise of its right of set-off. That right was codified in former California Code of Civil Procedure section 440. The California Supreme Court held that the bank's exercise of its right of set-off did not constitute state action despite the existence of the statute authorizing the set-off.²¹⁴

The court observed that the statute at issue "merely codified the right of setoff as it existed in courts of equity."²¹⁵ The court reasoned that the statute was "neutral," because it neither compelled nor encouraged the right of set-off.²¹⁶ The key to the court's conclusion that the statute did not convert the bank's action into state action was expressed as follows:

"The right of set-off, while recognized by the statute, was not created by it. The right is grounded in general principals of equity. 'In equity, a set-off . . . depends, not upon the [s]tatutes of [s]et-[o]ff, but upon the equitable jurisdiction of the Court over its suitors.' *Hobbs v. Duff*, 23 Cal. 596, 629 (1863). Thus, if Section 440

208. CAL. INS. CODE § 1861.05-.055 (West Supp. 1992).

209. The Commissioner may not approve of the use of territorial rating unless she or he finds that it bears a "substantial relationship to the risk of loss." CAL. INS. CODE § 1861.02(a)(4) (West Supp. 1992). State approval of a return to territorial rating would thus place the imprimatur of the state on the practice. This would satisfy the more restrictive federal state action standard articulated in *Flagg Bros.* See *supra* notes 188-92 and accompanying text.

210. See *Adams v. Department of Motor Vehicles*, 520 P.2d 961 (Cal. 1974).

211. Territorial rating in some form has been in existence since at least 1917. H. JEROME ZOFFER, *THE HISTORY OF AUTOMOBILE LIABILITY INSURANCE RATING* 11 (1959); *In The Matter of the Public Hearings of the Insurance Commissioner Relating to Automobile Insurance—Territorial Classifications—Effect on Rates*, RH 207, 9 (California Insurance Commissioner).

212. 521 P.2d 441 (Cal. 1974).

213. *Id.* at 442.

214. *Id.*

215. *Id.* at 445.

216. *Id.* at 447.

never had been enacted, the Bank would still have had the right to balance off mutual obligations." A statute which neither adds new rights nor permits private conduct prohibited under the common law, does not raise the conduct to the level of state action.²¹⁷

A second factor in *Kruger* that persuaded the court that exercise of the right of set-off did not constitute state action was that "the procedure of set-off, in contrast to other prejudgment remedies, require[d] no act of assistance from state officials."²¹⁸

Insurance companies might be expected to argue that their use of territorial rating parallels the bank's use of set-off in *Kruger*. They would assert that insurance companies had a common law right to refuse to insure anyone.²¹⁹ They would also state that section 11628 was merely a codification of their preexisting common law right to engage in territorial rating. Based on these two assertions, insurers would argue that the exist-

217. *Id.* (quoting *Jojola v. Wells Fargo Bank* (N.D. Cal. 1973 No. C-71 900 SAW)). The supreme court later criticized this reasoning:

In *Kruger v. Wells Fargo Bank*, *supra*, 11 Cal. 3d 352, 362-363 [521 P.2d 441, 447], we suggested that private summary seizure would be more likely to constitute a form of state action if that seizure was based upon a statute which created a remedy unknown to the common law. This reasoning has been criticized on the ground that the degree of state involvement in the remedy does not turn upon the age or origin of the remedy [citation omitted], and indeed remedies of venerable common law origin such as garnishment and attachment have been held to involve state action. [Citations omitted]. We do not therefore rest our holding that stop notice procedures involve state action merely upon the fact that the procedure was created by statute.

Connolly Dev. Inc. v. Superior Court, 553 P.2d 637, 645 n.14 (Cal. 1976) (en banc).

218. *Kruger*, 521 P.2d at 445.

219. *K.C. Working Chem. Co. v. Eureka-Security Fire And Marine Ins. Co. of Cincinnati*, Ohio, 185 P.2d 832, 839 (Cal. Ct. App. 1947). This case did hold that an insurance company is not bound to accept an application or proposal for insurance. *Id.*

The validity of this holding is doubtful. Insurance companies are enterprises affected with a public interest. Such enterprises are marked by the following characteristics: 1) they are involved in a business generally thought suitable for public regulation; 2) they perform a service of great importance to the public; 3) they hold themselves out as willing to perform the service for any member of the public who needs it, or at least for any member coming within established standards; and 4) they possess, due to the essential nature of the service, a decisive advantage of bargaining strength. *Tunkl v. Regents of the Univ. of Cal.*, 383 P.2d 441 (Cal. 1963).

This is an accurate description of insurance companies and their relationship to the public. The business of insurance is clearly thought to be suitable for public regulation, a proposition evidenced by the existence of the California Insurance Commissioner and the extensive statutory provisions found in the California Insurance Code and the statutes of all of the 50 states. Insurance is generally recognized as a matter of overwhelming importance to the public. See, e.g., Matthew O. Tobriner & Joseph R. Grodin, *The Individual and the Public Service Enterprise in the New Industrial State*, 55 CAL. L. REV. 1247, 1263-64, 1273-76 (1967). Automobile liability insurance is essential due to the mandatory liability insurance laws. Insurance companies hold themselves out as willing to provide that service for any member of the public who seeks it, so long as that person meets certain established standards. And insurance companies obviously possess a decisive advantage of bargaining strength against any member of the

ence of section 11628 and a decision by the Insurance Commissioner to permit the use of territorial rating would not convert their actions into state action.

Whatever the case may have been prior to the passage of Proposition 103, it is clear that insurance companies of this state do not at this point have a preexisting right to use territorial rating. They will not be able to use this rating factor unless the Insurance Commissioner affirmatively decides that territorial rating is permissible. The right of insurance companies to engage in territorial rating would be *created* by the Commissioner's approval under the terms of section 1861.01 of the Insurance Code. Moreover, insurers' ability to engage in territorial rating will require the assistance and approval of state officials, since all rates must be approved by the Insurance Commissioner before they may go into effect.²²⁰ Should the Commissioner approve the continued usage of territorial rating, his action will constitute affirmative state endorsement of, involvement in, and assistance to, the insurer's practice of redlining.²²¹ This would not be a "neutral" action, as that term is defined in *Kruger*. Instead, approval would be more akin to the actions of the state in the *Adams* case, where state action was found.²²²

b. Pervasive State Regulation of the Insurance Industry

The second California theory of state action might be characterized as a "pervasive regulation" standard. Under this standard, state action is found where the breadth and depth of governmental regulation of an entity's business practices inextricably ties the state to the entity's conduct. This theory of state action is articulated in *Gay Law Students v. Pacific Telephone and Telegraph*.²²³ In that case, gay individuals and organiza-

public who seeks their services. *See German Alliance Ins. Co. v. Superintendent of Ins. of the State of Kan.*, 233 U.S. 389 (1914).

Since the insurance business is affected with a public interest, it can be argued convincingly that insurance companies did not have a common law right to discriminate. At common law, an enterprise affected with a public interest has a duty to serve all customers on reasonable terms without discrimination. *Gay Law Students*, 595 P.2d 592, 606. *But see Harris v. Capital Growth Investors XIV*, 805 P.2d 873, 888 n.13 (Cal. 1991) (arguing that the common law duty does not extend to pricing decisions).

220. CAL. INS. CODE §§ 1860.05-.055 (West Supp. 1992).

221. An additional factor that distinguishes this problem from the *Kruger* case is the fact that *Kruger* involved a procedural due process claim — plaintiff claiming that she had a right to notice and some type of hearing before the bank took her money. The California Supreme Court stated in its *Gay Law Students* opinion that a more exacting standard of state action is applied in procedural due process cases than in cases involving discrimination that violates the equal protection clause. *Gay Law Students*, 595 P.2d at 601 n.9.

222. *See supra* notes 199-205 and accompanying text.

223. 595 P.2d at 598.

tions alleged that Pacific Telephone and Telegraph Company (PT&T), a privately owned public utility company, discriminated against gays and lesbians. The California Supreme Court found that employment discrimination against gays and lesbians was not prohibited by the state's Fair Employment Practices Act.²²⁴ At the same time, the court held that the plaintiffs had stated a cause of action under the equal protection clauses of the California Constitution.

A number of factors led the court to conclude that discrimination in employment by PT&T was state action. The court began by stating that the California regulatory scheme demonstrates that the state expects a public utility to conduct its affairs more like a governmental entity than like a private corporation.²²⁵ It based this conclusion on the state's establishment of the prices a utility charges for its services and of the standards that govern its facilities and services.²²⁶ The court pointed out that the state determines the system and form of accounts and records that a public utility maintains, and exercises special scrutiny over the utility's issuance of stocks and bonds.²²⁷ Finally, the court noted that many utilities, including PT&T, have the power of eminent domain.²²⁸ The court concluded that under these circumstances a public utility cannot claim the prerogatives of "private autonomy" that may attach to a purely private business enterprise.²²⁹

The court then outlined three additional factors that led it to conclude that the alleged actions of PT&T, if proven, would constitute state action. First, the exclusion from employment in a quasi-monopolistic situation is particularly egregious because the victim has limited alternatives available. Whereas a person seeking employment from a single private employer can generally find the same job opportunity elsewhere, the prospective employee of a state regulated utility may have no such option because the utility is the only employer in the area offering certain jobs.²³⁰ The court stated that this lack of competition removes even the "limited check" that competition places on employment discrimination, because the state-protected utility does not have to worry that a qualified applicant will be hired by a competitor seeking competitive advantage.²³¹

224. *Id.* at 612.

225. *Id.* at 599.

226. *Id.*

227. *Id.*

228. *Id.*

229. *Id.*

230. The complaint alleged that many of the jobs available at PT&T required skills useful only in telephone companies. *Id.* at 596.

231. *Id.* at 599-600.

Second, the court observed that the public cannot avoid giving indirect support to the discriminatory practices of a public utility. Where ordinary private businesses are involved, the public can boycott those who discriminate. But in the case of a public utility, no such option is available, since the utility has a state-granted monopoly over provision of the service.²³²

The third factor that led the court to conclude that PT&T's actions constituted state action is the source of the utility's quasi-monopolistic power over employment opportunities. That power is directly derived from a state-provided exclusive franchise. Since the state has immunized public utilities from the check of free market competition, the state has placed the utility in a position to wield enormous power over an individual's employment opportunities.²³³ The court concluded that "Under these circumstances, PT&T can point to no legitimate countervailing interest in 'privacy' or 'personal autonomy' which could reasonably justify exempting its discriminatory employment practices from constitutional constraints."²³⁴

The *Gay Law Students* opinion states that its holding is limited to the narrow but important question of whether the equal protection clauses are violated when a privately owned public utility excludes a class of individuals from employment opportunities.²³⁵ The question in the auto insurance context is equally important: whether the equal protection clauses are violated when privately owned insurance companies deprive classes of people of the important ability to drive by engaging in territorial rating. Since territorial rating effectively precludes residents of inner city communities from buying the insurance coverage required by the state, state action should be found if the Insurance Commissioner approves of its use.

