

**Nos. A04-2088 and A04-2054**

State of Minnesota  
**In Supreme Court**

Christopher P. Schermer, John V. Smith, Marjorie B. Smith,  
 Reverend Albert Gallmon, on behalf of themselves  
 and all others similarly situated,

*Petitioners,*

vs.

State Farm Fire and Casualty Company,  
 State Farm General Insurance Company,

*Respondents.*

**BRIEF OF PETITIONERS**

**LARSON • KING, LLP**

Louise Dovre Bjorkman (#0166947)  
 Lawrence R. King (#55827)  
 T. Joseph Snodgrass (#231071)  
 Shawn M. Raiter (#240424)  
 2800 Wells Fargo Place  
 30 East Seventh Street  
 St. Paul, MN 55101-4922  
 (651) 312-6500

**LOCKRIDGE GRINDAL NAUEN P.L.L.P.**

Charles N. Nauen (#121216)  
 Robert K. Shelquist (#21310X)  
 100 Washington Avenue South, Suite 2200  
 Minneapolis, MN 55401  
 (612) 339-6900

**ZIMMERMAN REED, P.L.L.P.**

Charles S. Zimmerman (#120054)  
 J. Gordon Rudd (#222082)  
 David M. Cialkowski (#306526)  
 651 Nicollet Mall, Suite 501  
 Minneapolis, MN 55402  
 (612) 341-0400

**McSWEENEY & FAY**

Rhett A. McSweeney (#269542)  
 2116 Second Avenue South  
 Minneapolis, MN 55404  
 (612) 333-6900

*Attorneys for Petitioners Christopher P. Schermer, John V. Smith,  
 Marjorie B. Smith, Reverend Albert Gallmon, on behalf of themselves and  
 all others similarly situated*

*(Additional Counsel Listed on following page)*

OFFICE OF THE ATTORNEY  
GENERAL FOR THE STATE OF  
MINNESOTA

Hon. Mike Hatch (#42158)  
Attorney General  
Brian Dockendorf (#302715)  
Assistant Attorney General  
445 Minnesota Street, Suite 1400  
St. Paul, MN 55101-2131  
(651) 296-1494

*Attorneys for Amicus Curiae  
State of Minnesota*

SCWHEBEL, GOETZ &  
SIEBEN, P.A.  
Sharon L. Van Dyck (#183799)  
5120 IDS Center  
80 South Eighth Street  
Minneapolis, MN 55402  
(612) 344-0417

CHESTNUT &  
CAMBRONNE, P.A.  
Jeffrey D. Bores (#227699)  
3700 Campbell Mithun Tower  
222 South Ninth Street  
Minneapolis, MN 55402  
(612) 339-7300

*Attorneys for Amicus Curiae  
Minnesota Trial Lawyers Association*

LEONARD, STREET & DEINARD  
Todd A. Noteboom (#240047)  
William L. Greene (#198730)  
Monica L. Davies (#315023)  
150 South Fifth Street, Suite 2300  
Minneapolis, MN 55402  
(612) 335-1500

*Attorneys for Respondents State Farm Fire  
and Casualty Company, State Farm  
General Insurance Company*

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## STATEMENT OF THE ISSUES

- 1. Where homeowner's insurance policyholders paid a surcharge that violated Minnesota's anti-redlining statute are they entitled to rescind the illegal contract term and recover the illegal surcharge amount?**

The Minnesota Court of Appeals refused to follow long-standing Minnesota law requiring avoidance of illegal contract terms and interpreted this Court's decision in *Morris v. Am. Family Mut. Ins. Co.*, 386 N.W.2d 233 (Minn. 1986) as creating a blanket bar to any type of private claim involving the legal requirements contained in the Unfair Claims Practices Act, Minn. Stat. § 72A.20, subd. 13 (2005), even equitable claims arising from illegality of contract.

### **Apposite authorities:**

*Shank v. Fidelity Mutual Life Ins. Co.*, 221 Minn. 124, 21 N.W.2d 235 (Minn. 1945)

*Yang v. Voyageur Houseboats, Inc.*, 701 N.W.2d 783 (Minn. 2005)

- 2. When the Minnesota Department of Commerce approves a surcharge that violates anti-redlining legislation, should the Court adopt and apply a filed rate doctrine to bar the policyholders from rescinding the illegal surcharge and getting their money back?**

The Minnesota Court of Appeals created new law by adopting and applying the federal filed rate doctrine to an insurance discrimination case involving state law that does not involve ratemaking.

### **Apposite authorities:**

*Keogh v. Chicago & N.W. Ry. Co.*, 260 U.S. 156 (1922)

## STATEMENT OF THE CASE

This case involves State Farm policyholders who seek partial rescission of their contracts based on a violation of Minnesota's anti-redlining law. The Hennepin County District Court, the Honorable John Q. McShane presiding, certified this matter as a class action on September 12, 2003. (PA 273.)<sup>1</sup> After discovery, the parties made cross-motions for summary judgment. The district court granted summary judgment to State Farm on September 3, 2004, finding the Class' claims barred by the filed rate doctrine and this Court's decision in *Morris v. Am. Family Ins. Co.*, 386 N.W.2d 233 (Minn. 1986) (PA 32.) The district court denied the Class' motions, finding a fact question with respect to whether the surcharge State Farm imposed violated the anti-redlining statute but that the Class' claims were barred, in any event, by this Court's decision in *Morris*. (PA 51.)

The Class appealed the district court's judgment and certain related orders of the same date on January 18, 2005. The Class asserted the district court erred in its legal interpretation of the anti-redlining statute and in finding fact issues as to whether the surcharge violated the statute. In addition, the Class challenged the district court's reliance on the filed rate doctrine and *Morris* to divest itself of jurisdiction.

On September 6, 2005, the Minnesota Court of Appeals affirmed the district court's judgment. (PA 3-10.) The appellate court created a filed rate doctrine and further held that *Morris* bars the Class' claims. (*Id.*) The Court of

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<sup>1</sup> References to "PA" are to the Appendix to Petitioners' Brief.

Appeals did not address the Class' other legal and factual arguments. This Court granted further review by Order dated December 13, 2005. (PA 1.)

## STATEMENT OF THE FACTS

### A. State Farm's Utilities Rating Plan Insurance Classification.

Between 1997 and 2002, State Farm filed and used a "Utilities Rating Plan" ("URP") with the Minnesota Department of Commerce ("DOC") for homeowners and farm insurance policies. (PA 95-97.) The URP was not a rate but an insurance classification. An insurance classification is the means by which an insurer groups its own policyholders to provide discounts or surcharges to the applicable insurance rate.

In this case, the Class members were surcharged a flat percentage of their base rate, either 3%, 6% or 10% surcharge to their premium if, ostensibly, their structure's electrical utilities were more than 39 years old. (PA 95-97.) The Class does not challenge the rate they paid, nor does the Class seek to recalculate and pay a lower rate. Rather, the Class seeks rescission of the illegal surcharge.<sup>2</sup>

The trial court defined the class members as homeowners, farm or rental dwelling policyholders who paid surcharges under the URP during the period of 1997 to 2003. (PA 33.) Approximately 172,735 Class members were surcharged under homeowners, farm or rental dwelling insurance policies. (PA 13 at ¶2.)

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<sup>2</sup> It is perhaps useful to illustrate the surcharge and the relief sought here. If a homeowner living in an older neighborhood was charged a base premium of \$500 by State Farm during a policy-period for homeowners' insurance, and the URP then imposed a 6% surcharge during that policy period, the homeowner's contractual rescission claim would be in the amount of \$30 for that policy period. Here, the Class has not sought and will not seek to have the court recalculate any part of the \$500 base premium. Rather, the question is whether the surcharge was legal.

The Class members paid \$19,255,726 in URP surcharges to State Farm during the class period. (PA 90 at ¶8.)

**B. The Historical Role Of Age Of Dwelling In The Insurance Industry.**

Insurance companies openly charged higher premiums to certain racial and ethnic minorities because of racist stereotypes and the alleged “moral hazard” associated with these groups well through the 1960s. (PA 100 at ¶7.) In 1969, Minnesota prohibited the use of racial or ethnic insurance classifications. Minn. Stat. § 70A.05(2) (2005).

In hopes of avoiding overt violation of new laws like the one passed in Minnesota, insurers discontinued direct references to race or ethnicity in classifications but continued to discriminate by using certain “surrogates” that appeared racially or ethnically neutral but which were still discriminatory.<sup>3</sup> In homeowners insurance, the primary surrogate used by insurers was age of dwelling. (PA 100-101 at ¶¶7-8.)

In the 1970s, the use of age of dwelling as an underwriting guideline led to harsh criticisms of the insurance industry. (*Id.* 101-102 at ¶10). In response to growing concern over the discriminatory effect of the guideline to deny insurance to applicants, responsible insurers stopped using age of dwelling as an underwriting requirement. (*Id.* 102-103 at ¶11.)

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<sup>3</sup> See *In re Monumental Life Ins. Co.*, 365 F.3d 408, 412 & n.4 (5th Cir. 2004) (discussing surrogates for race used by life insurance companies in the 1960’s, including occupation, educational level, and socioeconomic status.).

