# STATE OF CALIFORNIA

# OFFICE OF ADMINISTRATIVE LAW

**2010 OAL DETERMINATION NO. 21**
**(OAL FILE NO. CTU2010-0329-02)**



**REQUESTED BY:** **THE AMERICAN COUNCIL OF LIFE INSURERS, THE AMERICAN INSURANCE ASSOCIATION, THE ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES, ASSOCIATION OF CALIFORNIA LIFE AND HEALTH INSURANCE COMPANIES AND PERSONAL INSURANCE FEDERATION OF CALIFORNIA**

**CONCERNING:** **THE DEPARTMENT OF INSURANCE'S TREATMENT OF IRAN-RELATED INVESTMENTS BY INSURERS**

**DETERMINATION ISSUED PURSUANT TO GOVERNMENT CODE SECTION 11340.5.**

## SCOPE OF REVIEW

A determination by the Office of Administrative Law (OAL) evaluates whether or not an action or enactment by a state agency complies with California administrative law governing how state agencies adopt regulations. Our review is limited to the sole issue of whether the challenged rule meets the definition of "regulation" as defined in Government Code section 11342.600 and is subject to the Administrative Procedure Act (APA). If a rule meets the definition of "regulation," but was not adopted pursuant to the APA and should have been, it is an "underground regulation" as defined in California Code of Regulations, title 1, section 250. Nothing in this analysis evaluates the advisability or the wisdom of the underlying action or enactment. OAL has neither the legal authority nor the technical expertise to evaluate the underlying policy issues involved in the subject of this Determination.

## CHALLENGED RULES

On March 29, 2010, the American Council of Life Insurers, the American Insurance Association, the Association of California Insurance Companies, the Association of California Life and Health Insurance Companies and the Personal Insurance Federation of California (hereafter collectively referred to as "Petitioners"), submitted a Petition for Determination pursuant to Government Code section 11340.5 as to alleged underground regulations of the Department of Insurance.[1] On May 27, 2010, after reviewing the petition

[1] The California Insurance Commissioner "controls" the Department of Insurance and is responsible for the actions taken herein which are carried out by the Department. (Insurance Code section 12906.) This determination will refer to the "Department" and the "Commissioner" interchangeably.

and the accompanying documentation, OAL accepted the petition for consideration as to the following alleged underground regulations:[2]

A. The rule, expressed in a letter dated February 10, 2010, stating that effective March 31, 2010, the Department will treat all investments by insurers holding a certificate of authority to transact insurance in California in companies on the List[3] (which is incorporated by reference in the letter) and affiliates owned 50% or more by companies on the List, as non-admitted on the insurer's financial statements in that they are subject to financial risk as a result of doing business with the Iranian oil and natural gas, nuclear, and defense sectors. It further states that for all financial statements filed with the Department for periods ending on or after March 31, 2010, each insurer is required to report all of its investment holdings in companies on the List as not admitted assets. The February 10, 2010, letter is attached as Exhibit A. [Referred to as the "Non-admitted Asset Determination" herein.][4]

B. A document titled "Response Form" that requires insurers to agree or not to agree by March 12, 2010, that they will refrain from investing in companies on the List or affiliates owned 50% or more by companies on the List until either: (a) Iran is removed from the United States State Department's list of state sponsors of terrorism, or (b) the company and its affiliates cease to do business with Iran's oil and natural gas, nuclear, and defense sectors and is removed from the List. The Response Form is attached as Exhibit B. [Referred to as the "Mandatory Response Form" herein.]

Please note, in accepting this matter for review, OAL renders an opinion solely as to whether the alleged challenged rules are "regulations" as defined in Government Code section 11342.600, which should have been, but were not adopted pursuant to the Administrative Procedure Act. This Determination does not evaluate whether the agency has the authority to take the actions alleged. This Determination evaluates only whether the actions are, or are not, underground regulations.

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[2] Prior to responding to the petition on its merits, the Department requested that OAL exercise its discretion to decline the petition pursuant to California Code of Regulations, title 1, section 270(c), due to allegations of ethical violations of the attorney who was at the time representing the Petitioners. OAL, in accepting the petition for consideration, indicated that it would not decline to consider a petition due to allegations of ethics violations of an attorney and that those allegations are best addressed by the State Bar or a court.

[3] The List is a document attached to the Department's February 10, 2010 letter which contains the names of fifty companies and is titled: "CALIFORNIA DEPARTMENT OF INSURANCE LIST OF COMPANIES DOING BUSINESS WITH THE IRANIAN PETOLEUM/NATURAL GAS, NUCLEAR, AND DEFENSE SECTORS (AS OF FEBRUARY 9, 2010)."

[4] OAL's letter accepting the petition expressed the challenged rules as three separate rules similar to those submitted by Petitioners. Upon additional research and study, we concluded that the challenged rules are (1) the February 10, 2010 letter, including the incorporated by reference List of companies alleged to be doing business with the Iranian Petroleum/Natural Gas, Nuclear and Defense Sectors and, (2) the Mandatory Response Form. We will be treating them as two challenged rules herein.