A majority of the factors that led to a finding of state action in *Gay Law Students* would also be present if the Commissioner allows territorial rating. The importance of the issue and the similarity of the factors present call for application of the pervasive-regulation state action theory invoked in *Gay Law Students* to the analysis of territorial rating.

Even before the passage of Proposition 103, the regulatory system governing insurance resembled the regulatory system governing utilities. Businesses cannot write insurance in California without a state-issued li-

232. *Id.* at 600.

233. *Id.*

234. *Id.* The reasoning of the *Gay Law Students* opinion is directly contrary to the rationale expressed by the majority in *Jackson v. Metropolitan Edison Co*, 419 U.S. 345 (1974). See *supra* notes 179-87 and accompanying text.

235. *Gay Law Students*, 595 P.2d at 598-99.

cense.²³⁶ In order to obtain that license, insurers must meet capital requirements and surplus requirements set by law.²³⁷ The state sets the minimum reserves a liability carrier must maintain.²³⁸ The state determines the system and form of insurance company financial statements.²³⁹ The state also exercises special scrutiny over the issuance of stocks and bonds by admitted insurers.²⁴⁰ The state determines the kinds of securities insurers may invest their assets in.²⁴¹ The state also dictates how insurers may invest their excess funds.²⁴²

With the passage of Proposition 103, the regulatory scheme for the business of insurance became more pervasive. The prices that insurers charge for their products and the standards that govern their services are now established by the state.²⁴³ Insurers have been directed to provide good-driver discount plans, and the statute sets the terms and conditions under which insurers must accept such drivers for coverage.²⁴⁴ Finally, Proposition 103 limited the grounds on which an insurer can cancel an automobile insurance policy.²⁴⁵

The characteristics of the regulatory scheme for automobile insurance parallel the characteristics of the regulatory scheme that led the court to conclude that state action was present in *Gay Law Students*.²⁴⁶ The three additional factors that led to the finding of state action in the *Gay Law Students* opinion are also present, in various permutations, in the automobile insurance context. First, although there is no state-protected monopoly present,²⁴⁷ approval by the Insurance Commissioner of the use of territorial rating will harm the victims of redlining more than PT&T's decision to discriminate harmed gay job applicants. In *Gay Law Students*, the court was concerned because the job seekers had available only limited alternatives.²⁴⁸ If the Commissioner allows insurers to use

236. CAL. INS. CODE § 700 (West 1972). The sections of the Insurance Code cited in notes 237-45 *infra* remain in effect.

237. *Id.* §§ 700.01-700.05.

238. *Id.* §§ 11557-11558.

239. *Id.* §§ 900-925.4.

240. *Id.* §§ 820-860.

241. *Id.* §§ 1170-1182.

242. *Id.* §§ 1190-1202.

243. *Id.* §§ 1861.01(c), 1861.05.

244. *Id.* § § 1861.02(b), 1861.025.

245. *Id.* § 1861.03(c).

246. The only thing that is markedly different is that insurers do not have the power of eminent domain. *Gay Law Students Ass'n v. Pacific Tel. and Tel. Co.*, 595 P.2d 592, 599 (Cal. 1979).

247. The law does countenance some anticompetitive practices by the insurance industry, such as the sharing of loss experience data. CAL. INS. CODE § 1861.03(b) (West 1972).

248. 595 P.2d at 596.

territorial rating, then his action will leave residents of the inner cities in Los Angeles County and the San Francisco Bay Area with no alternative for avoiding the discriminatory prices forced on them by territorial rating.²⁴⁹ When this effect is coupled with the financial responsibility laws,²⁵⁰ it is apparent that approval of territorial rating will be more devastating than the discrimination at issue in *Gay Law Students*.

The second factor in *Gay Law Students* leading to the state action finding was the public's inability to avoid indirect support of the discriminatory practices of a public utility. Because of the state-granted monopoly, consumers did not have the option of boycotting PT&T.²⁵¹ That will also be the case if the Insurance Commissioner approves of the use of territorial rating. California drivers cannot lawfully avoid giving indirect support to the insurance industry's discriminatory practices because they must buy liability insurance.²⁵² That state coercion, coupled with the fact that all insurance companies engage in the practice of territorial rating, creates a situation identical to the situation identified by the court in *Gay Law Students*.

The third state action factor in *Gay Law Students* was the enormous power over an individual's employment opportunities created by the state's actions.²⁵³ The insurance industry's ability to engage in territorial rating, and the uniformity of the practice within California, will be directly attributable to state action if the Insurance Commissioner approves the use of territorial rating.²⁵⁴ The requirement that drivers purchase automobile liability insurance is directly attributable to state action. The state has thus placed the insurance industry in a position where it can wield enormous power over an individual's right to drive. Since that enormous power is directly attributable to actions of the state,

249. Territorial rating is utilized by all insurance companies licensed to issue automobile insurance in California. See *supra* note 2. It can be convincingly argued that the victims of redlining are in a worse position than were the individual plaintiffs in *Gay Law Students*. The plaintiffs in that case could go to areas of the state not serviced by PT&T and seek employment free of the defendant's allegedly discriminatory practices. While the victims of redlining can, theoretically, move to an area that is not redlined, in reality their options are limited by economics and the unspoken racial restrictions that still exist in American society. See *supra* Part I.A.2.

250. See *supra* Part I.B.

251. *Gay Law Students*, 595 P.2d at 596.

252. See *supra* Part I.B.

253. 595 P.2d at 600.

254. In addition, it must be remembered that the existence of communities that are identifiably Black, Hispanic, Asian and/or poor is attributable, at least in part, to state action. *Serrano v. Priest*, 487 P.2d 1241, 1254 (Cal. 1971); *San Francisco Unified Sch. Dist. v. Johnson*, 479 P.2d 669, 676 (Cal. 1971). 1 GUNNAR MYRDAL, *AN AMERICAN DILEMMA: THE NEGRO PROBLEM AND MODERN DEMOCRACY* 348-49 (Pantheon Books 1972) (1944).

insurers can point to no legitimate countervailing interest in privacy or personal autonomy that could reasonably justify exempting their discriminatory practices from constitutional constraints.²⁵⁵

c. Symbiotic Relationship

The third theory of state action applicable to this problem was articulated by the California Supreme Court in *Mulkey v. Reitman*,²⁵⁶ when it declared Proposition 14 unconstitutional. Proposition 14 was an initiative measure that amended the California Constitution to prohibit state and local governments from denying, limiting, or abridging the right of any person to decline to sell property to anyone that person chose.²⁵⁷ The amendment was passed to nullify legislation intended to eliminate housing discrimination in California.²⁵⁸ The Unruh Civil Rights Act,²⁵⁹ which included language prohibiting discrimination by real estate brokers,²⁶⁰ the Hawkins Act,²⁶¹ which prohibited racial discrimination in publicly assisted housing; measures prohibiting restrictive racial covenants;²⁶² and the Rumford Fair Housing Act²⁶³ were examples of measures that Proposition 14 was intended to prohibit and repeal.²⁶⁴ The plaintiffs challenged the constitutionality of Proposition 14 under the California and federal constitutions.²⁶⁵

The California Supreme Court acknowledged that the Equal Protection Clause of the Fourteenth Amendment²⁶⁶ may be invoked only where the state is significantly involved in the discriminatory conduct.²⁶⁷ Cit-

255. *Gay Law Students*, 595 P.2d at 600. In *King v. Meese*, the majority argued in a footnote that the business of insurance only shares one characteristic with PT&T—the public's need to buy the product. 743 P.2d 889, 896-97 n.12 (1987). As the foregoing discussion illustrates, the court's summary dismissal of the parallels between insurers and public utilities is too facile.

256. 413 P.2d 825 (Cal. 1966).

257. *Id.* at 828.

258. *Id.* at 829.

259. CAL. CIV. CODE §§ 51-52 (Deering 1990).

260. *Id.* § 51. See *Burks v. Poppy Constr. Co.*, 370 P.2d 313, 316 (Cal. 1962); *Lee v. O'Hara*, 370 P.2d 321, 321-22 (Cal. 1962).

261. CAL. HEALTH & SAFETY CODE §§ 35700-35741 (repealed 1963) (West 1973).

262. CAL. CIV. CODE §§ 53, 782 (Deering 1990).

263. CAL. HEALTH & SAFETY CODE §§ 35700-35744 (West 1973).

264. *Mulkey*, 413 P.2d at 829.

265. The plaintiffs were two African-Americans who attempted to rent an apartment in Orange County. The landlords and managers refused to rent an apartment to the plaintiffs because of their race. The plaintiffs filed suit alleging that the refusal to rent to them violated the Unruh Act. The trial court ruled against the plaintiffs on the ground that the passage of Proposition 14 invalidated the Unruh Act. *Mulkey*, 413 P.2d at 827.

266. The court found it unnecessary to discuss the constitutionality of the measure under the state constitution. *Id.* at 828.

267. *Id.* at 830.

ing federal precedent, the court stated that conduct that is formally private can become so intertwined with governmental policies that it too will be deemed state action.²⁶⁸ The court then held that state action is present whenever the state, in any meaningful way, lends its processes to the achievement of discrimination, even though that goal was not within the state's purpose.²⁶⁹ The *Mulkey* opinion, citing *Shelley v. Kraemer*,²⁷⁰ also declares that whenever one who seeks to discriminate solicits and obtains the aid of government in accomplishing that goal, "significant state action, within the prescription of the equal protection clause, is involved." The court further held that this is true "even where the actor is a private citizen motivated by purely personal interests."²⁷¹

Finally, the *Mulkey* opinion, citing several United States Supreme Court opinions, emphatically declared that state authorization of private discriminatory conduct is prohibited by the Equal Protection Clause. The court concluded that such publicly aided private discrimination is state action, because state authorization means that the private party is acting "under the authority of state law."²⁷² The court stated:

We cannot realistically conclude that, because the final act of discrimination is undertaken by a private party motivated only by personal economic or social considerations, we must close our eyes and ears to the events which purport to make the final act legally possible. Here the state has affirmatively acted to change its existing laws from a situation wherein the discrimination practiced was legally restricted to one wherein it is encouraged, within the meaning of the cited decisions. Certainly the act of which complaint is made is as much if not more, the legislative action which authorized private discrimination as it is the final, private act of discrimination itself.²⁷³

The United States Supreme Court affirmed *Mulkey* in *Reitman v. Mulkey*.²⁷⁴ The Court observed that Proposition 14 "was intended to authorize, and does authorize, racial discrimination in the housing market. The right to discriminate is now one of the basic policies of the State."²⁷⁵

A decision to allow insurance companies to continue to use territorial rating, with its attendant adverse impact on minorities and the poor,

268. *Id.*

269. *Id.*

270. 334 U.S. 1 (1948).