Nevertheless, in the 1980s and 1990s State Farm and some other insurers crafted other ways to use the age of dwelling to discriminate. Specifically, insurers attempted to limit the sale of insurance products in older areas, and promote sales in newer areas, by limiting policyholders to “market value coverage” for homes built before 1955 as opposed to “guaranteed full replacement cost coverage” for other policyholders. (*Id.* 104-106 at ¶¶15-18.) Lawsuits and administrative actions were brought against these insurers, including State Farm. (*Id.*) In response, State Farm and other insurers agreed to stop using age of dwelling as a criterion for providing full replacement coverage. (*Id.*) In 1997, State Farm ceased this practice in Minnesota. (PCA 1-3.)<sup>4</sup>

**C. State Farm’s URP Classifications Were Never Based Upon The Risk Of Loss For Electrical Utilities.**

Upon ceasing its age of dwelling underwriting practices in 1997, State Farm simultaneously began classifying its customers based on the age of their homes. (PA 98-107.) In 1996, State Farm developed a rating plan classification uniformly referred to internally as an “age of dwelling” classification. (PA 108-113.) The classification generated discounts and surcharges by grouping policyholders according to the age of their dwelling, correlating losses and determining a discount or surcharge for each grouping. (*Id.*) State Farm documents proved that State Farm’s motivation for creating this age of dwelling classification was to subsidize discounts for “the best customer” who lived in newer homes. (PA 114.)

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<sup>4</sup> References to “PCA” are to the Confidential Appendix to Petitioner’s Brief.

Before implementing its URP in 1997, State Farm knew such classifications based on age of dwelling were illegal in certain states including Minnesota. (PA 115.) (“I also think we want to avoid the word ‘age,’ a few states even have statutory prohibitions on ‘age of dwelling’ rating.”) State Farm also knew, from its involvement with age of dwelling/redlining issues between the 1970s and 1990s that its classification would fall more heavily on minorities. (PA 99 at ¶4.) State Farm subsequently decided to cover its tracks by changing the name of its “age of dwelling” classification to the “Utilities Rating Plan.” (PA 115.)

State Farm further knew that there was no legitimate basis upon which it could classify policyholders based upon the age of electrical utilities. State Farm’s own claims data showed that losses arising from electrical systems – new or old – were only 2.2% of total losses. (PA 116-117.) Even if there were any proof that more losses were caused by older electrical systems – which there was not – the risk of loss arising from electrical utilities was too small to permit the use of a classification. (*Id.* at ¶6.)

State Farm submitted data to the DOC in 1997 for homeowners’ policies that purported to show that, by grouping homes based upon the age of electrical utilities, the risk of loss increased with age. (PA 96; PCA 5.) Before implementing its URP, State Farm claimed the support for the charge was provided by a single utility system – electrical. (*Id.*) In 2002, State Farm admitted to the DOC that the data it had submitted in 1997 labeled “age of utilities” was actually prohibited “age of dwelling” data. (PA 66, 78-79.) State Farm used solely age of dwelling data to

create the classification's discounts and surcharges because there was simply not a sufficient risk of loss associated with the age of electrical utilities to justify the surcharge State Farm wanted to assess to people who owned older homes. (PA 116-117.)

**D. The URP Classification Discriminated Against Minorities.**

Minnesota's minority communities, defined as those areas in which more than half of the owner-occupied housing units are minority-owned, were more than twice as likely as non-minority communities to be surcharged by State Farm. (PA 126 at ¶16.) Expert statistical analysis showed that the difference between the average percent of policies surcharged in minority communities compared to white communities was equal to 33.8 units of standard distribution. (*Id.*) Statewide, Minnesota's minority policyholders were 28% more likely than non-minority policyholders to pay a surcharge. (*Id.* 124 at ¶12.) This disparity between the likelihood of a white and minority policyholder being surcharged represents 27.5 units of standard deviation. (*Id.*)

**E. State Farm Mislabeled Its 1997 DOC Filing To Hide The Fact That It Used Age Of Dwelling As Opposed To Age Of Electrical Utilities In Billing Policyholders.**

State Farm admits that, while it collected both age of dwelling and age of utilities data from policyholders, it exclusively used age of dwelling data to determine all of the surcharges imposed on Class members. (PA 68-69). State

Farm used age of dwelling data from policyholder applications to charge its class members under the URP. (PA 26.)

When filing the URP in 1997, State Farm falsely labeled the “age of dwelling” data as “age of utilities” data. (PCA 44.)<sup>5</sup> At no time was this purposely mislabeled filing reviewed, much less studied, when filed in the DOC in 1997. (PCA 46).<sup>6</sup> Indeed, the record was also clear that, if the DOC knew that State Farm was using only age of dwelling data, the DOC would not have accepted the 1997 filing. (PCA 48).

State Farm did not reveal its URP surcharges on policy declaration pages because of concerns about a flood of telephone calls resulting in “problems relating to Fair Housing.” (PA 106 at ¶19.) Conversely, State Farm prominently displayed the URP discount on policy declarations pages. (PA 27-38.) Some State Farm employees openly acknowledged the impropriety of this action and objected to concealing the surcharges, calling them “secret charges.” (PCA 27.) One employee questioned: “from a legal perspective, should we really have any

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<sup>5</sup> One DOC witness testified:

Q: If we look back at the 1997 data, although its labeled age of utilities, you agree with me that’s not age of utilities data, that’s age of home data, correct?

A: Yes. (PCA 44.).

<sup>6</sup> Another DOC witness testified:

Q: Would you say that a thorough review of [the mislabeled filing] was done on an actuarial basis back in 1997?

A: I think it is safe to say it wasn’t. (PCA 46.)

‘secret charges’ that we include in the premium but don’t reveal on our quotes?”  
(PCA 27a.)

**F. The 2001-2002 DOC Investigation.**

In January 2001, a Faribault resident complained to the DOC about State Farm’s surcharges. (PCA 16-25.) In October 2002, the DOC presented State Farm with a draft cease and desist order concerning the policyholder’s complaint. (PA 62-69.)

In paragraph 23 of the proposed cease and desist order, the DOC stated that State Farm’s URP violated Minn. Stat. § 72A.20, subd. 13(b): “Respondent tracks the age of its insureds’ dwellings. Its loss data is correlated with dwelling age. Therefore, since Respondent’s URP is based upon the age of the primary structure, which is prohibited, the URP rating plan is illegal according to Minn. Stat. § 72A.20, subd. 13(b) (2000).” (PA 68-69 at ¶23). The DOC also charged State Farm with submitting “false and misleading” information in 1997 to the Commissioner because of State Farm’s decision to label age of dwelling data as age of utilities data. (PA 69 at ¶25.)

In December 2002, the DOC and State Farm executed three Consent Orders, one of which concerned the URP classifications. (PA 70-76.) The URP Consent Order stated that Commissioner James Bernstein was prepared to proceed against State Farm for violations of §72A.20, subd. 13, as well as the statutes prohibiting false insurance filings. (*Id.* at 70.) A corporate officer for State Farm waived State

Farm's right to contest the allegations. (*Id.* at 73.) The DOC Consent Order forced State Farm to cease and desist surcharging Minnesotans under the URP within 45 days and to pay the State \$75,000 in investigation fees. (*Id.* at 71.)

Former Commerce Commissioner Bernstein, who executed the settlement, has explained that Minnesota policyholders were free to proceed in court against State Farm because the Consent Order did not resolve their claims:<sup>7</sup>

The Department of Commerce did not resolve the claims of the individuals harmed by State Farm's discriminatory, illegal rates. Nothing prohibits Minnesotans from bringing claims against an insurer for discriminatory, illegal rates.

(PA 79 at ¶14.) The Attorney General agreed with Commissioner Bernstein's statements. (PA 86 at ¶9.) In fact, State Farm voluntarily returned the illegal surcharge to a single policyholder who subsequently contacted the Attorney General to complain about the URP surcharge. (PCA 24-25.) The case at hand seeks the return of the illegal surcharges to all policyholders who made these payments to State Farm. (PA 11.)

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<sup>7</sup> The DOC never filed a contested case concerning the URP. As a result, there was no opportunity for the public to intervene or be heard about the classification in any administrative proceeding. Nor was there any opportunity to appeal under contested case hearing procedures set out in Minn. Stat. §§ 14.57-14.69 (2004). Further, no public report or public notice was ever issued concerning the DOC's investigation and subsequent disapproval of the use of the surcharge rate, other than through the consent order and 8-sentence public press release dated December 4, 2002. (PA 75.)

**G. State Farm's 2004 Classification And The Positions Of The DOC, Attorney General And Governor.**

On January 21, 2004, while this lawsuit was underway, State Farm filed a new URP classification. (PCA 10-13.) Simultaneously, State Farm requested that the DOC publicly confirm that the 1997 URP classification, which was the subject of the cease and desist order, was now "in compliance with Minnesota Statute section 72A.20, subd. 13" and that the DOC "never made any findings that the URP was unlawful." (PA 10.) The DOC, under a new Commissioner, initially approved the 2004 classification and assisted State Farm in the present litigation concerning the 1997 URP but refused to publicly opine that the 1997 URP complied with Minnesota law. (PA 281-284.)