## DETERMINATION

OAL determines that each of the rules articulated above, the Non-admitted Asset Determination and the Mandatory Response Form, meet the definition of "regulation" in Government Code section 11342.600, that should have been adopted pursuant to the APA.

## FACTUAL BACKGROUND

On March 29, 2010, OAL received the petition submitted on behalf of the Petitioners alleging that the Department of Insurance (Department) has issued, used, enforced, or attempted to enforce underground regulations. The petition concerns the Department's requirements for insurers relative to investments in companies that the Commissioner designated as doing business with the Iranian oil and natural gas, nuclear, and defense sectors. The Commissioner stated that no investments that an insurer holds in certain companies on a list would be recognized for statement credit on financial statements filed with the Department and must be listed as "non-admitted" assets for financial statement purposes, as follows:

> The elimination of statement credit for investments in companies on the list will mean that insurers will be required to reduce the capital and surplus reported on their financial statements by the amount of investments in these 50 [now 51] companies. California law requires insurers to carry a minimum level of capital and surplus in order to continue to be licensed to sell insurance in this state.[5]

According to the Department, the Commissioner has responsibility for ensuring that the assets held by insurance companies are financially sound.[6] In light of this obligation, the Legislature provided the Commissioner with broad authority to take prompt action against **individual** insurers who the Commissioner finds to have inadequate levels of "risk based capital" (commencing with Ins. Code sec. 739). If corrective action needs to be taken, and the insurer is so notified by the Department, the insurer has the right to request a hearing (Ins. Code sec. 739.7). Similarly, if the Commissioner finds that a company is conducting its business and affairs in such a manner as to threaten to render it insolvent, or conducting affairs in a manner which is hazardous to its policyholders, creditors or the public, the Commissioner may make any order reasonably necessary to correct, eliminate or remedy such conduct or condition after a public hearing (Ins. Code sec. 1065.1). The Commissioner also has authority to assess penalties after holding public hearings concerning certain matters (see for instance Ins. Code sec. 1068.2) as well as other powers of enforcement and protection. Also, the Commissioner may, after a hearing, require the disposal of any investments made in violation of the provisions of Article 4 (Property Authorized for Excess Funds Investments) (Ins. Code sec. 1202).

In 2008, the California Legislature enacted legislation which further defines the scope and limits of foreign investments by insurers (Assem. Bill No. 2203 (2007-2008 Reg. Sess.)). Among other things, it prohibits insurers from acquiring investments from, or located in,

[5] Attached as Exhibit C to this determination is the Commissioner's February 10, 2010 press release.
[6] Attached as Exhibit D to this determination is the Department's Response to the Petition (hereafter "Response"), at p. 1.

foreign jurisdictions designated as state sponsors of terrorism by the United States.[7] The new legislation, which details the types and amounts of investments allowed by insurers in foreign investments, was codified in Insurance Code sections 1240, 1241, 1241.1 and 1242.

The Commissioner contends that "Iran's pursuit of nuclear weapons, its support of international terrorism, and its despotic rule not only render ***it*** unstable politically and economically, but put at risk **any company** that does business with the Iranian nuclear, defense, and energy sectors. [Emphasis in original.]"[8]

In June 2009, the Commissioner commenced a Terror Financing Probe, "an effort to monitor and evaluate Iran-related investments by insurers doing business in California."[9] The Commissioner issued a "data call" to all insurers requesting information about Iran-related holdings in their portfolios pursuant to his authority to "'examine the business and affairs' of **an insurer** whenever the Commissioner 'deems [it] necessary'. [Emphasis added.]"[10] In July 2009, the Commissioner required insurers to identify companies in their portfolio that "do business with the Iranian nuclear, defense, energy, and banking sectors."[11] The Commissioner then hired experts who spent months evaluating the investments on a "security-by-security" basis.

Although no insurer was found to be in violation of the law, the Department indicated in a press release dated December 2, 2009, that the Commissioner called for a "complete divestment" of all investments having an **indirect** relationship with Iran. In the press release, he further indicated that he launched an effort "six months ago" to determine the level of investments in Iran. The press release states that the Commissioner was calling "upon the insurance industry to do what's right and divest themselves of these investments. If they do not do it voluntarily, [he] will use every tool at [his] disposal to force divestment."[12] It further states that the companies will be given 30 days to notify the Department in writing that they will comply with divestment and 90 days to eliminate those holdings from their portfolios. It states that if companies do not voluntarily agree to divest, the Commissioner will make public the list of those who refuse; "subpoena high-ranking executives of these insurance companies to testify under oath and ask them why they believe it is in the interest of California policyholders for their premium dollars to be invested in companies propping up Iran's energy, nuclear, defense and banking sectors" and, after this hearing, if an insurer still refuses to divest, the Commissioner "will take all legal action available to him to effectuate divestment."[13]

As a result of the Department's uncovering of billions of dollars in indirect investments in Iran, the Department distributed multiple documents related to insurer investments in Iran. One is Exhibit A, the February 10, 2010 letter to insurance companies notifying them that the Department has compiled a "List of Companies Doing Business in Specified Iranian

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[7] According to the Assembly Bill Analysis, during the pending of the vote on the legislation, Cuba, Iran, North Korea, Sudan and Syria were designated.