271. *Mulkey*, 413 P.2d at 831.

272. *Id.* at 833.

273. *Id.* at 834.

274. 387 U.S. 369 (1967).

275. *Id.* at 381.

would be tantamount to the authorization of racial and economic discrimination in the automobile insurance market.

The intent of Proposition 103 was to end territorial rating. This is demonstrated by the legislative history of the measure. When an initiative is passed by the voters, the ballot arguments contained in the voters' pamphlet are the legislative history of the measure.²⁷⁶ In this instance, the best evidence of the intent of the voters in passing Proposition 103 lies in the analysis by the Legislative Analyst and the arguments submitted against the proposition. The summary of Proposition 103 prepared by the Office of the Legislative Analyst said the following about the impact of the measure on automobile insurance rates:

DETERMINING FACTORS FOR RATES. In general, the measure requires that rates and premiums for automobile insurance be determined on the basis of the insured person's driving record, miles driven and number of years of driving experience.²⁷⁷

The ballot argument submitted in rebuttal to the argument in favor of Proposition 103, stated that "RATES WILL INCREASE by an average 22% for two thirds of the state's drivers, according to the State Department of Insurance, because *PROP 103 eliminates rating based on the driving safety record of your neighborhood.*"²⁷⁸ In the argument against Proposition 103 contained in the voters' pamphlet, opponents contended that "PROP 103 forces insurers to ignore the driving safety record of where you live."²⁷⁹ Certainly, the insurance industry campaign against the initiative, outside of Los Angeles County, consistently informed voters that the initiative would raise their rates because it would eliminate territorial rating.²⁸⁰

Like the passage of Proposition 14, approval of territorial rating would place the imprimatur of the Commissioner and the state of Cali-

276. In *Carlos v. Superior Court*, 672 P.2d 862 (Cal. 1983), the supreme court remarked that California courts construing an initiative measure often refer to the analysis and arguments in the voters' pamphlet as an aid to ascertaining the intent of the framers and the electorate. *Id.* at 865. The case of *White v. Davis*, 533 P.2d 222 (Cal. 1975) offers an excellent example of the supreme court's use of this technique. In *White*, the supreme court was interpreting the newly enacted constitutional right to privacy, CAL. CONST. art. I, sec. 1, added to the state constitution by Proposition 11. In construing that constitutional provision, the supreme court relied heavily upon the election brochure arguments. The court noted that "California decisions have long recognized the propriety of resorting to such election brochure arguments as an aid in construing legislative measures and constitutional amendments adopted pursuant to a vote of the people." 533 P.2d at 234 n.11.

277. California Ballot Pamphlet, General Election, November 8, 1988, at 140.

278. *Id.* at 100 (emphasis added).

279. *Id.* at 101.

280. Kenneth Reich, *Insurers Seek to Keep Territorial Ratings*, L.A. TIMES, June 20, 1989, at A3.

ifornia on a practice of the insurance industry that clearly discriminates against racial minorities and the poor. Since Proposition 103 at minimum prohibits the use of territorial rating without the approval of the Insurance Commissioner, a decision approving the use of this rating factor would indeed encourage and condone a discriminatory practice. This would constitute state action under the standard established in *Mulkey*.²⁸¹ The complaint of the minorities and the poor adversely affected by a decision to allow redlining will be as much with the Commissioner's action as it will be with the industry's redlining practices.

B. A Decision To Allow the Use of Territorial Rating Should be Reviewed under the Strict Scrutiny Standard

The California Supreme Court has adopted a two-tier analysis for questions arising under the equal protection clauses of the California Constitution.²⁸² On the first tier, the state draws distinctions between different groups of individuals, which do not touch on "fundamental interests" or involve "suspect classifications." In those cases, the equal protection clauses require that the classifications bear a rational relationship to a legitimate public purpose.²⁸³ The second tier of cases are those where the legislation or action by the state involves "suspect classifications" or touches on "fundamental interests."²⁸⁴

The right to drive is not considered "fundamental."²⁸⁵ But redlining harms two suspect classes: racial minorities and the poor. Territorial rating discriminates on the basis of geography, so those suspect classes are not disadvantaged on the face of the policy. Moreover, there is no hard proof that the insurance industry or the state harbor an invidious purpose.²⁸⁶ So the first question is whether the strict scrutiny standard

281. *Mulkey* was decided under the Fourteenth Amendment to the federal constitution. While the United States Supreme Court has never overruled *Mulkey*, it is clear that the Court has retreated from the broad implications of that holding. See, e.g., *Crawford v. Los Angeles Board of Education*, 458 U.S. 527, 538 (1982); *Dayton Board of Education v. Brinkman*, 433 U.S. 406, 414 (1977).

California is free to apply the principles and standards it announced in *Mulkey* under the independent authority of the equal protection clauses of the California Constitution. See *supra* notes 194-98 and accompanying text.

282. CAL. CONST. art. I, §§ 7(a), 7(b); art. IV, § 16.

283. *Darces v. Woods*, 679 P.2d 458 (Cal. 1984).

284. The test for imposition of strict scrutiny is stated in the alternative: strict scrutiny is applied whenever a law or policy affects a fundamental interest *or* disadvantages a suspect class. *Id.*

285. See *infra* notes 308-12 and accompanying text.

286. While proof of such invidious purpose is difficult to come by, many charge that it is present. A study done by the New Jersey Department of Insurance acknowledged that base rates there varied inversely with the gross income of the territory. While the report concluded

should apply where the state policy has a disparate impact on suspect classifications, but there is no proof that the state or the insurance industry intend to engage in racial or economic discrimination.

1. *Disparate Impact on Racial Minorities*²⁸⁷

The California Supreme Court began to develop a disparate impact theory for cases involving racial discrimination under the state constitution in school desegregation cases. In these cases, the court held that the state equal protection clauses dictate that state officials are not constitutionally free to adopt a facially neutral policy if that policy has an actual, differential impact on minority children. The court began developing this standard in *Jackson v. Pasadena City School District*.²⁸⁸ In *Jackson*, the trial court sustained a demurrer to a complaint alleging that the Pasadena School District had gerrymandered junior high school boundaries so that white students would not have to attend a junior high school that had an enrollment with a high percentage of African-Americans and other racial minorities.²⁸⁹ In reversing this ruling, the supreme court held that even if the plaintiff could not prove intentional discrimination by the school district, he might be entitled to relief:

[E]ven in the absence of gerrymandering or other affirmative discriminatory conduct by a school board, a student under some circumstances would be entitled to relief where, by reason of residential segregation, substantial racial imbalance exists at his school. . . . Residential segregation is in itself an evil which tends to frustrate the youth in the area and to cause antisocial attitudes and behavior. Where such segregation exists it is not enough for a

that a case for a pattern of racial discrimination had not been made out, it acknowledged "the possibility of territorial boundaries doing the work of suspect or unlawful criteria." NEW JERSEY DEPARTMENT OF INSURANCE, HEARING ON AUTOMOBILE INSURANCE CLASSIFICATIONS AND RELATED METHODOLOGIES: FINAL DETERMINATION—MAJOR FINDINGS AND CONCLUSIONS 45 (1981). See also *Dunn v. Midwestern Indem. Mid-Am. Fire & Casualty Co.*, 472 F. Supp. 1106 (S.D. Ohio 1979); *Rights and Remedies of Insurance Policyholders, Part 1: Discrimination by Property and Casualty Insurance Companies: The Fairness in the Coverage and Cost of Insurance: Hearings Before the Subcomm. on Citizens and Shareholders Rights and Remedies of the Senate Comm. on the Judiciary, 95th Cong., 2d Sess. 223-351, 352-409, 410-51, 452-87, 634-748 (1978); In the Matter of the Public Hearings of the Insurance Commissioner Relating to Automobile Insurance—Territorial Classifications—Effect on Rates*, RH 207.

One commentator has recognized the force of these allegations: "When territory of residence functions as a close surrogate for race in automobile insurance, differential treatment on the basis of race has been symbolically eliminated, but for many persons the disparate treatment continues in fact through the use of territorial variables." Abraham, *supra* note 102, at 443 (emphasis added).

287. Race is the original "suspect classification." *McLaughlin v. Florida*, 379 U.S. 184, 191-92 (1964).

288. 382 P.2d 878 (Cal. 1963).

289. *Id.* at 879-80.

school board to refrain from affirmative discriminatory conduct. . . . The right to an equal opportunity for education and the harmful consequences of segregation require that school boards take steps, insofar as reasonably feasible, to alleviate racial imbalance in schools regardless of its cause.²⁹⁰

In the second case, *Crawford v. Board of Education of the City of Los Angeles*,²⁹¹ the court reviewed a trial court's ruling that the Los Angeles Unified School District was segregated. The trial court specifically found that the Board of Education had, since at least 1963, segregated its students de jure.²⁹² On appeal, the defendants argued that the segregation that existed was de facto.²⁹³ On that basis the defendants asserted that they had no constitutional obligation to remedy the situation.²⁹⁴

The supreme court rejected this argument. It observed that while maintenance of a neighborhood school policy might, on its face, appear neutral, the effect of such schemes is invariably to inflict a racially specific harm on minority students when such policies result in segregated education.²⁹⁵ The court quoted several studies noting that the harm associated with a segregated education occurred whether the segregation was de jure or de facto.²⁹⁶ Based on these conclusions, the court held that a school board is not free to adopt facially neutral policies where those policies have an "actual differential impact on the minority children in its schools."²⁹⁷ The court based this ruling entirely on the equal protection clauses of the California Constitution.²⁹⁸

290. *Id.* at 881-82. The court held that improper discrimination exists even where some white children attend predominantly black schools and vice versa. *Id.* at 881. The court quoted the *Jackson* opinion with approval in *San Francisco Unified Sch. Dist. v. Johnson*, 479 P.2d 669, 682 (Cal. 1971).

291. 551 P.2d 28 (Cal. 1976).

292. *Id.* at 30. De jure segregation has been described as "segregation specifically mandated by law or by public policy pursued under color of law." *Hobsen v. Hansen*, 269 F. Supp. 401, 493 (D.C. 1967). John W. Hanley, Jr., Comment, *Keyes v. School District No. 1: Unlocking the Northern Schoolhouse Doors*, 9 HARV. C.R.-C.L. L. REV. 124 (1974).

293. *Crawford*, 551 P.2d at 33. De facto segregation has been defined as "racial imbalance resulting merely from adherence to the traditional, racially neutral, neighborhood school policy in a community marked by racially segregated residential patterns." Frank I. Goodman, *De Facto School Segregation: A Constitutional and Empirical Analysis*, 60 CAL. L. REV. 275 (1972).

294. *Crawford*, 551 P.2d at 33.