The Attorney General sought to intervene in this case, and submitted an affidavit to the trial court, stating that the URP classifications were illegal because, even if the groupings were based upon age of utilities, the classifications were not based upon losses arising from electrical utilities. (PA 83-87, 139-145.) The Attorney General's view is consistent with that held by at least one current DOC employee. (PA 147.) ("State Farm's current [2004] filing does not appear to be in compliance with Minnesota law any more than their prior filing."). Two other DOC employees, after private meetings with the attorneys representing State Farm in this litigation, subsequently testified to the contrary.<sup>8</sup> These two DOC employees were

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<sup>8</sup> Questions were also raised as to whether State Farm again used age of dwelling data instead of age of utilities data in the 2004 URP filing. The DOC refused to investigate the issue, stating that:

openly hostile to the anti-redlining law and interpreted the statute a fashion that rendered the law meaningless. (PCA 41.) (“I don’t think that was a good statute. So yes. I think the statute should be repealed.”)

Approval of the 2004 URP classification, in contrast to the prohibited 1997-2002 classifications, generated a modest amount of local publicity. (PA 281-286.) On August 20, 2004, Governor Pawlenty suspended approval of the 2004 URP classification, which had not yet taken effect, and further directed the DOC to suspend approval of any product similar to the URP “pending resolution of the legal issues.” (PA 285.)

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“Minnesota has limited staff – I have limited time. In the magnitude of things, a 6 percent surcharge on a category is simply not significant enough to warrant the time and expense of a greater review. There are other issues that are more important – to my understanding at least, there are other issues that are more important to the commerce department than this one, and that I have to use my time for those priorities.”

(PCA 44.)

## ARGUMENT

### I. Summary of Argument and Standard of Review.

Minnesota courts are charged with the important responsibility of interpreting and applying the law and administering justice. These duties include protecting the constitutional and other legal rights of individuals in the face of governmental and private challenges. Judicial review is essential to ensure equal justice for all and impose checks and balances on the powers of the executive and legislative branches.

In this case, the lower courts abdicated their responsibility for interpreting and applying long-standing Minnesota law and public policy that prohibit insurance companies from charging higher premiums based solely on a home's age- a practice that discriminates against minority homeowners. Despite the Commissioner of Commerce's 2002 determination that State Farm's URP violated the anti-redlining law, the courts refused to exercise jurisdiction over the Class' request for partial rescission based on illegality. The Minnesota Court of Appeals created a filed rate doctrine and misconstrued this Court's decision in *Morris v. American Family Ins. Co.*, 386 N.W.2d 233 (Minn. 1986) in reaching its decision that it could not exercise its judicial authority in this case.

The appellate court's analysis is flawed. It fails to follow this Court's precedent that contract terms that violate public policy or the law are invalid and unenforceable. More importantly, the Court of Appeals places the enforcement, interpretation and application of important anti-discrimination law in the hands of

an executive branch agency that shifts with the political sands.<sup>9</sup> This Court should find that neither the proposed filed rate doctrine nor *Morris* present obstacles to the exercise of the courts' judicial functions with respect to the Class' common law claims. To hold otherwise would undermine the significant policy and law prohibiting discrimination and diminish the judiciary's role in guarding individual rights.

This appeal presents legal issues that this Court reviews *de novo*. *In re Daniel*, 656 N.W.2d 543, 545 (Minn. 2003); *Frost-Benco Elec. Ass'n v. Minn. Pub. Utils. Comm'n*, 358 N.W.2d 639, 642 (Minn. 1984). The Class respectfully requests that the Court exercise its judicial authority, reverse the appellate court's decision and remand the alleged fact issues to the district court.

## **II. Minnesota Law Permits a Party to Seek Rescission of Contract Terms That Violate the Law or Public Policy.**

Minnesota courts have long held that contract provisions (including insurance policy terms) that violate a statute or public policy are void and ineffective:

It is axiomatic that the parties to an insurance contract, like the parties to contracts generally, cannot make a contract which is prohibited by law or contrary to public policy; and where there is a conflict between the law or statutory provisions on the one hand and

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<sup>9</sup> This case exemplifies the inherent problems of leaving statutory interpretation to an executive agency. In 2004, a different Commerce Commissioner approved State Farm's "new" URP that was identical to the previous URP. (PA 281-286). Governor Pawlenty ultimately halted the Commissioner's approval on the grounds the courts should interpret and apply the anti-redlining law to the URP. (*Id.*).

the provisions of an insurance policy on the other, the former must prevail.

*Shank v. Fidelity Mut. Ins. Co.*, 221 Minn. 124, 130, 21 N.W.2d 235, 238 (Minn. 1945) (citation omitted). In *Shank*, the Court voided an aviation rider on a life insurance policy despite the fact the policyholder amended his application to specifically acknowledge the existence of the rider and the commissioner of insurance accepted for filing, without approving or disapproving, the policy with the rider. The *Shank* court held that because the rider violated a statute and offended the public policy of the state, it was void and the beneficiary was entitled to collect the face amount of the policy. *Id.* at 238-239.

Courts look particularly closely at insurance contracts because the insurance business is “quasi public” and implicates the need to protect the public. *Id.* at 238. Insurance policy terms that do not conform to the law or public policy are void and subject to legal and equitable remedies including reformation and rescission. *Watson v. United Services Auto. Ass’n.*, 566 N.W.2d 683, 692 (Minn. 1997) (fraud exclusion that conflicts with statutory requirements of standard fire policy was void and subject to reformation); *Coughlin v. Reliance Life Ins. Co.*, 161 Minn. 446, 453, 201 N.W. 920 (1925) (forfeiture provision was void because it was not contained in the insurance policy itself in violation of statute).

**A. State Farm’s URP is void because it violates public policy.**

The trial court granted State Farm’s summary judgment motion. On appeal, this Court views the facts in the light most favorable to the Class. *Yang v.*

*Voyagaire Houseboats, Inc.*, 701 N.W.2d 783, 788 (Minn. 2005). While ostensibly based on the age of a home's electrical utilities, State Farm's URP was based on the age of the home. State Farm admitted to DOC officials that the URP was based on the age of the dwellings and that it did not have electrical system loss data or other actuarial support for the URP. (PA66, 78-79). State Farm's counsel likewise conceded in a hearing before the district court that State Farm used age of dwelling data as a "surrogate" for age of utilities data in 1997. (PA 34).

Statistical evidence demonstrates Minnesota's minority communities, defined as those areas in which more than half of the owner-occupied housing units are minority-owned, were more than twice as likely as non-minority communities to be surcharged by State Farm. (PA 126 at ¶16). The statistical expert determined the difference between the average percent of policies surcharged in minority communities compared to white communities was equal to 33.8 units of standard distribution. (*Id.*). Statewide, Minnesota's minority policyholders were 28% more likely than non-minority policyholders to pay a surcharge. (*Id.* 124 at ¶12). This disparity between the likelihood of a white and minority policyholder being surcharged represents 27.5 units of standard deviation. (*Id.*).

A standard deviation is a statistical measurement of the likelihood of the disparity occurring by random factors unrelated to race.<sup>10</sup> Here, the 27.5 units of deviation reflects that the chances of observing a higher rate of surcharges among Minnesota minorities and minority communities by **chance** (as opposed to a discriminatory practice) is less than one in ten billion. Courts have observed in discrimination cases that a disparity of just two standard deviations triggers an inference of intentional discrimination. *Jenson v. Eveleth Taconite Co.*, 824 F. Supp. 847, 861 (D. Minn. 1993).

The sad history of race discrimination in this country demonstrates courts did not always consider such discrimination to violate the law or public policy. *See e.g., Plessy v. Ferguson*, 163 U.S. 537 (1896). However, at this point in time, the pernicious nature of discrimination based on race is unassailable. While State Farm will surely assert its URP did not discriminate against people of color and their communities, State Farm will have to concede that discrimination on the basis of race violates the strong public policy of Minnesota.

This Court has the authority to develop the common law based on both legal and policy considerations. In *Yang v. Voyagaire Houseboats, Inc.*, 701 N.W.2d 783 (Minn. 2005), the Court rejected unambiguous exculpatory and indemnity clauses in a houseboat rental agreement because they violated public

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<sup>10</sup> *See Waisome v. Port Auth. of New York and New Jersey*, 948 F.2d 1370, 1376 (2d Cir. 1991) (“Standard deviation analysis measures the probability that a result is a random deviation from the predicted result -- the more standard deviations the lower the probability the result is a random one.”).

policy. Although the contract terms requiring the renter to indemnify the rental company for claims relating to the condition of the houseboat did not conflict with a statute, this Court focused on public policy considerations finding “[a]s a matter of public policy, innkeepers cannot shift liability for their own negligence onto the guests they have a duty to protect.” *Id.* at 792.

Similarly, in the present case the Court should allow the Class’ contract rescission claims to proceed. Discrimination based on race, whether it exists in the context of education, employment, housing, insurance or otherwise, is simply wrong. It violates the public policy of Minnesota. Any contract provision that violates such strong public policy establishes a basis for rescission independent of any particular legislation.

The fact the Legislature specifically prohibited the precise discriminatory practice State Farm employed should not prevent the Class from pursuing the equitable remedy of rescission. As noted below, the Class is not asserting a private cause of action under the Unfair Claims Practices Act (“UCPA”), Minn. Stat. § 72A.20. Rather, the Class is asserting the common law claim of rescission. The fact State Farm’s discriminatory conduct that offends public policy also violates the UCPA should not permit State Farm to retain the economic fruits of its wrongful conduct. Such a result would deeply offend public policy. A calculating insurer could knowingly engage in discriminatory redlining secure in the knowledge that any administrative penalties it may face under the UCPA would pale in comparison to the millions of dollars it collected because of its

offensive practice. Such would be the case here where State Farm paid a \$75,000 fine but has yet to return the almost \$20,000,000 it collected in improper surcharges.