[8] Response, at p. 1

[9] Ibid, at p. 5.

[10] Ibid.

[11] Ibid.

[12] Attached as Exhibit F to this determination is a copy of the December 2, 2009 press release making this announcement.

[13] Ibid.

Economic Sectors." The letter indicates that the Insurance Commissioner "has determined that companies on the List are subject to financial risk as a result of doing business with the Iranian oil and natural gas, nuclear, and defense sectors." The letter further states that **"[e]ffective March 31, 2010, the Department will treat all investments by insurers holding a certificate of authority to transact insurance in California in companies on the List and affiliates owned 50% or more by companies on the List as non-admitted on the insurer's financial statements. For all financial statements filed with the Department for periods ending on or after March 31, 2010, each insurer must report all of its investment holdings on the List as not admitted assets.** [Emphasis in original.]" The letter then makes a "request" for a moratorium on specified future Iran-related investments and requires a response to the request. The letter ends with "[i]f your company does not respond to or declines the Department's request for a moratorium on future investments in companies on the List and affiliates owned 50% or more by those companies, the Department may publish your company's name on the Department's website." A response form was provided to the insurers upon which they are required to indicate whether they would agree, or not agree, to a moratorium on Iranian related investments. The response was mandatory as is reflected in the Commissioner's February 10, 2010 press release,[14] which states: "Attached is the Department's form which all insurers must complete and return to the Department by March 12, 2010 indicating whether they will agree not to invest in the future in companies on the list."

In March, 2010, ". . . the Department announced that insurers reported no direct investments in Iran and, therefore [they] are in **full compliance with state law** prohibiting those investments. But the Department uncovered billions of dollars of indirect investments in companies doing business with the Iranian oil and natural gas, nuclear and defense sectors. [Emphasis added.]"[15] The Department does not assert that any of the investments which are the subject of this Determination are outside the statutory mandates.

According to another press release by the Department, "[a]s of March 31, 2010, the [Department] disqualified an estimated $6 billion in holdings in the 50 Iran-related companies. [Emphasis in original.]"[16]

On April 16, 2010, the Department provided insurers with a supplemental financial filing on Iran related investments to be included in quarterly and annual reporting. The letter indicates that the Department has developed an Iran Related Investments Supplemental Filing Workbook and that the Workbook was to be completed and returned by May 31, 2010.[17] The letter further provides that the Department was modifying its position on these investments and that they will not be "disqualified" but will be treated as non-admitted. At the end of the letter, it states that **"[c]ompanies that fail to submit a completed IRI-2010 Supplemental Filing** by the due date requested **will be considered in non-compliance** and will be referred to the Department of Insurance's Legal Division for further action. [Emphasis added.]" The Department's website under the title "Insurers: Supplemental Financial Filing On Iran Related

[14] Exhibit C.
[15] Attached as Exhibit E to this determination is a copy of the March 26, 2010 press release.
[16] Attached as Exhibit G is the Department's May 13, 2010 press release.
[17] Attached as Exhibit H to this determination is a copy of the Department's April 16, 2010 letter. This Determination does not address whether the April 16, 2010, letter and its attachments, are underground regulations.

Investments (IRI-2010)" states that "ALL CALIFORNIA ADMITTED INSURERS" are required to report on the Iran-related assets via the IRI-2010 Supplemental Financial Filing.[18]

On April 16, 2010, the Department also added one additional company to the List.[19]

"All but a handful of the 1,300 insurers admitted to do business in California responded"[20] to the Commissioner's letter regarding future investments in Iran. More than 1,000 insurers returned the form or a letter indicting that they do not intend to make future investments in companies on the List. According to the Department, "[t]he Commissioner has not entered orders against any insurers in connection with Iran investment matters."[21]

On July 27, 2010, OAL received a response to the petition from the Department. On August 10, 2010, OAL received the Petitioner's reply. No comments were received from the public on this matter.

## UNDERGROUND REGULATIONS

Government Code section 11342.600 defines "regulation" as "every rule, regulation, order, or standard of general application or the amendment, supplement, or revision of any rule, regulation, order, or standard adopted by any state agency to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure." Any regulation adopted by a state agency through its exercise of quasi-legislative power delegated to it by statute to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure, is subject to the APA unless a **statute expressly exempts** the regulation from APA review (Gov. Code, secs. 11340.5 and 11346). Government Code section 11340.5, subdivision (a), provides:

> No state agency shall issue, utilize, enforce, or attempt to enforce any guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule, which is a regulation as defined in [Government Code] Section 11342.600, unless the guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule has been adopted as a regulation and filed with the Secretary of State pursuant to [the APA].