295. *Id.* at 34.

296. *Id.* at 37.

297. *Id.* at 38. The court cited with approval *People v. Superior Court (Dean)*, 113 Cal. Rptr. 732, 736 (1974), and *People v. Spears*, 122 Cal. Rptr. 93 (1975). *Dean* and *Spears* are jury selection cases that hold that state officials have an affirmative obligation to develop rules and procedures that prevent discrimination. *Crawford*, 551 P.2d at 38.

298. Before *Crawford* was decided, the California Supreme Court's school desegregation opinions were not based on the California Constitution. The court was convinced that the United States Supreme Court would reject the de jure/de facto distinction. By the time *Craw-*

The development of this line of analysis in California courts was impeded by the passage of Proposition 1 in 1979. Proposition 1 amended Article I, section 7 of the California Constitution so that its provisions must be read parallel with the Equal Protection Clause of the United States Constitution with respect to the assignment of students for purposes of school desegregation.²⁹⁹ The result of the enactment of that constitutional amendment was that mandatory pupil reassignment (busing) may only be required where there is a finding of de jure discrimination.³⁰⁰ This effectively overruled the line of cases stating that the de jure/de facto distinction was meaningless under the California Constitution for cases involving busing.

Proposition 1 did not, however, abrogate the principle that the California Constitution imposes a duty on school officials to remedy segregation whether that discrimination is de facto or de jure. *McKinny v. Board of Trustees*, a school desegregation case, was decided after the enactment of Proposition 1.³⁰¹ One issue before the court was how the passage of Proposition 1 affected its decision in *Crawford*. The court concluded that the amendment merely conformed the School Board's obligations with respect to busing to the duties imposed by the federal constitution. The court emphatically stated that this was the only change wrought by the constitutional amendment:

However, the amendment neither releases school districts from their state constitutional obligation to take reasonably feasible

ford was decided, it seemed reasonably clear that the United States Supreme Court would employ the de facto/de jure distinction. See *Crawford*, 551 P.2d at 33-34 n.4. Ultimately, of course, the United Supreme Court did adopt that distinction. *Dayton Bd. of Educ. v. Brinkman*, 433 U.S. 406, 413 (1977). As a result, in *Crawford* the California Supreme Court explicitly based its ruling on the equal protection clauses of the California Constitution. *Crawford*, 551 P.2d at 35.

Article I, section 24 was added to the state constitution in 1974. It provides that "rights guaranteed by this Constitution are not dependent upon those guaranteed by the United States Constitution." The California courts have subsequently relied upon Article I, section 24 of the California Constitution as an additional source of the independent vitality of the state constitutional guarantees. See e.g., *People v. Brisendine*, 531 P.2d 1099, 1114 (Cal. 1975); *People v. Morgan*, 150 Cal. Rptr. 712, 720 (Ct. App. 1978).

299. The language of Article I, section 7 relevant to this discussion states:

A person may not be . . . denied equal protection of the laws; provided, that nothing contained herein or elsewhere in this Constitution imposes upon the State of California or any public entity, board, or official any obligations or responsibilities which exceed those imposed by the Equal Protection Clause of the 14th Amendment to the United States Constitution with respect to the use of pupil school assignment or pupil transportation.

CAL. CONST. art. I, § 7.

300. CAL. CONST. art. I, § 7; *Crawford v. Bd. of Educ.*, 170 Cal. Rptr. 495, 497-98 (Ct. App. 1980).

301. 642 P.2d 460 (Cal. 1982).

steps to alleviate segregation regardless of its cause, nor divests California courts of authority to order desegregation measures other than pupil school assignment or pupil transportation.³⁰²

In *Jackson* and *Crawford*, the court held that adoption of "neutral" policies are unconstitutional when they have an actual differential impact on minority children.³⁰³ In effect, the court ruled that the adoption of such measures involves the suspect classification of race.³⁰⁴

Jackson and *Crawford* demonstrate that a decision by the Insurance Commissioner to reinstate territorial rating should be subjected to strict scrutiny. First, territorial rating, unlike a decision to adopt a policy of neighborhood schools, is not a "neutral" policy. Territorial rating is a policy that on its face countenances discrimination. It allows insurers to charge different rates to drivers with exactly the same driving characteristics, owning exactly the same automobile. Those markedly different rates are based solely on a characteristic that bears *no* relationship to individual responsibility.³⁰⁵ Territorial rating is discrimination that runs afoul of the constitutional principle that burdens imposed by law should bear some relationship to individual responsibility or wrongdoing.³⁰⁶ That alone is enough, when coupled with the adverse impact of territorial rating on racial minorities, to require strict scrutiny.

Even if one accepts, for purposes of argument, that territorial rating could be construed as a "neutral" policy, studies done by the Department of Insurance amply demonstrate that the practice has an actual, differential, and adverse impact on racial minorities. Residents of Oakland, Compton, and South Central Los Angeles, as well as communities in Berkeley largely populated by racial minorities, currently pay substantially more for automobile insurance than they would pay if they lived in nearby predominantly white and relatively affluent neighborhoods.³⁰⁷ Thus, if the Insurance Commissioner were to approve of territorial rating, he would be lending the imprimatur of the state to a practice that adversely affects a suspect class, people of color. Based on the *Jack-*

302. *Id.* at 467.

303. *Jackson v. Pasadena City Sch. Dist.*, 382 P.2d 878, 880-81 (Cal. 1963); *Crawford*, 551 P.2d at 30.

304. The court held in *Jackson* and *Crawford* that the defendants had violated the Equal Protection Clauses, of the United States Constitution in *Jackson*, and the California Constitution in *Crawford*. Perhaps due to the clear mandate that existed for desegregation of the schools, the court did not discuss, in either case, what level of scrutiny it was applying in reviewing the actions of the defendants.

305. *See supra* Part I.A.

306. *Weber v. Aetna Casualty & Sur. Co.*, 406 U.S. 164, 175 (1972). *See supra* note 8 and accompanying text.

307. *See supra* notes 16-39 and accompanying text.

son/Crawford analysis, that decision should be subjected to strict scrutiny review.

There are two potential objections to the argument that the *Jack-son/Crawford* analysis requires use of strict scrutiny to assess the constitutionality of territorial rating. The first is that it is inappropriate to apply standards developed in cases involving education to a problem involving the right to drive a car. In California, education is recognized as a fundamental interest of the highest order.³⁰⁸ While the California courts have held that the right to drive is an important interest that affects the economic well-being of the state's citizens, they have refused to hold that it is a fundamental interest for equal protection purposes. In *Berlinghieri v. Department of Motor Vehicles*,³⁰⁹ the California Supreme Court observed that:

In our present travel-oriented society, the retention of a driver's license is an important right to every person who has obtained such a license. . . . Whether a driver's license is required only for delivering bread, commuting to work, transporting children or the elderly, meeting medical appointments, attending social or political functions, or any combination of these or other purposes, the revocation or suspension of that license, even for a six month period, can and often does constitute a severe personal and economic hardship.³¹⁰

Because of the importance of the right to drive, the California Supreme Court has held that, under the Due Process Clauses of the United States and California Constitutions, a decision to revoke or suspend a driver's license is subject to independent review.³¹¹ Nevertheless, the state supreme court has made it clear that statutes affecting the right to drive will not be subjected to strict scrutiny, because the right is not "fundamental," as that term is used in equal protection analysis.³¹²

Although the right to drive is not a "fundamental" right, a decision to allow the use of territory as a rating factor should be reviewed under the strict scrutiny standard. The test for applying strict scrutiny is stated in the alternative: strict scrutiny is required whenever a state law or policy affects a fundamental interest *or* affects a suspect classification.³¹³

308. In *Serrano v. Priest*, 487 P.2d 1241 (Cal. 1971), the California Supreme Court eloquently discussed the myriad reasons for its conclusion that education is a fundamental interest. *Id.* at 1255-59.

309. 657 P.2d 383 (Cal. 1983).

310. *Id.* at 387.

311. *Id.*

312. *Hernandez v. Department of Motor Vehicles*, 634 P.2d 917, 922 (Cal. 1981); *Perkey v. Department of Motor Vehicles*, 721 P.2d 50, 52 (Cal. 1986). Thus it would appear that redlining does not impinge on a fundamental interest.

313. *Darces v. Woods*, 679 P.2d 458, 469 (Cal. 1984).

Since territorial rating disadvantages a suspect classification—racial minorities³¹⁴—that alone is sufficient to require review under the strict scrutiny standard. When redlining's adverse impact on racial minorities is combined with the fact that failure to buy automobile insurance can lead to the loss of the important right to drive,³¹⁵ it can be argued convincingly that a decision to reinstate territorial rating must be examined under the most exacting constitutional standard.

*Hardy v. Stumpf*³¹⁶ raises a second argument against applying strict scrutiny because of territorial rating's disparate impact on minorities. In *Hardy*, the plaintiff was a woman who wanted to be a police officer. The City of Oakland required all candidates to pass a strength and agility test, which the plaintiff failed.³¹⁷ She argued that since the test disqualified a disproportionate number of female applicants,³¹⁸ it should be subjected to strict scrutiny.³¹⁹ The California Supreme Court rejected this contention, holding that disproportionate impact, *standing alone*, does not trigger the rule that gender or racial classifications are subjected to strict scrutiny.³²⁰

The *Hardy* court concluded that the physical agility and strength test being challenged was neutral on its face.³²¹ The court's holding in *Hardy* that proof of disproportionate impact alone was insufficient to invoke strict scrutiny was based on this finding of neutrality.³²²

The distinction between the situation in *Hardy* and the problem of territorial rating resides in the word "neutral." As explained before, territorial rating is not a "neutral" practice.³²³ Territorial rating explicitly discriminates, and does so without regard to individual responsibility.³²⁴ Since territorial rating is not a "neutral" practice, the holding in *Hardy*

314. *See supra* Part I.A.

315. *See supra* Part I.B.

316. 576 P.2d 1342 (Cal. 1978).

317. *Id.* at 1343-44.

318. Plaintiff proved that a disproportionate number of women were unable to pass one aspect of the test. *Id.* at 1344.

319. *Id.*

320. *Id.* at 1345.

321. *Id.* at 1344.

322. *Id.*

323. *See* Part I.A.

324. *See supra* note 156 and accompanying text. There is a second distinction between *Hardy* and the problem of redlining. Ms. Hardy could attempt to overcome her disqualification by practicing wall scaling and improving her skills. Indeed, the supreme court noted that Ms. Hardy passed the wall scaling test after she failed the agility examination, and that she could retake the physical agility test in four months. *Hardy*, 576 P.2d at 1344 n.1.

The victims of redlining cannot obtain lower rates by improving their driving skills. Because rates are determined by where drivers live, drivers in redlined areas are condemned to high rates by their neighborhoods alone.

should not immunize a decision to reinstate territorial rating from review under the strict scrutiny standard.