The Court should permit the Class' rescission claims to proceed.

**B. State Farm's URP is void because it violates the law.**

Minn. Stat. § 72A.20, subd. 13 prohibits insurers from "charging differential rates for an equivalent amount of homeowner's insurance coverage... for property located in a town ... in which the insurer offers to sell or writes homeowner's insurance, solely because: ... (b) of the age of the primary structure sought to be insured." *Id.* Subdivision 13 (b) contains a safe harbor exception that allows an insurer to charge a higher premium "based upon the age of the insured structure's plumbing, electrical, heating or cooling system or other part of the structure, the age of which affects the risk of loss." Minn. Stat. § 72A.20, subd. 13.

State Farm's URP classifications violated subdivision 13's prohibition against discriminatory practices in two ways. First, State Farm's surcharges were based solely on the age of the Class members' homes. Second, even if State Farm did not impose surcharges based only on the age of the homes, the safe harbor provision does not apply because State Farm did not have data showing the age of the homes' electrical utilities (or any other utility) affected the risk of loss.

The Class is entitled to rescission and a refund of the surcharge based on the illegality of this contract term. *Nauman v. J's Restaurants Int'l., Inc.*, 316

N.W.2d 523, 524 (Minn. 1982) (plaintiff entitled to rescission and refund of franchise fees where defendants failed to register the franchise fees as required by law); *Kavli v. Leifman*, 207 Minn. 549, 553, 292 N.W. 210, 213 (1940) (right to recover money paid under a rescinded contract is “grounded on the theory that the vendor, having obtained money under a contract made void by rescission, is unjustly enriched at the vendee’s expense and, as a consequence, should be subjected to a legal duty to restore that which has been improperly gained.”).

**1. *Morris v. Am. Family* does not apply to bar the Class’ claims because the Class is not asserting a private cause of action under the Unfair Claims Practices Act.**

The Court of Appeals dismissed the Class’ contract rescission claim based chiefly on *Morris v. Am. Fam. Ins. Co.*, 386 N.W.2d 233 (Minn. 1986). The appellate court concluded that because the particular law State Farm violated is contained in the UCPA, *Morris* automatically bars the Class’ common law rescission claim. This interpretation of *Morris* is overly expansive and fails to recognize the important distinction between asserting a claim under a statute and using that statute as a basis for rescinding an illegal contract term.<sup>11</sup>

As a starting point, it is useful to review the facts and issues presented in *Morris*. The case involved an insured who sought to assert, in addition to her

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<sup>11</sup> This is not the first time the Court of Appeals has applied *Morris* under circumstances where a party is not seeking a private cause of action under the UCPA. In *Glass Service Co., Inc. v. State Farm Mut. Auto. Ins. Co.*, 530 N.W.2d 867, 872 (Minn. Ct. App. 1995), the court upheld dismissal of Glass Service’s tortious interference with contract claim because State Farm’s wrongful conduct violated the UCPA.

contract claim for no-fault benefits, a cause of action based on American Family's refusal to pay her benefits without conducting a reasonable investigation as required by the UCPA. Morris argued the UCPA itself or Minn. Stat. § 8.31 provided her a private cause of action.

In determining otherwise, the *Morris* court first analyzed the UCPA's history and purpose, the 1984 amendments and the Model Unfair Claims Practices Act ("Model Act") drafted by the National Association of Insurance Commissioners upon which the UCPA is based. *Morris*, 386 N.W.2d at 234-235. The Court concluded the UCPA did not, by its terms, afford Morris a private cause of action and the Model Act did not contemplate creation of private claims for prohibited claims practices. *Id.* at 235.

This Court next rejected the Court of Appeals' finding that Minn. Stat. § 8.31, subd. 3a provides private remedies for violations of the UCPA. The Court noted that prior to 1983, § 8.31 expressly excluded from its reach "any person, firm or corporation engaged in the insurance business and as such subject to sections 72A.17 to 72A.30." Minn. Stat. § 8.31, subd. 4 (1982). In 1983, the legislature repealed subdivision 4 to ensure the Attorney General was authorized to take action under the UCPA. This Court noted the legislative history of the 1983 amendment was brief, reflecting only the intent to repeal subdivision 4 because it "locked [the Attorney General] out of the insurance industry." *Morris*, 386 N.W.2d at 236, fn 5. Based on this legislative history, the Court held the

legislative intent to create a private cause of action for violations of the UCPA was “uncertain.” *Id.*

In the absence of clear intent to create a private action, the *Morris* court next considered whether it should imply such an action. The Court examined the practical difficulty a private claimant would have in proving a “general business practice” violated the UCPA. *Id.* at 236-237. Of greater concern was the potential impact a private cause of action such as *Morris* asserted would have on the common law including providing third parties a direct claim against insurers and providing broad tort-based recovery for UCPA violations. *Id.* at 237. The *Morris* court concluded these considerations did not support implication of a private cause of action.

Here, the Class is not asserting a private cause of action under the UCPA. The Class is not seeking to impose duties on State Farm that do not already exist under the common law. Under the common law, an insurer may not impose contract terms that violate a statute. The fact that redlining is proscribed in the UCPA does not change the fact that redlining is illegal and constitutes a basis for partial rescission. To hold otherwise would conflict with long-standing Minnesota and other law.

The legal distinction between an illegal contract term and a statutory cause of action is well-illustrated by *In re Kennerly*, 90 B.R. 781 (D.S.C. 1987). In that case, the plaintiffs sought to have a mortgage voided and the security released because the mortgage violated federal farm and small business regulations. The

defendant argued the case should be dismissed because there was no private cause of action for violating the regulations. Noting the distinction between avoidance of contract terms that violate a statute and a private cause of action, the federal district court held:

The plaintiff in the proceeding at bar is not pursuing a private cause of action under the regulations. Nor is the plaintiff attempting to police variations of the regulations. Instead, the plaintiff seeks to avoid the validity of a mortgage obtained through alleged violations of the regulatory prohibitions.

*Id.* at 787.

The Maryland Court of Appeals also noted this distinction in *Son v. Margolius, Mallios, Davis, Ride & Tomar*, 689 A.2d 645 (Md. Ct. Spec. App. 1997), *reversed on other grounds*, 709 A.2d 112 (Md. 1998). There, the plaintiff sought to avoid the contract he entered into with his law firm because the provision for fee splitting violated Maryland law. The court rejected defendants' motion to dismiss, noting:

We need not address, as appellees urge, the existence of a private cause of action for violation of the statute prohibiting barratry. Appellant did not bring a cause of action for violation of the statute prohibiting barratry. Appellant did not bring a cause of action for private enforcement of the Act. He instead attempted to void his contracts... . The issue that directly concerns us, therefore, is not whether the appellees' conduct actually violated the Barratry Act. We, instead, must determine whether the various contracts between the parties had as their object the violation of public policy as expressed in statutes or rules of conduct. All parties, and the trial court, seemed to miss this distinction.

*Id.* at 653.

The California Supreme Court specifically held the prohibition on private causes of action for violation of unfair claims practices statutes does not preclude courts from exercising their jurisdiction to impose civil damages or other remedies against insurers in appropriate common law actions- such as breach of contract. In *Moradi-Shalal v. Fireman's Fund Ins. Cos.*, 46 Cal. 3d 287 (Cal. 1988), a party injured in a motor vehicle accident sued the defendant driver's insurer for refusing to promptly and fairly settle her claim against the insured driver. The California Supreme Court overruled its precedent, joining Minnesota and the majority of other states in holding that private causes of action under unfair claims practices acts are not allowed. *Id.* at 298, 304.

The *Moraldi-Shalal* court cautioned that its decision "is not an invitation to the insurance industry to commit the unfair practices proscribed by the Insurance Code." *Id.* at 304. The California Supreme Court specifically noted its ruling did not preclude parties from seeking recovery from insurers for statutory violations:

Moreover, apart from administrative remedies, the courts retain jurisdiction to impose civil damages or other remedies against insurers in appropriate common law actions, based on such traditional theories as... breach of contract or breach of the implied covenant of good faith and fair dealing.

*Id.* at 304-305.

The *Moraldi-Shalal* holding has been relied upon to provide equitable relief to policyholders for an insurer's violations of unfair claims practices statutes. *See Neufeld v. Balboa Ins. Co.*, 84 Cal.App. 4th 759, 766, 101 Cal. Rptr. 2d 151 (Cal. Ct. App. 2000) (summary judgment in favor of insurance company reversed where

insured contends company should be estopped from relying on one-year suit provision that company failed to disclose to insured in violation of Unfair Practices Act); *Spray, Gould & Bowers v. Associated Int'l. Ins. Co.*, 71 Cal. App. 4<sup>th</sup> 1260, 1271-72, 84 Cal. Rptr. 2d 552, 558-59 (Cal. App. 1999) (insurer's violation of insurance regulations regarding insurer's duty to notify insured of time limits regarding claims may provide basis for estoppel against insurer's contract limitation defense). As the California Court of Appeals for the 4<sup>th</sup> District stated "[i]t is one thing not to allow a private cause of action; it is another not to allow an insurer to gain the benefit of a claimant's ignorance that a regulation is supposed to dispel." *Neufeld*, 84 Cal. App. 4<sup>th</sup> at 764, 101 Cal. Rptr. at 154.