Government Code section 11346(a) states:

> **It is the purpose of this chapter to establish basic minimum procedural requirements** for the adoption, amendment, or repeal of administrative regulations. Except as provided in Section 11346.1, the provisions of this chapter are applicable to the exercise of any quasi-legislative power conferred by any statute heretofore or hereafter enacted,

[18] Attached as Exhibit I to this determination is a copy of the page taken from the Department's website, http://www.insurance.ca.gov/0250-insurers/0300-insureres/0100-applications/IRI-2010/inde... (as of September 14, 2010)
[19] Response, p. 7.
[20] Ibid, p. 3.
[21] Ibid.

> but nothing in this chapter repeals or diminishes additional requirements imposed by any statute. **This chapter shall not be superseded or modified by any subsequent legislation except to the extent that the legislation shall do so expressly**. [Emphasis added.]

When an agency issues, utilizes, enforces, or attempts to enforce a rule in violation of section 11340.5, it creates an underground regulation as defined in title 1, California Code of Regulations, section 250(a):

> "Underground regulation" means any guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule, including a rule governing a state agency procedure, that is a regulation as defined in Section 11342.600 of the Government Code, but has not been adopted as a regulation and filed with the Secretary of State pursuant to the APA and is not subject to an express statutory exemption from adoption pursuant to the APA.

OAL may issue a determination as to whether or not an agency has issued, utilized, enforced, or attempted to enforce a rule that meets the definition of "regulation" as defined in section 11342.600 and should have been adopted pursuant to the APA. (Gov. Code sec.11340.5.) An OAL determination that an agency has issued, utilized, enforced, or attempted to enforce an underground regulation is - entitled to "due deference" in any subsequent litigation of the issue pursuant to *Grier v. Kizer* (1990) 219 Cal.App.3d 422 [268 Cal.Rptr. 244].[22]

OAL's legislative mandate was summarized by the court in *State Water Resources Control Board vs. The Office of Administrative Law* (1993) 12 Cal.App.4th 697, 702 [16 Cal.Rptr.2d 25], (hereafter *State Water Resources Control Board)*, as follows:

> The Legislature established the OAL as a central office with the power and duty to review administrative regulations. The Legislature expressed its reasons in no uncertain terms stating, in essence, that it was concerned with the confusion and uncertainty generated by the proliferation of regulations by various state agencies, and that it sought to alleviate these problems by establishing a central agency with the power and duty to review regulations to ensure that they are written in a comprehensible manner, are authorized by statute and are consistent with other law. (Gov. Code, §§ 11340, subd. (e), and 11340.1.) In order to further that function, the relevant Government Code sections are careful to provide OAL authority over regulatory measures whether or not they are designated "regulations" by the relevant agency. In other words, if it looks like a regulation, reads like a regulation, and acts like a regulation, it will be treated as a regulation whether or not the agency in question so labeled it.

Any doubt as to the applicability of the APA, should be resolved in favor of the APA. As *Grier v. Kizer, supra,* 219 Cal.App.3d 422, 438 states:

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[22] *Grier v. Kizer, supra,* 219 Cal.App.3d 422, was disapproved as to an unrelated issue. It is still good law for the purposes stated.

> Further, because the Legislature adopted the APA to give interested persons the opportunity to provide input on proposed regulatory action (*Armistead, supra,* 22 Cal.3d at p. 204, 149 Cal.Rptr.1, 583 P.2d 744), we are of the view that any doubt as to the applicability of the APA's requirements should be resolved in favor of the APA.

Therefore, we are mindful of this admonition when analyzing whether the challenged actions constitute underground regulations.

## ANALYSIS

OAL's authority to issue a determination extends only to the limited question of whether the challenged rule is a "regulation" subject to the APA. This analysis will determine (1) whether the challenged rule is a "regulation" within the meaning of Government Code section 11342.600, and (2) whether the challenged rule falls within any recognized exemption from APA requirements.

As previously stated, a regulation is defined in Government Code section 11342.600 as:

> . . . **every** rule, regulation, **order, or standard of general application** or the amendment, supplement, or revision of any rule, regulation, order, or standard **adopted by any state agency to** implement, interpret, or **make specific the law enforced or administered by it, or to govern its procedure**. [Emphasis added.]

In *Tidewater Marine Western, Inc. v. Victoria Bradshaw* (1996) 14 Cal.4th 557, 571 [59 Cal.Rptr.2d 186] (hereafter *Tidewater),* the California Supreme Court found that:

> A regulation subject to the Administrative Procedure Act (APA) (Gov. Code, §11340 et seq.) has two principal identifying characteristics. First, the agency must intend its rule to apply generally, rather than in a specific case. The rule need not, however, apply universally; a rule applies generally so long as it declares how a certain class of cases will be decided. Second, the rule must implement, interpret, or make specific the law enforced or administered by the agency, or govern the agency's procedure (Gov. Code, §11342, subd. (g)).[23]

As stated in *Tidewater, supra, 14 Cal.4th 557,* the first element used to identify a "regulation" is **whether the rule applies generally.** The court in *Tidewater, supra, 14 Cal.4th 557,* pointed out that a rule need not apply to all persons in the state of California. It is sufficient if the rule applies to a clearly defined class of persons or situations.