2. *Disparate Impact on the Poor*

In *Serrano v. Priest*,³²⁵ the California Supreme Court held that wealth is a suspect classification. The court agreed with the sentiment expressed by the United States Supreme Court that “a careful examination on our part is especially warranted where lines are drawn on the basis of wealth . . . [a] factor which would independently render a classification highly suspect and thereby demand a more exacting judicial scrutiny.”³²⁶ Based in part on that conclusion, the supreme court found that California’s geographic system for financing public education discriminated on the basis of wealth.

Carefully considered, the facts presented in *Serrano* demonstrate that it is best understood as a disparate impact case, even though the supreme court never mentions the term. In *Serrano*, the plaintiffs were challenging the constitutionality of California’s school financing system. California’s statutory system allocated resources on a territorial basis through the designation of local school districts, each with an individual and unique tax base.³²⁷

The defendants raised several contentions in defense of this system. One was that the classification was constitutional as long as it was based on the wealth of the district, not of the individual.³²⁸ The court rejected that contention, holding that discrimination on the basis of district wealth is also invalid. The court declared that to make the quality of a child’s education dependent on the fortuitous distribution of commercial property is an irrelevant basis for educational financing.³²⁹

The *Serrano* defendants also argued that the system was constitutional because the discrimination was unintentional, or de facto.³³⁰ The first *Serrano* opinion specifically rejected this contention:

[T]his Court held eight years ago such [de facto] discrimination invalid, and declared that school boards should undertake affirmative steps to alleviate racial imbalance, however created. Consequently, any discrimination based on wealth can hardly be vindicated by reference to de facto racial segregation, which we have already condemned. In sum, we are of the view that the

325. 487 P.2d 1241 (Cal. 1971).

326. *Id.* at 1250 (quoting *McDonald v. Board of Elections*, 394 U.S. 802, 807 (1969)).

327. *Id.* at 1246.

328. *Id.* at 1250-51.

329. *Id.* at 1252-53.

330. *Id.* at 1253.

school financing system discriminates upon the basis of the wealth of a district and its residents.³³¹

The supreme court remanded the case to the superior court for further proceedings.³³² A full trial was held on the allegations made by the plaintiffs. While the case was pending, the California Legislature made substantial changes in the laws governing school financing in an effort to respond to some of the plaintiffs' complaints.³³³

The trial court made extensive findings of fact and conclusions of law. It determined that while the changes instituted by the legislature did ameliorate some of the disparities in per pupil expenditures, it did not eliminate those disparities.³³⁴ Based on this finding, the trial court determined that the school financing system continued to discriminate on the basis of wealth. For that reason, the trial court held that the school financing system violated the equal protection provisions of the state constitution.³³⁵

In *Serrano v. Priest (Serrano II)*³³⁶ the California Supreme Court affirmed the trial court's ruling. The supreme court agreed with the trial court's conclusion that the school financing system discriminated on the basis of district wealth.³³⁷ The court acknowledged that *San Antonio Independent School District v. Rodriguez*³³⁸ invalidated its earlier conclusion that wealth was a suspect classification under the Fourteenth Amendment.³³⁹ In response, the court held that wealth is a suspect classification under the equal protection clauses of the California Constitution.³⁴⁰ Since the school financing scheme affected a suspect classification

331. *Id.* at 1255 (citations omitted).

332. *Id.* at 1266. The case had come before the supreme court after the trial court sustained demurrers to the complaint without leave to amend. *Id.* at 1245.

333. *Serrano v. Priest*, 557 P.2d 929, 931-32, 935-56 (Cal. 1976) (en banc) (*Serrano II*).

334. The trial court found, among other things, that poorer districts continued to have to tax themselves at higher levels than did wealthy districts in order to obtain the same level of service for their students, and that, to the extent that the state system continued to rely upon local property taxes to finance part of the schools, district wealth continued to determine what kind of education a child would receive. *Id.* at 939 n.20.

335. *Id.* at 939.

336. 557 P.2d 929 (Cal. 1976) (en banc).

337. The high court agreed with the trial court that the changes made in the school financing system by the Legislature, while a marked improvement, did not render the system acceptable under the state's equal protection clauses. *Id.* at 957-58.

338. 411 U.S. 1 (1973).

339. *Serrano II*, 557 P.2d at 951. In *Rodriguez*, the United States Supreme Court decided that wealth is not a suspect classification under the federal constitution. 411 U.S. at 28-29.

340. The California Supreme Court based its conclusion that wealth is a suspect classification on the independent vitality of the state equal protection provisions. *Serrano II*, 557 P.2d at 951.

and involved a fundamental interest,³⁴¹ it was subjected to strict scrutiny.³⁴² The court declared the scheme unconstitutional because it did not serve a compelling state interest.³⁴³

The statistics collected by the California Department of Insurance prove that territorial rating causes residents of the poorest areas of this state's major metropolitan areas to pay the highest rates in the state for automobile insurance.³⁴⁴ Like the school financing scheme under fire in *Serrano*, territorial rating promotes line-drawing on the basis of wealth, and has a proven adverse impact on the poor. Because the *Serrano* opinion declares that such line-drawing independently renders a classification highly suspect,³⁴⁵ a decision to reinstate territorial rating should be reviewed using strict scrutiny.³⁴⁶

C. A Decision to Permit Territorial Rating Would Not Survive Strict Scrutiny

1. *The State Has a Compelling Interest in Making Automobile Insurance Available*

The California Supreme Court has treated measures that disadvantage a "suspect class" as presumptively invidious.³⁴⁷ The court enforces the mandate of equal protection in those cases by requiring the state to demonstrate that the classification serves a compelling state interest that

341. The supreme court also declared that education is a fundamental interest under the state constitution. The court relied upon the equal protection clauses of the state constitution, and three of its sections that specifically control the provision and financing of public education. *Id.* at 950 n.42.

342. The court hedged on declaring wealth a full fledged "suspect classification." It stated that it was not holding that all cases involving governmental classifications based upon wealth warranted strict scrutiny review. Instead, the court declared that the combination of wealth discrimination affecting education, a fundamental interest, required strict scrutiny under the California Constitution. *Id.* at 951 n.45. It should be noted that the court has held on at least one other occasion that discrimination based upon poverty invokes strict scrutiny. *In re Antazo*, 473 P.2d 999, 1000 (Cal. 1970) (en banc). *See also* Committee to Defend Reprod. Rights v. Myers, 625 P.2d 779, 796 (Cal. 1981) (stating that the indigent poor share many characteristics of other "insular minorities" who may not be adequately protected from discriminatory treatment).

343. *Serrano II*, 557 P.2d 953.

344. *See supra* Part I.A.

345. *Serrano v. Priest* (*Serrano I*), 487 P.2d 1241, 1250 (Cal. 1971).

346. This is especially true because territorial rating could cause residents of inner cities to lose their driving privileges. While the right to drive is not fundamental, it is an important right that is deserving of constitutional protection from arbitrary termination. *See supra* notes 309-12 and accompanying text.

The combination of redlining's potential effect on the important right drive with its effect on the suspect classifications of race and wealth should subject a decision to reinstate territorial rating to strict scrutiny review.

347. *Darces v. Woods*, 679 P.2d 458, 470 (Cal. 1984).

justifies the law.³⁴⁸

The state should make insurance available to all who need or desire it. Often, the purchase of insurance is required by lenders as a condition for obtaining loans.³⁴⁹ In other instances, the individual's personal circumstances require the purchase of insurance as a hedge against potentially disastrous personal liability claims or losses.³⁵⁰ In this context, the United States Supreme Court recognized in 1914 that insurance is, in many cases, a necessity.³⁵¹

The state is a beneficiary of an efficient insurance system. Insurance reduces the cost to the public fisc of the losses caused by accidents.³⁵² To protect the state's interest in the insurance system, the Insurance Code contains extensive statutory protection against insurer insolvency.³⁵³ The state also has created a safety net to protect consumers when insurers become insolvent or appear to be on the verge of insolvency.³⁵⁴ The existence of these mechanisms demonstrates the depth of the state's interest in guarding the solvency of insurers.

Finally, the enactment of statutes that mandate the purchase of automobile liability insurance imposes on the state a due process obligation to make that insurance available at rates that are neither arbitrary nor capricious.³⁵⁵

Allowing insurers to set rates on the basis of group classifications is generally defended on the ground that this is the best method available for spreading risk in a manner that allows insurers to set rates and make a reasonable profit.³⁵⁶ It is said that while it would be ideal to set each individual's rates on the basis of her own personal characteristics, it is not possible or it is too expensive to collect the data necessary to allow

348. *Id.* at 94.

349. CASEY, PEZIER & SPETZLER, *supra* note 85, at 7. See also OFFICE OF THE FEDERAL INSURANCE ADMINISTRATOR, INSURANCE CRISIS IN AMERICA (1977), in *Rights and Remedies of Insurance Policyholders*, *supra* note 286.

350. Wortham, *supra* note 193, at 395.

351. *German Alliance Ins. Co. v. Kansas*, 233 U.S. 389, 414 (1914). The Court was speaking of fire insurance in that case.

352. *Id.* at 413.

353. See *supra* notes 236-42 and accompanying text.

354. CAL. INS. CODE §§ 1010-1065 (West Supp. 1991).

355. *King v. Meese*, 743 P.2d 889, 897 (Cal. 1987). See *supra* notes 149-50.

356. AUTOMOBILE INSURANCE - TERRITORIAL CLASSIFICATIONS - EFFECT ON RATES, RH 207, 8-9 (California Insurance Commissioner 1979); STATE RATING BUREAU, MASSACHUSETTS DIVISION OF INSURANCE, AUTOMOBILE INSURANCE RISK CLASSIFICATION: EQUITY & ACCURACY, at 2-3 (1978); *Rights and Remedies of Insurance Policyholders, 1978: Hearings Before the Subcomm. on Citizens and Shareholders Rights and Remedies of the Comm. on the Judiciary*, United States Senate, 95th Cong., 2d. Sess. 106 (1978) (Prepared Statement on Behalf of the National Association of Insurance Commissioners).

individualized rate setting.³⁵⁷ Accepting that premise as true, it follows that allowing insurers to set rates based on membership in some manner of classification probably serves the state's compelling interest in keeping the state's insurers solvent so that automobile liability insurance is available.

2. *The State Must Show that Territorial Rating Is Necessary to Advance the State Interest in Making Automobile Insurance Available*

While the state can show that maintaining insurer insolvency is a compelling interest, the second prong of the strict scrutiny test is not so easily satisfied. Where a statute affects suspect classifications, the state bears the burden of proving that the distinctions drawn by the law are necessary to further the state's purpose.³⁵⁸ Even if a measure affecting suspect classifications is deemed "necessary," it must be precisely tailored to serve the state's compelling governmental interest.³⁵⁹ If there are less restrictive alternatives available, a statute will not survive strict scrutiny.³⁶⁰

357. One commentator wrote of this issue:

The need to make allowance for competent operation was recognized early, but the problem has defied solution; human qualities, the best possible basis for rating, are impossible to evaluate accurately. The entire history of auto liability insurance rate making has been the search for bases of rating which would parallel the unattainable goal of measuring individual driver's abilities and habits.