These authorities do not stand alone. Both the First and Second Restatements of Contracts recognize a policyholder's remedy of rescission for return of premiums in cases where insurance contracts violate statutes designed, as in this case, to protect them. Restatement (Second) of Contracts § 198 and illustration 1 (1981) (restitution of premiums allowed for policies violating insurance laws); Restatement (First) Contracts § 601 (1932) ("If refusal ... to rescind an illegal bargain would produce a harmful effect on the parties for whose protection the law making the bargain illegal exists, enforcement or rescission, whichever is appropriate, is allowed."). Accordingly, other courts have permitted policyholder class actions seeking a partial refund of premium payments where insurance terms violate the law. *See e.g., Dornberger v. Metropolitan Life Ins. Co.*, 961 F. Supp. 506, 538-540 (S.D.N.Y. 1997).

This Court has likewise permitted parties to seek equitable relief where insurance policy terms violate a statute. In *Watson v. United Services Auto, Ass'n*, the plaintiff insured brought a contract claim arguing the language of the policy exclusion for acts committed by an insured was vague and should be construed to permit her to recover as an “innocent co-insured” for her fire losses. The Court rejected this ambiguity argument but nonetheless found the policy exclusion invalid because it violated the statutory requirements of the standard fire policy. *Id.*, 566 N.W.2d at 692. Watson did not sue her insurer under Minn. Stat. § 65A.01, but this Court used that statute in determining the policy exclusion was void and subject to reformation.

Here, the Class similarly seeks a different equitable remedy, rescission, based on violation of a different statute, the UCPA. These distinctions do not make a difference. The fact the anti-redlining provision is contained in the UCPA does not make State Farm’s URP any more legal or enforceable. It is void any way you look at it. Denial of a rescission remedy to the Class would conflict with long-standing Minnesota law and work a terrible injustice.

- 2. If the Court finds the *Morris* analysis applies, the Court should imply a private cause of action related solely to the anti-redlining provisions of the UCPA.**
  - a). The 1979 Legislation establishing the anti-redlining law evinces the intent to permit private causes of action.**

Even if this Court were to find the Class is not entitled to pursue a common law rescission claim to recover payments made pursuant to a contract term that

violates the UCPA, the Court should imply a private cause of action for violations of the anti-redlining portion of the UCPA. The Legislature passed the anti-redlining provision in 1979. The legislation creating the anti-redlining statute contained a partial immunity provision:

**Subd. 6. Immunity of insurer or commissioner.**

There shall be no liability on the part of and no cause of action of any nature shall arise against the commissioner or against any insurer, its authorized representative, its agents, its employees or any firm, person or corporation furnishing to the insured information as to reasons for declination, nonrenewal, or cancellation, for any statement made by them in any written notice of declination, nonrenewal or cancellation, for the providing of information relating thereto, or for statements made or evidence submitted at any hearings or investigations conducted in connection therewith. **This subdivision shall not apply to any action or proceeding arising under section 4 of this act.**

1979 Minn. Laws, ch. 207, sec. 4. The revisor of statutes has since changed the reference from “section 4” to “section 72A.20.” Minn. Stat. § 65A.29, subd. 6 (2005).

The Legislature’s establishment of partial immunity for the commissioner and insurers with respect to certain conduct and claims and express directive that this immunity does not extend to “any action or proceeding” arising under the UCPA provides evidence the Legislature did not intend to foreclose private claims for violations of the UCPA.

There is no indication the *Morris* court was made aware of or considered the impact of the partial immunity provision. The act containing the 1984 amendments to the UCPA which the Court considered in *Morris* did not contain a

similar provision. The Class urges the Court to evaluate this statutory provision as some evidence that the Legislature did not intend to foreclose private causes of action based on the UCPA.<sup>12</sup> The Court should also view the immunity provision as a factor to weigh in deciding whether to imply a private cause of action for violation of the anti-redlining law.

Another indication the Legislature did not intend to foreclose private actions for redlining violations is contained in Minn. Stat. § 72A.201, subd. 1. This provision empowers the DOC to impose administrative remedies for a violation of § 72A.20, subd. 12 (the “unfair service” part of the UCPA), but specifically states “[n]o individual violation constitutes an unfair, discriminatory, or unlawful practice in business, commerce or trade for purposes of section 8.31.” Minn. Stat. § 72A.201, subd. 1. This language would prohibit both the Attorney General and a private person from pursuing claims related to unfair service. The Legislature did not similarly seek to limit enforcement powers and remedies under § 8.31 with respect to the anti-redlining portion of the UCPA.

Distinguishing the anti-redlining law from other provisions of the UCPA makes sense in the context of the Model Act. The Model Act upon which the UCPA is based and on which this Court relied in *Morris*, does not and has never contained an anti-redlining provision. Model Unfair Claims Settlement Practices

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<sup>12</sup> The appellate court dismissed this argument based on an incorrect reading of the phrase “any action or proceeding” to apply solely to the DOC’s claims against insurance company. The language of the partial immunity provision contains no such limitation.

Act (Model #900) (N.A.I.C. 1997) (PA 254); Model Unfair Claims Practices Act, 1 N.A.I.C. Proc. (1972). Thus, the drafter's intention that the Model Act not create private causes of action has no bearing on the question of whether a private cause of action is available for claims arising out of insurance redlining.

**b). The *Morris* concerns would not be implicated if the Court permits a private cause of action related solely to the anti-redlining section of the UCPA.**

As noted above, this Court expressed concern in *Morris* about the impact private claims would have on the common law and the potential expansion of tort recoveries into the arena of traditional contract-based claims. Specifically, the *Morris* court determined that implying a private cause of action under the UCPA would permit third parties to assert claims against a defendant's insurer based on failure to properly handle and settle claims. *Morris v. American Family Ins. Co.*, 386 N.W.2d at 237.<sup>13</sup> The Court also envisioned broad tort claims for such items as emotional distress and punitive damages. *Id.*

Neither of these concerns would be present if the Court implies a private cause of action with respect to the anti-redlining portion of the UCPA. Recognition of this limited claim would not offend traditional contract principles because the claim would only exist between an insured and an insurer. No new duties are imposed because insurers are already obligated to make sure the terms of their policies comply with the law. The potential remedies would be similarly

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<sup>13</sup> Minn. Stat. § 72A.20, subd. 12a (c) (5) defines "claimant" broadly to include individuals and corporations who have a claim against a person or corporation that is insured under an insurance policy or contract.

limited to traditional contract remedies including rescission, reformation and money damages resulting from contract breach. Insureds would not be entitled to recover tort-based damages for items like emotional distress, pain and suffering and punitive damages. Implication of a private cause of action limited to the anti-redlining portion of the UCPA would further the important purposes of this provision and fairly hold insurers responsible for complying with the law.

The remedies available to insureds such as the Class members under the current law are simply inadequate. Both the DOC and Attorney General are authorized to enforce the UCPA. *See Morris v. American Family Ins. Co.*, 386 N.W.2d at 236; *Hatch v. American Family Ins. Co.*, 609 N.W.2d 1, 4 (Minn. Ct. App. 2000). Where, as here, an insurer faced with anti-redlining charges consents to an order discontinuing the rating practice and there is no contested hearing, policyholders are left without a remedy for their economic loss. That is wrong. Insureds who make payments under contract terms that violate the law should get their money back even if the DOC does not have the resources to pursue the matter or an insurance company decides to cut its losses and enter into a consent decree. Allowing an insurance company to impose an illegal surcharge, pay an administrative fee and keep millions of dollars in illegal premium payments is untenable. Implying a limited private cause of action to redlining claims would ensure that this form of housing discrimination does not continue in Minnesota.

### **III. The Court Should not Create a Filed Rate Doctrine to Bar the Class' Claims.**

#### **A. Adoption of a filed rate doctrine in this case is incompatible with the doctrine's history and purpose.**

The filed rate doctrine has its origins in monopoly and oligopoly regulation. The doctrine is most often applied to interstate shippers, telephone companies and other highly regulated utilities. *Keough v. Chicago & N.W. Ry. Co.*, 260 U.S. 156 (1922); *Maislin Indus., U.S. v. Primary Steel, Inc.*, 497 U.S. 116, 138 (1990) (Stevens, J., dissenting). The filed rate doctrine prevents a regulated entity from charging any rate other than those the entity properly filed with the regulatory agency. The doctrine is designed to prevent rate discrimination and to avoid judicial second-guessing or usurpation of the agency's function. *H.J. Inc. v. Northwestern Bell Tel. Co.*, 954 F.2d 485, 488 (8th Cir. 1992). "[T]he filed rate doctrine recognizes that where a legislature has established a scheme for utility rate-making, the rights of the rate-payer in regard to the rate he pays are defined by that scheme." *Taffet v. Southern Co.*, 967 F.2d 1483, 1490 (11th Cir. 1992).

While created to protect consumers from unscrupulous shippers and utilities, the filed rate doctrine has been criticized in recent years because it is now being applied by corporations seeking to immunize their misconduct: "the consumer protection rationale was turned on its head as the filed tariff doctrine became a shield for regulated firms against litigation, including competitor and consumer suits in federal and state courts." Jim Rossi, *Lowering the Filed Tariff Shield: Judicial Enforcement for a Deregulatory Era*, 56 Vand. L. Rev. 1591,

1596 (2003); *see also* *Ting v. AT&T*, 319 F.3d 1126, 1131 (9th Cir. 2003) (“[T]he filed rate doctrine, in practice, led to ‘quite unjust’ results.”).