With respect to the first element of *Tidewater, supra, 14 Cal.4th 557,* each challenged rule will be addressed individually.

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[23] Section 11342(g) was re-numbered in 2000 to section 11342.600 without substantive change.

**A. The Non-admitted Asset Determination and the List incorporated by reference.**

The Non-admitted Asset Determination is a requirement in the February 10, 2010 letter (Exhibit A) that all insurers who hold a certificate of authority to transact insurance in California and who hold investments in companies on the List, which is incorporated by reference, are prohibited from listing those assets as admitted assets on their California financial statements. The letter determines that the 50 companies on the List are "subject to financial risk" and are "doing business with the Iranian Petroleum/Natural gas, nuclear, and defense sectors." The class that is affected by the determination is **all insurers holding certificates of authority to transact insurance in California** in that the challenged rule affects what assets the insurers may list as admitted on the financial statements. Ultimately, none of the admitted insurers may list the assets of the companies on the List as admitted assets. As such, the clearly defined class is all insurers who hold a certificate of authority to transact insurance in California.

The challenged rule also affects all those companies who cannot be considered "admitted assets" for the purpose of investment in their companies in that they are on the List as subject to financial risk. The Commissioner has designated all companies on the List as doing business with Iran's oil and natural gas, nuclear and defense sectors through a process enlisting the aid of experts of the Commissioner's choosing apparently without public participation in the process.

The Department asserts that the companies on the List were selected on a case-by-case basis and "[n]o single criterion or methodology applies uniformly to each company on the List."[24] However, the List states at the top that it is a "List of Companies Doing Business with the Iranian Petroleum/Natural Gas, Nuclear and Defense Sectors." Therefore, the single criterion used appears to be the Commissioner's evaluation of whether or not the company is "doing business with" the Iranian petroleum/natural gas, nuclear and defense sectors. However, the specific criteria used to determine whether a particular company was "doing business with" the designated sectors of Iran is unknown.

The Non-admitted Asset Determination and the List of companies incorporated by reference apply generally to a clearly defined class: all insurers who hold a certificate of authority to transact insurance in California. All the insurers are affected in that each of them is precluded from listing those assets as admitted on their California financial statements filed with the Department. All insurers who hold California certificates must list these investments as "non-admitted," regardless of their state of domicile or any other factor. Any insurer who is licensed in California may not have holdings in the companies on the List as admitted assets. Therefore, the first prong of *Tidewater, supra, 14 Cal.4th 557,* is met with respect to the Non-admitted Asset Determination and the List of companies incorporated by reference.

**B. The Mandatory Response Form.**

The "Mandatory Response Form" attached as Exhibit B, **requires** all California insurers to agree or not to agree by March 12, 2010, that they will refrain from investing in companies

[24] Response, p. 11.

on the List or affiliates owned 50% or more by companies on the List until either (a) Iran is removed from the United States State Department's list of state sponsors of terrorism or (b) the company **and its affiliates** cease to do business with Iran's oil and natural gas, nuclear, and defense sectors and is removed from the List. It is a mandatory response form in that all insurers must respond by stating they agree not to invest in companies on the List or that they do not agree to the moratorium on investments by March 12, 2010, otherwise they will be subject to whatever consequences the Commissioner delineates. This Mandatory Response Form applies to the clearly defined class of **all insurers who hold a certificate of authority to transact insurance in California.** Therefore, the first prong of *Tidewater, supra, 14 Cal.4th 557,* is met with respect to the Mandatory Response Form.

The second element used to identify a "regulation" as stated in *Tidewater, supra,* 14 Cal.4th 557, is that the rule must implement, interpret or make specific the law enforced or administered by the agency, or govern the agency's procedure.

Again, with respect to the second prong, each challenged rule will be addressed individually.

**A. The Non-admitted Asset Determination and the List incorporated by reference.**

The Department asserts that "Insurance Code Section 923 gives the Commissioner broad authority to specify the use of forms and methods of financial reporting without undertaking rulemaking."[25] Insurance Code section 923 states:

> The commissioner shall require every insurer which is required to file an annual or quarterly statement to use the statement blanks and instructions thereto for the appropriate year adopted by the National Association of Insurance Commissioners. **The statements shall be completed in conformity with the Accounting Practices and Procedures Manual adopted by the National Association of Insurance Commissioners,** to the extent that the practices and procedures contained in the manual do not conflict with any other provision of this code. **The commissioner may make changes from time to time in the form of the statements and the number and method of filing reports as seem to him or her best adapted to elicit from the insurers a true exhibit of their condition.** The commissioner shall notify each insurer of any changes from the National Association of Insurance Commissioners' statement blanks which the commissioner has determined pursuant to this section to be appropriate. [Emphasis added.]