H. JEROME ZOFFER, *THE HISTORY OF AUTOMOBILE LIABILITY INSURANCE RATING* 14 (1959).

Another observer concluded that:

Perfect risk assessment by rating would accurately predict the risk any individual represents. But because most people have too few accidents to establish their probability of loss — even after many years of driving — such prediction is impossible.

STATE RATING BUREAU, MASSACHUSETTS DIVISION OF INSURANCE, *AUTOMOBILE INSURANCE RISK CLASSIFICATION: EQUITY AND ACCURACY*, at 2 (1978).

And the National Association of Insurance Commissioners informed Congress that:

Ideally, individual risk would be scrutinized and weighed like a commodity to price each buyer with precise accuracy according to the buyer's true loss potential Unfortunately, the best a supplier of insurance can do for small risks is to establish a class price for a class of similar risks based upon average experience

Rights and Remedies of Insurance Policyholders, 1978: Hearings Before the Subcomm. on Citizens and Shareholders Rights and Remedies of the Comm. on the Judiciary, United States Senate, 95th Cong., 2d. Sess. 107 (1978) (Prepared Statement on Behalf of the National Association of Insurance Commissioners).

358. *Darces v. Woods*, 679 P.2d 458, 473 (Cal. 1984); *In re Antazo*, 473 P.2d 999, 1005 (Cal. 1970).

359. *Darces*, 679 P.2d at 473.

360. *Payne v. Superior Court*, 553 P.2d 565, 570 (Cal. 1976) (en banc).

3. *The Use of Territorial Rating Is Not "Necessary"*

The use of territorial rating is not "necessary" to further the state's interest in maintaining insurer solvency. Robert Hunter, a former actuary and then the Deputy Federal Insurance Administrator³⁶¹ testified before Congress that any system of rating criteria can be made "actuarially sound."³⁶² Defining the term to mean achieving a reasonable profit for insurers, Hunter stated that an insurer could eliminate age, sex, and even territory, take a map of a state, compile the number of dollars it wanted to generate, and create a plan that was "actuarially sound" using merit rating criteria.³⁶³ Since alternatives are available that would allow insurers to create appropriate classes and write insurance profitably,³⁶⁴ the need to create group classifications does not render territorial rating necessary.

Insurers contend that approval of territorial rating is required because it is "actuarially sound." This contention is based on the language of California Insurance Code section 1861.05(a), which provides "No rate shall be approved or remain in effect which is excessive, inadequate, unfairly discriminatory"

Even if this contention is correct,³⁶⁵ the statutory language cannot override the mandate of the California Constitution that burdens imposed by the law bear some relationship with individual responsibility.³⁶⁶ In *Hartford Accident & Indem. Co. v. Insurance Comm'r*,³⁶⁷ insurers contended that similar language in the Pennsylvania Casualty and Surety Rate Regulation Act required the Insurance Commissioner to approve the use of gender-based rating criteria if the insurers could support the rates with actuarial data.³⁶⁸ The Pennsylvania Supreme Court rejected that contention, holding that the equal rights amendment to the Pennsylvania Constitution allowed the Insurance Commissioner to reject gender-based classifications despite their statistical relationship to risk of

361. Mr. Hunter is now the Director of the National Insurance Consumers Coalition.

362. *Rights and Remedies of Insurance Policyholders, 1978: Hearings Before the Subcomm. on Citizens and Shareholders Rights and Remedies of the Comm. on the Judiciary*, United States Senate, 95th Cong., 2d. Sess. 219 (1978) (testimony of Robert Hunter, Deputy Federal Insurance Administrator, Department of Housing and Urban Development).

363. *Id.* See also *Opinion, Findings and Decision on 1978 Automobile Insurance Rates*, *id.* at 521. (James Stone, Commissioner of Insurance, Massachusetts).

364. See *infra* Part IV.

365. There is substantial evidence to suggest that this language was never intended to require certain forms of classification. Wortham, *supra* note 193, at 381-393.

366. *Darces*, 679 P.2d 458, 474 (Cal. 1984).

367. 482 A.2d 542 (Pa. 1984).

368. *Id.* at 546.

loss. The court relied, in part, on this observation of the National Association of Insurance Commissioners:

[P]ublic policy . . . require[s] more adequate justification for rating factors than simple statistical correlation with loss; in this regard the task force recommends consideration of criteria such as causality, reliability, social acceptability, and incentive value in judging the reasonableness of a classification system.³⁶⁹

Nor is the selection of territory as a rating classification mandated by scientific or actuarial principles.³⁷⁰ The choice of rating classifications is in part a marketing device used by insurers to attract desirable policyholders and discourage undesirable potential policyholders.³⁷¹ Indeed, the popularity of territorial rating may be explained, in part, by its ability to discourage urban drivers, who are generally people of color and poor, from purchasing insurance.³⁷² Its popularity may also be attributable to the prejudices and stereotypes held by those making rating decisions.³⁷³

369. *Id.* at 548.

370. Professor Abraham put the proposition succinctly: "[T]here is nothing special or preordained about the classifications that turn out to be efficient." Abraham, *supra* note 102, at 423. He makes the point that economics prevent insurers from experimenting with new classifications. No individual insurer will restructure its rates because of the costs involved in collecting and analyzing the data for the new classification. Competitors would take advantage of the new classification without incurring the cost of developing the system and the data to support it. Thus, Abraham argues, it will require collective action for innovation to occur. *Id.* In this case, the innovation would occur if the Insurance Commissioner ordered an end to territorial rating. The New Jersey Department of Insurance also commented on the lack of scientific basis for many insurance classifications:

Choices of classification variables were more the product of competitive pressures than of any scientific effort to identify the full range of differences in risk among insureds. Selection among numerous alternatives was largely a matter of judgment . . . industry witnesses cannot produce a single traffic or population study, field observation, or other systematic study of any kind relating to the establishment of existing territorial boundaries. Efforts to explore with industry witnesses the thinking behind specific choices of variables were largely met with disclaimers of any direct or detailed information.

HEARING ON AUTOMOBILE INSURANCE CLASSIFICATION, *supra* note 17, at 5. *See also*, AUTOMOBILE INSURANCE RATE CLASSIFICATION, *supra* note 117, at 6.

371. Regina Austin, *The Insurance Classification Controversy*, 131 U. PA. L. REV. 517, 535; AUTOMOBILE INSURANCE RATE CLASSIFICATION, *supra* note 370, at 7, 8-9, 11; *See also* CASEY, PEZIER & SPETZLER, *supra* note 85, at 13.

372. The Stanford Research Institute noted that it found an inverse relationship between wealth and the amounts charged in rating territories in urban/suburban areas:

Territorial classifications show that disposable income is the highest on the average in medium rated territories, typically the suburban territories, and drops significantly both for the lowest rated territories (rural areas) and the highest rated territories (inner city areas).

CASEY, PEZIER & SPETZLER, *supra* note 85, at 97.

373. AUTOMOBILE INSURANCE RATE CLASSIFICATION, *supra* note 117, at 6, 8. That such assumptions and stereotypes might contribute to the making of rate classifications is vividly

While territorial rating may be profitable for insurers, its use is not required by statute or by principles of sound insurance rating policy. In short, the use of territory is not necessary to effectuate the state's compelling interest.³⁷⁴

The insurance industry objects that the loss of territorial rating would result in a "subsidy" to urban drivers.³⁷⁵ The fact that a subsidy might be created for urban drivers does not provide a compelling reason for the state to sanction continuation of a rating practice that discriminates against minorities and the poor. In a sense, all insurance classifications create subsidies, to the extent that they group poorer risks with better risks.³⁷⁶ The New Jersey Department of Insurance concluded that because of the inaccuracies inherent in territorial rating, the subsidy in many cases runs from the good urban driver to poor risks living in suburban and rural areas:

Direct assessment of the expected claims of individuals within each territory indicates an alarming frequency and magnitude of pricing errors in the higher rated territories. In the highest rated territory, for example, 35% of the adult base class is overcharged at least \$300.00 in relation to . . . expected costs for full coverage; 15% of

illustrated in the SRI study of automobile insurance rate classification. It quotes an insurance executive defending high inner city rates. The executive stated:

I used to live in one of those congested Chicago areas . . . and I can tell you that the higher insurance rates were primarily a homegrown phenomenon, the product of too little off-street parking, narrow streets designed for an earlier era, *very aggressive driving habits due in part to tensions among ethnic [sic] groups, high alcohol consumption among both drivers and pedestrians, a high level of claims consciousness*

CASEY, PEZIER & SPETZLER, *supra* note 85, at 60-61 (emphasis added). The SRI study acknowledged that many beliefs widely held by the insurance industry having little foundation in fact may be reflected in the availability and price of premiums. *Id.* at 31.

374. That insurers make money by using territorial rating, or that it will cost money to devise new classifications does not mean that territorial rating is "necessary" under the California Constitution. Proof that the use of suspect classifications results in administrative convenience or cost savings does not satisfy the necessity requirement. *Shapiro v. Thompson*, 394 U.S. 618, 636-38 (1969); *Memorial Hosp. v. Maricopa County*, 415 U.S. 250, 267-69 (1974); *Boren v. Department of Employment Dev.*, 130 Cal. Rptr. 683, 689-90 (Ct. App. 1976).

375. Typical of the industry position is this quotation from Lowell Beck, the president of the National Association of Independent Insurers:

While "the promoters of these initiatives [referring to Proposition 103] promise rate cuts and talk about competition and fairness, in reality they are talking about a hidden subsidy system That system takes money from good risks and uses that money to reduce the rates of higher risks *or those who function in high risk areas*"

Kathryn J. McIntyre, *Industry Stresses Fairness, Respect: Beck*, BUSINESS INSURANCE, November 20, 1989, at 91 (emphasis added). A spokesman for the American Insurance Industry claimed that proposals under Proposition 103 to eliminate the use of territory produce "unfair subsidies." *AIA To Unveil California Auto Rate Program*, NATIONAL UNDERWRITER—PROPERTY AND CASUALTY, November 27, 1989, at 6.