Courts have differed on whether to adopt a filed rate doctrine to a particular state’s insurance regulatory scheme. *Compare* *Williams v. Union Fidelity Life Ins. Co.*, 123 P.3d 213, 219 (Mont. 2005) (rejecting application of filed rate doctrine to state law insurance-related claims) *and* *Hanson v. Acceleration Life Ins. Co.*, No. Civ. A3-97-152, 1999 WL 33283345, \*4 (D.N.D. Mar. 16, 1999) (PA 287) (“This court concludes that the North Dakota Supreme Court would not preclude the presentation of this [insurance-related class action] case based upon the filed rate doctrine defense.”) *with* *Edge v. State Farm Mutual Auto. Ins. Co.*, 2005 WL 3279891, \_\_\_ S.E.2d \_\_\_ (S.C. 2005) (applying filed rate doctrine to state law insurance-related claims over dissent) (PA 298). *See also* Allan Kanner, *The Filed Rate Doctrine and Insurance Fraud Litigation*, 76 N.D. L. Rev. 1, 2 (2000).

In recent years, some state courts have applied the filed rate doctrine in the context of state insurance statutory schemes. In a number of those cases, the adoption of the filed rate doctrine was controversial. For example, in *Richardson v. Standard Guaranty Ins. Co.*, 853 A.2d 955 (N.J. Ct. App. 2004), the Court stated:

[W]e acknowledge that the continued existence of the filed rate doctrine is controversial, as the majority and dissenting opinions in *Weinberg* demonstrate. If we were writing on a blank slate, perhaps we could be persuaded to plaintiff’s view that this century old doctrine . . . should not be permitted to override the [Consumer Fraud Act], “one of the strongest consumer protection laws in the nation.”

*Id.* at 962; *see also Edge*, 2005 WL 3279891 at \*7, \_\_\_ S.E.2d \_\_\_ (dissent) (PA 298) (“Plaintiffs allege that State Farm assessed unauthorized surcharge points to Plaintiffs’ insurance policies in violation of the parties’ insurance contracts. In addition, Plaintiffs allege that these unauthorized surcharge points were assessed in violation of South Carolina law... the filed rate doctrine is simply not implicated in this case.”).

This Court has never adopted the filed rate doctrine with respect to any state regulatory scheme, and has never even referenced the doctrine in any opinion. Apart from this case, the filed rate doctrine has been referenced in a handful of Court of Appeal’s decisions – two involving trucking cases brought under the federal Interstate Commerce Act. *G & T Trucking Co. v. GFI Am., Inc.*, 535 N.W.2d 658 (Minn. Ct. App. 1995); *Atlantis Express, Inc. v. LL Transport Services, Inc.*, 481 N.W.2d 79 (Minn. Ct. App. 1992).

In one other case, that involved a shipper, the Court of Appeals refused to apply the filed rate doctrine for equitable reasons, holding that “common-law remedies can co-exist with administrative remedies” *Central Distribution Carriers, Inc. v. Mrs. Gerry’s Kitchen, Inc.*, 521 N.W.2d 870, 874 (Minn. Ct. App. 1994).

**B. The filed rate doctrine should not apply here because the Department of Commerce rejected State Farm’s URP.**

The Class has found no support for the notion that a surcharge, subsequently stricken from use by a regulator as in this case, is somehow entitled

to judicial deference through the filed rate doctrine. The filed rate doctrine only applies to rates that have been approved by a regulator. Respectfully, the doctrine has no application here because the DOC rejected the URP surcharges through the stipulated cease and desist order.

Although State Farm disagreed with Commissioner Bernstein's position, the fact remains that the URP was ultimately set aside because Commissioner Bernstein believed it was illegal and obtained because of State Farm's fraud. (PA 79). Commissioner Bernstein settled the DOC's claims in a manner that he believed allowed policyholders to assert their respective rights in court. (PA 82). As such, the filed rate doctrine has no application.

**C. The filed rate doctrine should not be adopted and applied to Minnesota's insurance regulatory scheme for violations of the state anti-redlining statute.**

Courts faced with the question of whether to extend the filed rate doctrine into new areas have focused upon the regulatory scheme at issue, and weighed a discrete number of factors, including (1) whether the issue presented involves the interpretation of a statute or regulation;<sup>14</sup> (2) whether an administrative agency can hear a grievance and provide a remedy;<sup>15</sup> (3) whether the statutory scheme would

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<sup>14</sup> See e.g., *Telco Communications Group, Inc. v. Race Rock of Orlando, LLC*, 57 F.Supp.2d 340, 341 (E.D.Va. 1999)

<sup>15</sup> See *H.J. Inc. v. N.W. Bell Tel. Co.*, 954 F.2d 485, 493 (8th Cir. 1992); *Hanson v. Acceleration Life Ins. Co.*, No. Civ. A3-97-152, 1999 WL 33283345, \*4 (D.N.D. Mar. 16, 1999) (PA 287).

be affected by having the courts, and not administrators, resolve the issue;<sup>16</sup> (4) whether there is meaningful public or administrative review of rate increases;<sup>17</sup> (5) whether the court must determine what a reasonable rate would be;<sup>18</sup> and (6) whether the regulator has exclusive jurisdiction over the subject matter.

**1. The filed rate doctrine does not preclude voiding a tariff or rate that violates law.**

In Minnesota, statutory interpretation is a uniquely judicial function, not a function left to regulators. *See Kersten v. Minnesota Mut. Life Ins. Co.*, 608 N.W.2d 869, 874 (Minn. 2000). Even courts from other jurisdictions that have applied the filed rate doctrine to an insurance regulatory scheme recognize that several exceptions exist, including an exception if the case can be resolved by interpreting and implementing statutes. *Edge*, 2005 WL 3279891 at \*4, \_\_\_ S.E.2d \_\_\_, n.7 (PA 298).

In determining whether to extend the filed rate doctrine in a particular case, some federal courts have held that the filed rate doctrine would not extend to a court's determination that a rate or tariff itself violates a statute or regulation<sup>19</sup>. As

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<sup>16</sup> *See H.J. Inc.*, 954 F.2d 485, 488 (8th Cir. 1992).

<sup>17</sup> *See Brown v. Ticor Title Inc. Co.*, 982 F.2d 386, 393-94 (9th Cir. 1992).

<sup>18</sup> *See H.J. Inc.*, 954 F.2d at 488.

<sup>19</sup> This circumstance is obviously different from most federal filed rate cases wherein the issue is whether certain types of misconduct (usually market misconduct) is alleged to have violated an antitrust or RICO law, resulting in rate increases to rate-payers. *E.g.*, *H.J., Inc.*, 954 F.2d at 486 (RICO claim alleging bribery misconduct resulted in rate increases); *Taffet*, 967 F.2d at 1486 (RICO claim alleging conspiracy misconduct resulted in rate increases).

explained above, these federal decisions are consistent with Minnesota law because Minnesota courts have refused to defer to the state insurance commissioner concerning the legality of an insurance filing or interpretation of a statute. *See e.g., Watson*, 566 N.W.2d at 683.

For example, in *Telco Communications Group, Inc. v. Race Rock of Orlando, LLC*, 57 F.Supp.2d 340 (E.D.Va. 1999), a telephone company sought to charge a consumer over \$92,000 for unauthorized telephone calls. Under a federal consumer protection law known as Regulation Z, the most a consumer could be required to pay under the law was \$50. The telephone company argued that the court must disregard the consumer protection law because the federal agency had approved the tariff terms. The district court refused to grant the telephone company's request, holding:

Plaintiff's reliance on [various filed rate decisions] is misplaced for several reasons. **None of these cases analyzed whether a court could ignore a federal consumer-protection regulation simply because a tariff was filed with the FCC . . . In *Wegoland* . . . the court did not discuss whether federal regulations should be set aside whenever a tariff has been filed. . . For these reasons, we find that **Telco's filing of a tariff does not exempt its telephone calling cards from the protections of Regulation Z.****

*Id.* at 344 (emphasis added).

Also, in *Atlantis Express, Inc. v. Associated Wholesale Grocers, Inc.*, 989 F.2d 281 (8th Cir. 1993), the Eighth Circuit held that even if a federal agency approves a tariff, the courts can set the tariff aside despite the filed rate doctrine if the tariff fails to comply with the legal requirements: "A carrier that seeks to

enforce a 'filed' rate must be prepared to show that it has done what the regulations of the ICC require for effective filing." *Id.* at 283-84; *see also In re Mitchell Trucking Co., Inc.*, 821 F.Supp. 32, 34 (D. Me. 1993) (carrier's failure to file required power of attorney voided its ability to collect filed rates because "[b]y failing to follow ICC regulations, there was no effective tariff on file.").

The issue here is whether State Farm's surcharge contractual term violates the anti-redlining statute and public policy. If the surcharge contract term conflicts with Minnesota law, it is void. *Shank*, 221 Minn. at 128, 21 N.W.2d at 238. Determining the legality of the contract term does not require the Court to evaluate actuarial data or otherwise determine the reasonableness of a rate. Rather, it requires a legal interpretation of Minn. Stat. § 72A.20, subd. 13. The Courts should not abandon their "exclusive" obligation to interpret the anti-redlining statute.