The Department asserts that it is implementing Insurance Code section 923 as to the requirements for filing annual and quarterly statements by insurers when imposing the challenged rules. We agree that when the Commissioner states in Exhibit A that "effective March 31, 2010, the Department will treat all investments by insurers holding a certificate of authority to transact insurance in California in companies on the List and affiliates owned 50% or more by companies on the List as non-admitted on the insurer's financial statements," the Department is intending to implement, interpret or make specific Insurance Code section 923. The Department further indicates in its Response that the Commissioner

[25] Response, p. 4.

was implementing his duties under other statutes as well when he took the challenged actions. The Department refers to the Commissioner's statutory duties under Insurance Code sections 739, 739.12, 939, 956 and 1069.2.[26] In particular, the Department invokes the Commissioner's authority under Insurance Code section 730 with respect to his powers to "examine" the business and affairs of an insurer.[27] The Department indicates that it was implementing the Commissioner's authority over insurers when compiling the List. In referring to Insurance Code sections 717(b), 706.5, 1196(a), 1215.5(f)(6) and 12921.3(d), the Department states: "The Commissioner's duty to safeguard insurer portfolios by making determinations about investment soundness, quality, liquidity and diversification (see., e.g., Ins. Code sections 717(b), 706.5, 1196(a) and 1215.5(f)(6)) and his authority to disseminate accurate information to insurers and the public ([Id.] Section 12921.3(d)) require the Commissioner to perform research and do studies from time to time."[28] We agree that the Department was intending to implement, interpret or make specific various provisions of the Insurance Code when issuing the challenged rules.

Thus, with respect to the Non-admitted Asset Determination and its incorporated List, the second prong of the two prong *Tidewater, supra,* 14 Cal.4th 557, test, is met.

**B. The Mandatory Response Form.**

The Mandatory Response Form (Exhibit B) requires insurers to agree or not to agree by March 12, 2010, that they will refrain from investing in companies on the List or affiliates owned 50% or more by companies on the List until either: (a) Iran is removed from the United States State Department's list of state sponsors of terrorism, or (b) the company and its affiliates cease to do business with Iran's oil and natural gas, nuclear, and defense sectors and is removed from the List.

The Department indicates that the request for information from insurers about investment activities was voluntary and "a lawful exercise of the Commissioner's power to 'examine the business and affairs' of insurers" pursuant to Insurance Code section 730(a).[29] Although the insurers were allowed to agree or not agree to the moratorium, they were required to respond or suffer the consequences. The Department is therefore implementing, interpreting or making specific Insurance Code section 730(a) when it required the response via the Mandatory Response Form (Exhibit B). Thus, with respect to The Mandatory Response Form, the second prong of the two prong *Tidewater, supra,* 14 Cal.4th 557, test, is met.

Because both prongs of *Tidewater, supra,* 14 Cal.4th 557, have been met, the Non-admitted Asset Determination and the List incorporated by reference, as well as the Mandatory Response Form, meet the definition of "regulation" in Government Code section 11342.600.

The final issue to examine is whether a challenged rule falls within an express statutory exemption from the APA. Exemptions from the APA can be general exemptions that apply to

[26] Ibid., p. 1.
[27] Ibid, p. 13.
[28] Response, p. 11.
[29] Ibid, p. 4.

all state rulemaking agencies. Exemptions may also be specific to a particular rulemaking agency or a specific program.

## EXEMPTION

Any regulation adopted by a state agency through its exercise of quasi-legislative power delegated to it by statute to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure, is subject to the APA unless a statute ***expressly exempts*** the regulation from APA review. (Government Code sections 11340.5 and 11346.) In *United Systems of Arkansas v. Stamison* (1998) 63 Cal.App.4th 1001, [74 Cal.Rptr.2d 407], the court indicated that "[w]hen the Legislature has intended to exempt regulations from the APA, it has done so by clear, unequivocal language." OAL, therefore, cannot recognize an "implied" exemption when the Legislature and the courts have clearly stated to the contrary.

The Department contends that the challenged rules are not subject to the APA for a number of reasons. However, the forms exemption found in Government Code section 11340.9(c), is the only express statutory exemption asserted by the Department.

### Forms Exemption

With respect to the Mandatory Response Form and the List,[30] the Department asserts that they are exempt from the rulemaking requirements of the APA pursuant to Government Code section 11340.9(c). Section 11340.9(c) states that the APA does not apply to any of the following:

> A form prescribed by a state agency or any instructions relating to the use of the form, **but this provision is not a limitation on any requirement that a regulation be adopted pursuant to this chapter when one is needed to implement the law under which the form is issued.** [Emphasis added.]