376. Abraham, *supra* note 102, at 422.

these adults are overcharged at least \$500.00.³⁷⁷

The question is how those inevitable subsidies are to be distributed.³⁷⁸ As the United States Supreme Court observed in *Los Angeles Department of Water and Power v. Manhart*:³⁷⁹

[W]hen insurance risks are grouped, the better risks always subsidize the poorer risks Treating different classes of risks as though they were the same for purposes of group insurance is a common practice which has never been considered inherently unfair. To insure the flabby and the fit as though they were equivalent risks may be more common than treating men and women alike; but nothing more than habit makes one "subsidy" seem less fair than the other.³⁸⁰

No insurer can prove that automobile liability insurance cannot be written prudently without resort to territorial rating. It is merely the habit, of insurers and of society as a whole, of penalizing minorities and the poor that makes the subsidy created by territorial rating acceptable. There is no compelling reason for the state to allow that practice to continue, because there are adequate alternative rating classifications available.³⁸¹

377. AUTOMOBILE INSURANCE RATE CLASSIFICATION, *supra* note 117, at 18-19.

378. This point was noted by the Massachusetts study of the problem of classification in automobile insurance rating. None of the rating criteria used in automobile insurance rating fared particularly well in predicting risk of loss. Thus the Massachusetts Division of Insurance concluded that:

[T]he decision of whether to retain, remove or institute a particular variable will depend upon the relative weight given to the variable's performance with respect to each criterion. . . . The choice made will differ depending upon which trade-offs are considered reasonable. *It is important to recognize that such trade-offs cannot be avoided in selecting a classification scheme.*

EQUITY & ACCURACY, *supra* note 117, at 2-6, 21 (emphasis added).

379. 435 U.S. 702 (1978).

380. *Id.* at 710. Even those experts sympathetic to the arguments of the insurance industry concur that the use of territory involves a "subsidy." Thus the National Association of Insurance Commissioners, whose testimony generally favored the continued use of territorial rating, informed Congress that:

[A] pure merit-rating system might impose an intolerable burden on those who are unfortunate enough to have accidents. The present system, by putting drivers in different groups with separate classifications, *tempers loss experience and makes it feasible for drivers with accident records to obtain insurance at prices which are not prohibitive.*

Rights and Remedies of Insurance Policyholders, *supra* note 286, at 108 (Prepared Statement on Behalf of the National Association of Insurance Commissioners) (emphasis added).

381. *See infra* notes 382-88, and accompanying text.

IV. A Proposed Solution to the Automobile Insurance Rating Dilemma

A. A System for Evaluating the Constitutionality of Rating Criteria

There is an inherent tension between the equal protection ideal that burdens imposed bear some relationship to individual responsibility³⁸² and insurers' need to place drivers in categories that bear some relation to the risk of loss presented.³⁸³ If territorial rating is eliminated,³⁸⁴ insurers will need alternative classifications for grouping risks that conform to the constitutional ideal.

Professor Leah Wortham has proposed a useful analytical system for evaluating rating criteria which strikes an appropriate balance between the insurers' need for categories that accurately predict risk of loss and the constitutional and social imperative of equal treatment. Wortham has suggested that rating classifications should be evaluated using the following criteria:

- (1) The statistical power of the characteristic's prediction of loss;
- (2) The degree of statistical separation of the grouping of insureds from the remainder of the insured population, which results from use of the category;³⁸⁵
- (3) Whether the characteristic's relation to loss can be supported by a persuasive causal explanation;³⁸⁶

382. See *Weber v. Aetna Casualty & Sur. Co.*, 406 U.S. 164 (1972), *supra* note 8 and accompanying text.

383. See *supra* note 153 and accompanying text.

384. Territorial rating could be substantially modified to reduce its discriminatory racial and economic impact within urban areas. One solution suggested by former Insurance Commissioner Gillespie would have created "regional territories." Memorandum from Roxani Gillespie, Insurance Commissioner (August 1989) Chart 2. This proposal would alleviate the most egregious aspect of territorial rating: It would eliminate insurers' ability to isolate territories on the basis of their racial composition and then charge those territories the highest rates within a geographical area. This change would not, however, eliminate the racial impact of territorial rating. As Justice Broussard observed, part of the racial impact of territorial rating is due to the fact the lowest rates in the state are charged in rural areas, where few people of color reside. *King v. Meese*, 745 P.2d 889, 902 n.8 (1987) (Broussard, J., concurring). That impact would remain.

The racial and economic impact of territorial rating would be further ameliorated if the Commissioner moved towards the Massachusetts/New Jersey model of "tempering" the impact of territory on rates. See *supra* note 117.

385. "Separation" measures the degree to which insureds in different risk classes have different expected losses. Abraham, *supra* note 102, at 410; EQUITY AND ACCURACY, *supra* note 117, at 3.

386. The inquiry is whether there is a direct causal connection between the criterion used and the likelihood of accident. An example of poor causal explanation is provided by the use of gender as a rating factor. While gender does have a high degree of predictive power and separation (i.e. statistics show that males tend to have more automobile accidents than fe-

(4) The degree of incentive for reduction in the number or cost of losses created by the use of the characteristic in rating;³⁸⁷

(5) The degree to which the classification is controllable by individual insureds;

(6) The compatibility of the use of the characteristic with widely held social values; and

(7) The alternatives to private insurance available to potential insureds who cannot purchase the concerned coverage.³⁸⁸

1. Territorial Rating

Territorial rating seems to be a valid predictor of loss³⁸⁹—although its performance in that category is not overwhelming.³⁹⁰ It fares badly on the rest of the Wortham criteria. The degree of separation for territorial rating is poor, particularly in high-rated territories.³⁹¹ The connection between the place where an automobile is garaged and the risk of loss is not supported, for the most part, by a persuasive causal explanation.³⁹² Territory is actually a surrogate for a complex of factors that contribute to the risk of loss.³⁹³ While the location where an automobile is garaged does have some gross causal relationship to the risk of loss,³⁹⁴ the strength of that relationship has been found to be minimal.³⁹⁵ Terri-

males), the gender of the drivers does not cause the accidents. *EQUITY & ACCURACY*, *supra* note 117, at 10.

387. One objective of insurance rating is to create incentives to halt or modify the behavior which causes accidents. *Id.* at 6; CASEY, PEZIER & SPETZLER, *supra* note 85, at 89. This criterion assumes that rating characteristics should encourage drivers to modify behavior that results in their placement in higher rating categories.

388. Wortham, *supra* note 193, at 417-18.

389. The available data suggest that territory is a valid statistical predictor of loss. Memorandum from the California Insurance Commissioner, accompanying Proposed Regulations on Private Passenger Automobile Rating Factors 2 (December 5, 1989); CALIFORNIA DEPARTMENT OF INSURANCE, RATE REGULATION DIVISION, STUDY OF CALIFORNIA DRIVING PERFORMANCE BY ZIP CODE (Phase II) 210 (1978); CASEY, PEZIER & SPETZLER, *supra* note 85, at 49.

390. While the SRI study concluded that insurers should be able to use territory as a rating criterion, it acknowledged that territory could explain only seven percent of the risk of loss. Other rating criteria perform as poorly. CASEY, PEZIER & SPETZLER, *supra* note 85, at 49 (1976).

391. *EQUITY AND ACCURACY*, *supra* note 117, at 14-15.

392. As noted earlier, even the advocates of territorial rating acknowledge that neighborhoods do not cause accidents. *See supra* note 156 and accompanying text.

393. *See supra* note 156.

394. AUTOMOBILE INSURANCE CLASSIFICATIONS AND RELATED METHODOLOGIES 44-52 (New Jersey Department of Insurance 1981) (Final determination).

395. *Id.*

tory provides no incentive to reduce loss costs,³⁹⁶ and because of patterns of housing segregation and economic limitations, it is not controllable by most insureds who live in redlined communities.³⁹⁷ Territorial rating is completely incompatible with the constitutional value that burdens should be borne according to individual responsibility.³⁹⁸ Although there is an alternative to private insurance available to those adversely affected by redlining—assigned risk coverage—its rates are also set using territory as the primary rating factor.³⁹⁹

2. *The Proposition 103 Rating Factors*

Using Professor Wortham's criteria, it is apparent that two of the three primary rating factors specified by Proposition 103 perform well. The first factor identified by Proposition 103 is the insured's driving safety record.⁴⁰⁰ Driving safety record has strong predictive power.⁴⁰¹ The relationship to loss can be explained by a causal connection; drivers with poor safety records tend to have more accidents than do drivers with good safety records.⁴⁰² The incentive to improve driving habits will be substantial, because drivers with good safety records will receive the

396. EQUITY AND ACCURACY, *supra* note 117, at 14-15. The only incentive is to move from an urban area to rural and suburban areas. As the Massachusetts Division of Insurance noted, that is a dubious incentive. *Id.*

397. *See supra* Part I.A.2.

398. *See Weber v. Aetna Casualty & Sur. Co.*, 406 U.S. 164 (1972), *supra* note 8 and accompanying text.

399. STUDY OF CALIFORNIA DRIVING PERFORMANCE BY ZIP CODE (Phase I), *supra* note 2, at 41-47; *King v. Meese*, 745 P.2d 887, 906 (Cal. 1987) (Broussard, J., concurring).

400. CAL. INS. CODE § 1861.02 (a)(1) (West Supp. 1992).

401. The California Department of Insurance concluded that "past driving history would appear to be one of the strongest of all predictors of future accident potential" STUDY OF CALIFORNIA DRIVING PERFORMANCE (Phase II), *supra* note 156, at 213. Massachusetts Insurance Commissioner James Stone stated that "[t]here is an obvious relationship between past driving record and future loss expectancy." *Rights and Remedies*, *supra* note 286, at 525 (Appendix E, Opinion, Findings and Decision on 1978 Automobile Insurance Rates). The New Jersey Department of Insurance also concluded that "[a]ccident and driver conviction records bear a direct relation to actual driving behavior . . . explanatory power of merit rating compares favorably with demographic and geographic variables." NEW JERSEY DEPARTMENT OF INSURANCE, HEARING ON AUTOMOBILE INSURANCE CLASSIFICATIONS AND RELATED METHODOLOGIES: FINAL DETERMINATION—MAJOR FINDINGS AND CONCLUSIONS, at 57-58 (1981) [hereinafter HEARING ON AUTOMOBILE INSURANCE CLASSIFICATIONS].

402. The California Department of Insurance found that drivers with poor records have many more accidents than do drivers who are free of convictions and accidents. The Department thus concluded that "from an actuarial standpoint, these data would clearly support charging bad record drivers higher premiums because the expected number of accident claims of bad record drivers would be much higher." STUDY OF CALIFORNIA DRIVING PERFORMANCE (Phase II), *supra* note 156, at 101. The SRI study noted that about 11% of drivers have an accident likelihood at least twice as large as the average. CASEY, PEZIER & SPETZLER, *supra* note 85, at 44.

most favorable liability insurance rates.⁴⁰³ That incentive will be increased because Proposition 103 also has a safe driver provision which ensures an additional twenty percent discount for drivers with good safety records.⁴⁰⁴

An individual insured's driving record is clearly controllable by the insured's own actions, at least to the extent that his/her own care in driving affects the number of accidents and moving violations incurred.