**2. The absence of an administrative remedy mandates against adoption of the filed rate doctrine.**

Courts analyzing whether to adopt a filed rate doctrine in insurance cases often look to whether the administrative scheme provides redress to a policyholder. *See H.J. Inc.*, 954 F.2d at 493 ("here, another forum exists for telephone consumers to recover the alleged overcharges"); *Hanson*, 1999 WL 33283345 at \*4 (citing *Taffet v. Southern Co.*, 967 F.2d 1483, 1490 (11th Cir. 1992)). Under the facts of this case, no administrative remedy was available to Class members who paid surcharges under the URP.

Minnesota's insurance statutes do not provide policyholders with the right to have grievances under Minn. Stat. § 72A.20, subd. 13 heard by the DOC. Rather, any administrative relief for a violation of the anti-redlining law depends entirely on how and if the DOC proceeds. In this case, the Class never learned about the DOC's investigation until after State Farm stipulated to the consent decree. No contested case was filed.

The DOC is authorized to investigate any insurer suspected of violating the anti-redlining statute under Minn. Stat. §§, subd. 1 and 72A.21.<sup>20</sup> If the DOC believes the anti-redlining statute was violated, the agency may choose to proceed against an offending insurer pursuant to Minn. Stat. § 72A.22, subd. 1. In that instance, affected policyholders have the opportunity to intervene and be heard under Minn. Stat. § 72A.22, subd. 2.

Here, the settlement agreement was reached before any contested case was filed. The settlement agreement was silent on the rights of the aggrieved policyholders, and these policyholders never had an opportunity to be heard and their rights were never adjudicated. (PA 82). Further, Commissioner Bernstein expressly understood that the rights of the policyholders would not be adjudicated

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<sup>20</sup> Minnesota's rate-making statute, Minn. Stat. § 70A.01 *et seq.*, does not address violations of the state anti-redlining law, Minn. Stat. § 72A.20, subd. 13. Under Minn. Stat. § 70A.11 ("disapproval of rates"), the commerce commissioner can file a contested case proceeding for rates that allegedly violate Minn. Stat. § 70A.04. However, nothing in § 70A addresses the anti-redlining statute. Minn. Stat. § 72A.20, subd. 13. Rather, the administrative proceedings concerning violations of Minn. Stat. § 72A.20, subd. 13 are governed by § 72A.22.

by the settlement, and that the policyholders could proceed directly against State Farm. (PA 82). Under these circumstances, application of the filed rate doctrine serves no purpose and would run counter to the very underpinnings of the filed rate doctrine. *Keogh v. Chicago & N.W. Ry. Co.*, 260 U.S. 156 (1922).

**3. Minnesota courts, not the DOC, must make the final determination regarding disputed violations of the anti-redlining law.**

Minnesota's statutory insurance scheme plainly conflicts with the Court of Appeal's creation of a "filed rate doctrine." First, unlike other states, there is simply no mention whatsoever in Minnesota's regulatory scheme of the existence or application of a filed rate doctrine. *See Ark. Code Ann. § 23-17-121 (2005)* (identifying instances in which filed rate doctrine applies to a telecommunications industry). Instead, State Farm asks this Court to impose a common law doctrine that allows the commissioner, not the courts, to have the final say as to the legality of contract terms that may violate Minn. Stat. § 72A.20, subd. 13.

However, the statutory scheme at issue mandates that courts, not the DOC, have the final determination regarding disputed violations of Minn. Stat. § 72A.20, subd. 13. Specifically, if the commissioner starts a formal proceeding against an insurer, policyholders/interveners are entitled to proceed under Minn. Stat. § 72A.26 and have their grievances heard by a district court.

Minn. Stat. § 72A.26 expressly provides that the courts, not the DOC, make the final determination as to whether the UCPA has been violated. The broad powers provided to the district court by the Legislature include the power to issue

any order, issue equitable relief (“orders enjoining and restraining”) and, significantly, to disagree with the commissioner. Minn. Stat. § 72A.26.<sup>21</sup>

Adoption of the filed rate doctrine here conflicts with the district court’s powers vested by Minn. Stat. § 72A.26. Under the Court of Appeal’s decision, if a policyholder appealed an adverse decision of the Commissioner, the district court would be forced to follow the filed rate doctrine and wholly defer to the Commissioner. This result is plainly contradicted by the statute and, as stated above, by this Court’s decisions in *Shank* and its progeny. Simply, the Legislature has decided that Minnesota courts are entitled to make the final determination as to whether Minn. Stat. § 72A.20, subd. 13 has been violated. Minnesota courts are expressly authorized to reach conclusions that are contrary to the DOC’s determinations. Minn. Stat. § 14.69. This statutory directive, and this Court’s prior decisions, conflict with the application of a filed rate doctrine.

**4. The filed rate doctrine cannot apply because the DOC does not have exclusive authority to resolve the legality of insurance-relating filings.**

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<sup>21</sup> The Legislature also ensured that any actions of the commissioner in the administrative process would not absolve the insurer of liability under the common law for its misconduct:

No order of the commissioner, or order or decree of any district court, under sections 72A.17 to 72A.32 shall in any way relieve or absolve any person affected by such order or decree from any liability under any other laws of this state.

Minn. Stat. § 72A.29, subd. 1. This statute protects the Class’ rescission/equitable claims.

The filed rate doctrine is premised upon a regulator's expertise in the field. However, where a regulator's authority is not exclusive, the filed rate doctrine should not apply because, as in this case, disputes can arise between the responsible regulators.

In *Morris*, this Court held that the Attorney General has the power to take action against insurers for unfair insurance claims practices. *Id.*, 386 N.W.2d at 236. The Court of Appeals has followed this ruling, because the DOC's enabling statutes simply do not provide for exclusive jurisdiction:

The Appellant is correct that the commissioner has the authority to bring certain court actions under these provisions. But it does not necessarily follow that the commissioner's power to bring suit is exclusive. **The legislature did not state that the commerce department's power was exclusive in any of the sections mentioned above... If the legislature had intended that the commerce commissioner have exclusive authority, it could have stated this explicitly....** [T]he existence of a comprehensive regulatory scheme in an area does not necessarily constrain the authority of others.

*Hatch v. Am. Family Mut. Ins. Co.*, 609 N.W.2d 1, 3-4 (Minn. Ct. App. 2000)  
(emphasis added).

Here, former Commissioner Bernstein (PA 77) and the Attorney General (PA 84) believe that State Farm violated the anti-redlining statute was violated, and further believe that policyholders can seek rescission of the illegal surcharges. Indeed, the Attorney General sought to intervene in this case, but the district court did not rule upon his request and instead granted summary judgment to State Farm.

The current Commerce Commissioner does not share the Attorney General's opinion (PA 281). If a filed rate doctrine is adopted, the Commerce Commissioner alone would determine violations of Minn. Stat. § 72A.20, subd. 13. Such a result would conflict with the Attorney General's enabling statute, as referenced in *Morris* and *Hatch*. Neither the Attorney General nor the Commerce Commissioner have exclusive jurisdiction over enforcement of the anti-redlining statute. The conflict between the Attorney General and the DOC must be resolved by the Courts, and the filed rate doctrine cannot be imposed over the anti-redlining statute.

**5. The public cannot participate in the approval of Minnesota insurance filings.**

In the insurance context, several courts have looked to the ability of the public to be involved in the rate-making process in determining whether to apply the filed rate doctrine. *See Brown v. Ticor Title Ins. Co.*, 982 F.2d 386, 393-94 (9th Cir. 1992); *Hanson*, 1999 WL 33283345 at \*4 (citing *Taffet v. Southern Co.*, 967 F.2d 1483, 1490 (11th Cir. 1992)) (PA 287) (“the statutory scheme provides no mechanism for meaningful review of rates filed with the Insurance Commissioner or for public input in a rate determination, hearings or otherwise”).

Minnesota's insurance statutes do not allow for public input in any rate determination. Leaving aside the fact that the Commissioner does not actually “determine” rates in Minnesota, Chapter 70A merely requires that all rates

furnished to the Commissioner “be open to public inspection at any reasonable time.” § 70A.07. There is no public participation in the rate-making process.

The current Minnesota Commerce Commissioner acknowledged that “Companies file rates and begin using them immediately. The DOC then decides whether the increase is valid. Rates seldom are overturned . . . .” (PA 306). The Commissioner has also stated that limiting insurers’ ability “to quickly adjust to a changing marketplace would be harmful to consumers.” (PA 306). The absence of any policyholder representation in a file and use state weighs against the adoption of a filed rate doctrine.

**6. The filed rate doctrine conflicts with the certain remedies clause of the Minnesota Constitution.**

The Minnesota Constitution guarantees insured consumers the right to a remedy in this case under the “remedies clause” or “open courts” clause found at article I, section 8, which provides:

Every person is entitled to a certain remedy in the laws for all injuries or wrongs which he may receive to his person, property or character, and to obtain justice freely and without purchase, completely and without denial, promptly and without delay, conformable to the laws.

Minn. Const. art. I, § 8. This constitutional right to a remedy at law cannot be abridged by any legislative act, administrative agency or the adoption of a federal doctrine, like the filed rate doctrine, without the provision of a reasonable alternative. Simply put, the filed rate doctrine cannot be applied here to deprive the Class of a remedy in the courts.