The forms exemption contained in Government Code section 11340.9(c) is a limited statutory exemption. According to the case of *Stoneham v. Rushen* (1982) 137 Cal.App.3d 729, 736 [188 Cal.Rptr.130] (hereafter *Stoneham*), the exemption is a "statutory exemption relating to **operational** forms.[Emphasis added.]" *Stoneham, supra,* involved primarily the question of whether the Corrections agency was required to comply with the notice and hearing requirements of the APA before issuing "administrative bulletins" implementing a new standardized classification system for prisoners. The agency pointed to the directors' "statutorily empowered" authority to "examine each prisoner and thereupon to classify the prisoner to determine the prison in which he will be confined." The agency indicated that the administrative bulletin was merely a "form" to be completed and therefore exempt from the APA. The court disagreed, stating at 737:

> The Director of Corrections was required to follow the notice and hearing requirements of the Administrative Procedure Act (Gov. Code, § 11342 et seq.) before she issued "administrative bulletins" implementing a new standardized inmate classification system. Although the act does not apply to a

[30] The Department does not claim that the Non-Admitted Asset Determination falls within the forms exemption.

> rule relating "only to the internal management of [a] state agency" or to "any form prescribed by a state agency or any instructions relating to the use of the form" (Gov. Code, § 11342, subd. (b)), the classification scheme employed by the director and the Department of Corrections extended well beyond matters relating solely to the management of the internal affairs of the agency itself, embodying as it did a rule of general application significantly affecting the male prison population in the custody of the department. **Nor did the standardized scoring system for inmates fall within the statutory exemption relating to operational forms. The use of a standardized score sheet to achieve a classification formerly determined on a subjective basis brought about a wholly new and different scheme affecting the placement and transfer of prisoners.** [Emphasis added.]

A form which simply provides for the operational convenience of capturing information which existing law already requires to be furnished falls within the forms exemption. If the requirements are already in statute or regulation, then merely requesting the required information to be submitted to the agency on a specific form does not subject the form to the APA. However, requiring **additional** information that is not in existing law would not fall within the forms exemption. Government Code section 11340.9(c) specifically states such when it provides: "**but this provision is not a limitation on any requirement that a regulation be adopted pursuant to this chapter when one is needed to implement the law under which the form is issued**. [Emphasis added.]"

The Mandatory Response Form does not merely reflect the capturing of information that is required by statute or regulation, it imposes a new requirement. The significant new requirement is that all insurers must indicate whether or not they will agree to the moratorium on Iranian related investments. Such a requirement is regulatory and merely adding the regulatory requirement to a form does not relieve the Department from the obligation of adopting the regulation pursuant to the APA. The forms exemption does not apply to the Mandatory Response Form.

Likewise, the List attached to the February 10, 2010 letter does not fall under the forms exemption to the APA. It is not even a form. It is a grouping of companies on a list with a designation of them as "doing business with the Iranian oil and natural gas, nuclear, and defense sectors." The List is not an operational form which provides for operational convenience of capturing information which existing law already requires to be furnished to the Department.

## AGENCY RESPONSE

In addition to the Department's contention that the above express, statutory exemption to the APA applies to the Mandatory Response Form and the List, the Department also asserts that:

- the challenged rules are not regulations;
- the actions are not subject to the APA in that they are not quasi-legislative action;
- Insurance Code section 923 does not require rulemaking;
- rulemaking would be inconsistent with and "effectively eviscerate" Insurance Code section 923;

- time constraints do not make rulemaking an option;
- statutory construction requires the specific provisions of Insurance Code section 923 to prevail over the general provisions of the APA;
- the challenged action is merely an accounting technique which is exempt from the APA; and,
- the investments were selected on a case-by-case basis and therefore do not come within the confines of the APA.

This Determination has already addressed the issue of whether or not the challenged actions are regulations as well as the express statutory exemption proposed by the Department. This section will address the other contentions raised in the Department's Response.

**1. The Department contends that the challenged rules are not quasi-legislative action.**

The Department asserts that it was not acting in a quasi-legislative manner when it took the action against Iran related assets and that the Commissioner was merely applying his existing statutory authority to oversee insurers. The Insurance Commissioner has very broad authority as discussed in the Factual Background, *supra*, with respect to examining the financial viability of individual insurers. Such authority appears to often, if not always, come with procedural safeguards, such as hearings. The challenged action was not taken against individual insurers, but was taken against **all** California insurers. When a regulatory action is taken against a specific class, the APA (unless an express statutory exemption exists) provides for procedural safeguards so that those being regulated have an opportunity to participate.

Since the term "quasi-legislative" is not defined in the California APA, we look to the judicial definition of the term to determine whether the challenged action reflects the exercise of quasi-legislative power. *Tidewater, supra,* 14 Cal.4th 557, 574-575, states that "[a] written statement of policy that an agency intends to apply generally, that is unrelated to a specific case, and that predicts how the agency will decide future cases is essentially legislative in nature even if it merely interprets applicable law." Using this definition of quasi-legislative, the challenged rules are a written statement of policy as demonstrated in the attached exhibits, that the Department intends to apply generally to all current and future insurers and investments. Therefore, the challenged rules constitute quasi-legislative action on the part of the Department and is subject to the APA.