The characteristic has the advantage of being compatible with a number of widely held social and legal values. It comports with the constitutional imperative that burdens imposed should bear some relationship to individual responsibility or wrongdoing.⁴⁰⁵ Drivers whose rates are increased because of carelessness in accumulating accidents or moving violations will understand the cause of their unfavorable treatment, and know it is due to their own actions, as opposed to the accident of their place of residence.

Finally, those drivers whose rates in the private market might become prohibitive because of poor driving records will have an alternative available: the assigned risk pool.⁴⁰⁶ Indeed, the only fault with driving safety record, under the Wortham criteria, is that the degree of separation for merit rating may be poor.⁴⁰⁷

The second rating factor approved by Proposition 103 is the number of miles driven annually.⁴⁰⁸ This rating factor also fares well under Professor Wortham's evaluation criteria. Annual mileage has a high degree of statistical power as a loss predictor.⁴⁰⁹ The characteristic has a straightforward relationship to risk of loss, which is supported by a causal explanation—the more miles you drive, the more likely it is that

403. EQUITY & ACCURACY, *supra* note 117, at 57; HEARING ON AUTOMOBILE INSURANCE CLASSIFICATIONS, *supra* note 401, at 57.

404. CAL. INS. CODE § 1861.02(b) (West Supp. 1992).

405. Weber v. Aetna Casualty & Sur. Co., 406 U.S. 164, 175. See *supra* note 8 and accompanying text.

406. California has an extensive assigned risk program for motorists. CAL. INS. CODE §§ 11620-11627 (West Supp. 1992). Presently, because of the effects of redlining, many residents of minority communities must purchase their automobile insurance through the assigned risk program, regardless of their driving record. King v. Meese, 745 P.2d 889, 907-08 (Broussard, J., concurring).

407. CASEY, PEZIER & SPETZLER, *supra* note 85, at 45-46.

408. CAL. INS. CODE § 1861.02(a)(2) (West Supp. 1992).

409. HEARING ON AUTOMOBILE INSURANCE CLASSIFICATIONS, *supra* note 401, at 54; EQUITY & ACCURACY, *supra* note 117, at 17; Abraham, *supra* note 102, at 412. Abraham notes in his article that insurers do not like to use mileage, despite its high predictive value, because of the difficulty in obtaining accurate information from insureds. Accord EQUITY & ACCURACY, *supra* note 117, at 17; HEARING ON AUTOMOBILE INSURANCE CLASSIFICATIONS, *supra* note 401, at 56-57; O'Hare, *Information Strategies as Regulatory Surrogates, in Social Regulation: Strategies for Reform* 221, 232 (E. Bardach & R. Kagan eds., 1982).

you will have an accident, regardless of your skill and/or care as a motorist.⁴¹⁰ Use of this factor also provides an incentive for reduction in losses, since you can cut your rates by reducing your mileage.⁴¹¹ Mileage can be controlled by the insured, with the possible exception of mileage directly attributable to demands of employment. Like driving safety record, the use of total miles driven is compatible with widely held social values. It is consistent with the notion that burdens imposed should bear some relationship to individual responsibility or wrongdoing. Drivers whose rates are high because they accumulate high mileage will know the cause for their rates, and will also know that those rates are due to their driving habits, not the accident of their place of residence.

Assigned risk coverage will be available to those assessed high rates due to excessive mileage accumulations. Presumably, if the excess mileage is due to the demands of work, employees will be able to negotiate partial payment of premiums, or increased mileage allowances, based on the additional burdens imposed due to their employment.⁴¹²

The third factor approved by Proposition 103 is years of driving experience.⁴¹³ Evaluation of this rating factor under Professor Wortham's criteria produces mixed results. The available evidence suggests that driving experience has good predictive power. The Massachusetts Division of Insurance conducted a study that concluded that the predictive power of years of driving experience compared favorably with age, a rating factor used by virtually all companies writing automobile insurance (where permitted).⁴¹⁴ The relationship of driving experience to risk loss can be explained by a causal connection; as with any skill, drivers make more errors when beginning to drive than at a later time.⁴¹⁵

On the negative side of the ledger, the variable is not totally controllable by the insured. The beginning of a driver's learning curve is usually determined by the minimum age for obtaining a driver's license.⁴¹⁶ Because the variable cannot be controlled by the insured, it provides no incentive for reduction of losses.⁴¹⁷ Like age,⁴¹⁸ years of driving experi-

410. EQUITY & ACCURACY, *supra* note 117, at 17; HEARING ON AUTOMOBILE INSURANCE CLASSIFICATIONS, *supra* note 401, at 54.

411. HEARING ON AUTOMOBILE INSURANCE CLASSIFICATIONS, *supra* note 401, at 56.

412. The author was unable to locate any discussion of the degree of separation provided by the use of mileage as a rating factor.

413. CAL. INS. CODE § 1861.02(a)(3) (West Supp. 1992).

414. EQUITY & ACCURACY, *supra* note 117, at 17-21.

415. *Id.*

416. The minimum age for obtaining a driver's license in California is 16. CAL. VEH. CODE § 12507 (West Supp. 1992).

417. EQUITY & ACCURACY, *supra* note 117, at 12 (stating that gender classification does not have any useful incentive value because it is beyond the control of the insured).

ence is susceptible to the claim that it is incompatible with the notion that burdens should bear some relationship to individual responsibility. Since drivers are not responsible for their level of experience, this factor is not as desirable as mileage and driving safety record.⁴¹⁹

3. *A Proposal for the Insurance Commissioner*

The Insurance Commissioner of California should not allow insurance companies to set automobile insurance rates based on geographic location. Any form of territorial rating will violate the constitutional imperative that burdens imposed by the law should have some relationship to individual responsibility.⁴²⁰ Territorial rating has no relationship to individual responsibility.⁴²¹ The practice discriminates against people of color and the urban poor, with the anomalous result that those individuals least able to pay are assessed the highest rates for a product that the state requires them to purchase.⁴²² If the Insurance Commissioner allows insurers to use territorial rating, he will place the imprimatur of the state on a practice that has a demonstrably disparate impact on two suspect classifications: people of color and the urban poor. While the maintenance of profitable insurance companies is a compelling state interest, territorial classifications are not necessary to advance that interest.⁴²³

The Insurance Commissioner should limit insurers to rating classifications that impose burdens based on individual responsibility. The classifications specifically approved by Proposition 103⁴²⁴ properly balance the insurers' need to group risks with this constitutional imperative. Requiring insurers to use the Proposition 103 rating classifications in conjunction with rating criteria that are not dependent upon territory⁴²⁵ will

418. *Id.* at 9.

419. No data is readily available on the degree of separation for this classification. While driving experience does not fare as well as driving safety record and mileage under the Wortham criteria, its performance is still superior to that of territorial rating. *See supra* notes 389-99 and accompanying text.

420. *See supra* note 8 and accompanying text.

421. *See supra* note 11 and accompanying text.

422. *See supra* notes 18-105 and accompanying text.

423. *See supra* notes 361-88 and accompanying text.

424. Driving safety record, annual miles driven, and years of driving experience. CAL. INS. CODE § 1861.02 (West Supp. 1992).

425. In December 1989 former Insurance Commissioner Roxani Gillespie issued proposed regulations which specified 22 rating characteristics which she would have allowed to be used in setting automobile liability insurance rates. CAL. CODE REGS. tit. 10, ch. 5, Adopt Subchapter 4.7 (proposed). To select these characteristics, Commissioner Gillespie appointed a panel of three actuarial experts to determine relationship to risk of loss. *Id.* § 2632.1 (f) (proposed regulations). Eight of the proposed rating factors satisfy, for the most part, the evaluation criteria set out by Professor Wortham. The eight characteristics are: vehicle type, make and model, cost of repair and replacement, design characteristics related to injury prevention

allow insurers to construct a system of automobile insurance rating that is "actuarially sound."⁴²⁶

Conclusion

Twelve years ago, Rose Bird, former Chief Justice of the California Supreme Court, observed that "[t]he law should be something more than just the handmaiden of a special class; it must ultimately be the servant of justice."⁴²⁷ The legislative and regulatory decisions that have allowed insurers to engage in redlining for so many years are examples of the law serving as the handmaiden of a very powerful special class—the insurance industry.⁴²⁸

As a result, people of color and the urban poor, those least able to pay, are consistently charged more for automobile liability insurance than any other group in the State of California. Members of those two suspect classifications have borne the brunt of the territorial rating system. If territorial rating is to continue, it must receive the approval of the Insurance Commissioner. Should the commissioner grant that approval, his action would convert the redlining activities of private insurers into state action for purposes of the equal protection clauses of the California Constitution. The effect of that decision would, consequently, violate the California Constitution.

and "damageability," vehicle characteristics (such as engine size, safety devices, and theft deterrent devices), vehicle performance capability, type of use of the vehicle (business, commercial, farming or personal). *Id.* § 2632.6 (c)(proposed). The relationship of each of these characteristics to risk of loss can be supported by a persuasive causal explanation. Each carries the seeds for encouraging reduction in the number of losses. Vehicles which present extra risks, in the form of extra power, higher repair costs, and/or lack of safety devices, will cost more to insure. The additional cost should discourage some potential buyers from purchasing those vehicles. All of these factors are in the control of the insured. Since he opts to purchase a particular automobile, he can change his risk of loss and his rates by choosing a different vehicle. For all of the above reasons, these factors are consistent with widely held social values, because they assess cost according to personal responsibility.

426. The Commissioner might decide to allow territorial rating in some form because the result is more palatable politically. *See supra* notes 115-23. If the Commissioner does allow the continuation of territorial rating, he should adopt territories that do not allow the kind of racial and economic isolation present in the current system. Moving to a system that uses much larger territories (i.e. urban, suburban, rural, or regional territories) will eliminate the most egregious racial and economic aspects of territorial rating as it is currently practiced. That will not, however, eliminate the racial impact of territorial rating. Moreover, a modified system of territorial rating would not satisfy the constitutional objective of conforming burdens to individual responsibility.

427. *Amador Valley Joint Union High Sch. Dist. v. State Bd. of Equalization*, 583 P.2d 1281, 1304 (Cal. 1978) (Bird, C.J., concurring and dissenting).

428. *See supra* notes 115-16 and accompanying text.

By adopting a system of automobile insurance rating that assigns rates based only on factors related to individual responsibility, the California Insurance Commissioner would eliminate the discriminatory racial and economic effects of redlining. This solution would not adversely affect the solvency of California insurers. Using the factors that have been outlined in Part IV of this Article, insurers would be able to form underwriting categories that are "actuarially sound."

The passage of Proposition 103 presents a unique opportunity to make California insurance law a servant of justice. The Commissioner should take advantage of that opportunity.