“The purpose of [article 1, section 8] is to protect common law rights and remedies for which the legislature has not provided a reasonable substitute.” *Hickman v. Group Health Plan, Inc.*, 396 N.W.2d 10, 14 (Minn. 1986). The filed rate doctrine conflicts and, indeed, would do away with Minnesota law which has long permitted parties to recover for illegal rate charges regardless of the existence of a regulatory scheme.

For example, in *Bell Lumber Co. v. Great Northern Ry. Co.*, 135 Minn. 271, 160 N.W. 688 (1916), a shipper filed a tariff charging more for fence posts than allowed by law. The ratepayer sued to recover rate payments made in excess of that permitted by Minnesota law. The Court held that the ratepayer could recover under the common law for amounts paid in excess of that allowed by law: “No force should be given the 1909 tariff schedule with its rules and classifications, for it was not established as the law prescribes.” *Id.* at 273, 160 N.W.2d at 688.

Similarly, in *Sullivan v. Minneapolis & R.R. Ry. Co.*, 121 Minn. 488, 142 N.W. 3 (Minn. 1913), the Court held that a Minnesota rate regulation scheme did not impair a ratepayer’s right to recover under the common law for illegal, discriminatory rates:

The evils of rate discrimination need no comment, and the capacity of the common law, through its adaptability to changed conditions, to meet them, in a measure at least, would seem to be unquestionable, even though it should be conceded that at one time there was no common-law rule against discrimination as such...

**What is the effect of our statutes relating to the regulation of railroad rates upon the matters in hand? ...** As originally enacted they were obviously aimed at two distinct evils, namely, excessiveness in rates and discrimination therein as between different persons and localities; and in order to reach them both it was provided, sometimes in the same act, that rates must be both reasonable and equal...

It would seem clear, therefore, that unless such conclusion be negated by certain consideration, with which we will close this opinion, **a shipper's common-law remedy for discrimination still obtains in this state, whatever may be the effect of our statutes upon his former remedy for extortion by exaction of unreasonable or excessive rates. One would have to be oblivious to the course of events to assume that the Legislature, though evidently fully realizing the evils of both excessiveness and discrimination in rates and prohibiting both under heavy penalty, intended to leave the individual shipper remediless in the latter case by depriving him of his theretofore existing remedy; and we affirm that no case can be found in the books declaring any such doctrine under similar circumstances.**

*Id.* (emphasis added).

“If common-law rights are taken away, then some reasonable substitute must be put in their place.” *Schmidt v. Modern Metals Foundry, Inc.*, 424 N.W.2d 538, 541 (Minn. 1988). Here, Class members are left with no reasonable substitute for their common law contract remedies. The entire 2001 administrative proceeding between State Farm and the DOC involved only the agency and the insurer; the injured parties had no voice and no participation, let alone a remedy.

The district court's adoption of the filed rate doctrine clearly conflicts with the common law rights this Court described in *Bell* and *Sullivan* and leaves policyholders without a remedy for their economic loss, thereby violating the Minnesota Constitution. As a result, the district court's decision must be reversed.

**E. Public policy weighs against adopting a filed rate doctrine to bar policyholders from seeking judicial recourse for violations of the anti-redlining statute.**

A filed rate doctrine effectively shuts the door to the courthouse on civil rights claimants seeking a remedy for violations of the anti-redlining law. Respectfully, public policy weighs heavily against this result because the judicial branch is responsible for protecting minority rights. In *State of Minnesota v. Russell*, 477 N.W.2d 886, 893 (Minn. 1991), Justice Yetka addressed the responsibility of the judicial branch for protecting the civil rights of minorities:

We must understand that the United States has been and still remains a largely homogeneous society and that the problems of minority groups, particularly blacks, often are misunderstood. **The judicial branch is charged with protecting the individual rights and liberties of all citizens, and in a case like this, where we lack actual experience necessary to place ourselves in the respondents' position, we must rely on our imagination, understanding and analytical judgment to reach the just result.**

In today's United States, the gap between the have's and the have-not's is constantly increasing. There is a growing subclass that echoes the late President Franklin D. Roosevelt's description of society during the heart of the Great Depression, when one-third of Americans were ill-housed, ill-clothed and ill-fed. Today's subclass is largely urban.

*Id.*, (Yetka, concurring).

Federal courts have refused to permit insurance regulators to have the exclusive right to determine and hear civil rights claims involving insurance rates. As the Fifth Circuit recently stated, “[e]very [federal] circuit that has considered the question has determined that federal anti-discrimination laws may be applied in an insurance context, even where the state insurance agencies have mechanisms

in place to regulate discriminatory practices.” *Dehoyos v. Allstate Corp.*, 345 F.3d 290, 295 (5th Cir. 2003) (citing decisions from Fourth, Sixth, Ninth and Eleventh Circuit Court of Appeals).

Federal courts have allowed class action lawsuits seeking to restore premiums charged under racially discriminatory classifications to proceed. In *Dehoyos*, the Fifth Circuit analyzed a nationwide class action alleging that credit-scoring classifications unfairly discriminated against minorities. *Dehoyos*, 345 F.3d at 295 n.5 (“[W]e find Appellants’ ‘filed rate’ argument unpersuasive. The application of anti-discrimination laws cannot reasonably be construed to supplant the specific rate controls of Florida and Texas”). Similarly, in *Carnegie et al. v. Mut. Sav. Life Ins. Co.*, No. CV-99-S-3292-NE, 2002 U.S. Dist. LEXIS 21396, \*87 (N.D. Ala. 2002) (PA 309), a class of policyholders sued its insurer for charging premiums based upon race and also upon occupational classifications that were “used as a proxy for race.” The Plaintiffs sought “disgorgement of the differential in premiums collected” and other remedies. The court certified the Class and allowed the causes of action to proceed.

Like the cases involving credit-scoring and occupational classifications, the Class here seeks to obtain relief from an age of home classification that violated Minnesota’s anti-redlining law. This Court should not hold that it is powerless to protect Minnesota citizens from classifications based, expressly or by surrogate, upon race. Rather than conflicting with Minnesota’s regulatory scheme, the Class’ suit embraces state law.

Certainly, the Legislature did not intend to prohibit classifications that act to redline Minnesota communities while simultaneously allowing an insurer to redline if the DOC erroneously approves the practice. Courts do not permit this result: “[I]t is counterfeit logic to assert that the restoration of the equality of rates commanded by the law and the statutes, by recovery of the difference involved in the discrimination, is in any true sense a fixing of a rate or an interference with one previously established.” *Sullivan*, 121 Minn. at 503, 142 N.W. at 9.

### CONCLUSION

This Court has long held that insurance policy terms that violate public policy or the law are invalid and unenforceable. *Morris* did not change this precedent and no filed rate doctrine should supplant this rule. The Class is not asserting a private cause of action under the UCPA. Even if it were, the Court should permit such an action with respect to the anti-redlining portion of the UCPA. The Court should decline to create a filed rate doctrine. Such a doctrine is unwise and inapplicable where, as here, the relevant issue is one of law, not rate-making.

The lower courts erred in declining to exercise their jurisdiction to interpret and apply the important anti-redlining law in this case, thereby permitting State Farm to retain the money it received by virtue of the illegal URP surcharge. This result undermines the significant policy and law prohibiting discrimination and is simply wrong. The Class respectfully requests that the Court reverse the decision

of the Court of Appeals and remand the Class' rescission claims to the district court for trial on their merits.

Dated this 12<sup>th</sup> day of January, 2006.      Respectfully submitted,

**LARSON • KING, LLP**



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Lawrence R. King (#55827)  
T. Joseph Snodgrass (#231071)  
Shawn M. Raiter (#240424)  
Louise Dovre Bjorkman (#0166947)  
2800 Wells Fargo Place  
30 East Seventh Street  
St. Paul, MN 55101  
(651) 312-6510

**LOCKRIDGE GRINDAL NAUEN  
P.L.L.P.**

Charles N. Nauen (#121216)  
Robert K. Shelquist (#21310X)  
100 Washington Avenue South, Suite  
2200  
Minneapolis, MN 55401  
(612) 339-6900

**ZIMMERMAN REED, P.L.L.P.**

Charles S. Zimmerman (#120054)  
J. Gordon Rudd, Jr. (#222082)  
651 Nicollet Mall, Suite 501  
Minneapolis, MN 55402  
(612) 341-0400

**McSWEENEY & FAY**

Rhett A. McSweeney (#269542)  
800 Washington Avenue North, Ste. 506  
Minneapolis, MN 55401  
(612) 333-6900

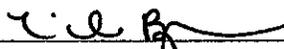
***ATTORNEYS FOR PETITIONERS***

**CERTIFICATE**

Pursuant to Rule 132.01, subd. 3(a)(1), the undersigned set the type of the foregoing memorandum of law in Times New Roman, a proportional, 13-point font, on 8 ½ by 11 inch paper with written matter not exceeding 6 ½ by 9 ½ inches. The resulting principal brief contains 12,466 words, as determined by employing the word counter of the word-processing software, Microsoft Word XP, used to prepare it.

Dated this 12<sup>th</sup> day of January, 2006.

**LARSON • KING, LLP**

  
\_\_\_\_\_  
Lawrence R. King (#55827)  
T. Joseph Snodgrass (#231071)  
Louise Dovre Bjorkman (#0166947)  
Shawn M. Raiter (#240424)  
2800 Wells Fargo Place  
30 East Seventh Street  
St. Paul, MN 55101  
(651) 312-6510

1154601