**2. The Department contends that Insurance Code section 923, on which the Commissioner based his actions, does not require rulemaking.**[31]

The Department contends that "the Commissioner was not required to undertake a rulemaking to require insurers to file financial reports on their Iran-related holdings and to safeguard insurers' portfolios by treating investments in companies on the List as 'non-admitted' on insurers' financial statements" because Insurance Code section 923 gives the Commissioner "broad authority to specify the use of forms and methods of financial reporting **without undertaking rulemaking.** [Emphasis added.]"[32]

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[31] Response, p. 16.
[32] Ibid, p. 4.

The Department asserts that rulemaking is inconsistent with Insurance Code section 923. Section 923 states:

> The commissioner shall require every insurer which is required to file an annual or quarterly statement to use the statement blanks and instructions thereto for the appropriate year adopted by the National Association of Insurance Commissioners. The statements shall be completed in conformity with the Accounting Practices and Procedures Manual adopted by the National Association of Insurance Commissioners, to the extent that the practices and procedures contained in the manual do not conflict with any other provision of this code. **The commissioner may make changes from time to time in the form of the statements and the number and method of filing reports as seem to him or her best adapted to elicit from the insurers a true exhibit of their condition. The commissioner shall notify each insurer of any changes from the National Association of Insurance Commissioners' statement blanks which the commissioner has determined pursuant to this section to be appropriate.** [Emphasis added.]

OAL agrees that Insurance Code section 923 provides authority for the Commissioner to "make changes from time to time in the form of the statements and the number and method of filing reports as seem to him or her best adapted to elicit from the insurers a true exhibit of their condition." However, Insurance Code section 923 does not state "without compliance with the APA" or "such changes will be exempt from Chapter 3.5 (commencing with Section 11340) of Part 1 of Division 3 of Title 2 of the Government Code."[33] As stated previously, when the Legislature intends to exempt actions from the APA, it does so expressly. OAL does not find language adequate to exempt the Department's actions from complying with the APA in Insurance Code section 923.

The Department relies upon *Paleski v. State Dep't of Health Services* (2006) 144 Cal.App.4th 713 [51 Cal.Rptr.3d 28] for the proposition that "the existence of specific statutory provisions for notifying licensees of agency requirements meant that APA procedures do not apply."[34] The court did find that the APA didn't apply in that case. However, Welfare & Institutions Code section 14105.395, upon which the decision is based, **expressly** exempted the criteria from the APA and said that the criteria was only to be published in the provider manuals.[35] The

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[33] An example of typical exemption is contained in footnote 34, below.

[34] Response, p. 19.

[35] Welfare & Institutions Code section 14105.395(c)states:

> **Changes made pursuant to this section are exempt from the requirements of the Administrative Procedure Act (Chapter 3.5 (commencing with Section 11340), Chapter 4 (commencing with Section 11370), and Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code), and shall not be subject to the review and approval of the Office of Administrative Law.** The department shall consult with interested parties and appropriate stakeholders in implementing this section with respect to all of the following:
> (1) Notifying the provider representatives of the proposed change.
> (2) Scheduling at least one meeting to discuss the change.
> (3) Allowing for written input regarding the change.
> (4) Providing advance notice on the implementation and effective date of the change.
> [Emphasis added.]

Department has not pointed out any express exemption in the Insurance Code with respect to the challenged actions.

The Department further contends that the "notice" requirements of Insurance Code section 923 are evidence of the Legislature's recognition for an evolving financial statement reporting process that can quickly adapt to the complexities of the financial market. Thus, the APA is inapplicable. The Department indicates that the Legislature was "[c]ognizant of the importance of providing insurers with advance warning of changes to financial reporting requirements."[36] However, the "advance warning" is not evident in the statute and, as stated by the Department at page 19 of the Response, "at the point when insurers are notified, the Commissioner, *already will have made* the decision to change the reporting requirements." Insurance Code section 923 states that "[t]he commissioner shall notify each insurer of any changes from the National Association of Insurance Commissioners' statement blanks which the commissioner **has determined** pursuant to this section to be appropriate." The past tense of "has determined" does not seem to indicate "advance warning." The Commissioner must inform **all** insurers that a change is being required in the financial reporting.

A requirement to ***notify*** each insurer ***after*** the fact is not comparable to the procedural due process of notice and public participation provided by the APA in the development of regulations, including the opportunity to suggest changes and make comments. As *Tidewater, supra,* 14 Cal.4th 557, at p. 568 states:

> The APA establishes the procedures by which state agencies may adopt regulations. The agency must give the public notice of its proposed regulatory action (Gov. Code, §§ 11346.4, 11346.5); issue a complete text of the proposed regulation with a statement of the reasons for it (Gov. Code, § 11346.2, subds.(a), (b)); give interested parties an opportunity to comment on the proposed regulation (Gov. Code, § 11346.8); respond in writing to public comments (Gov. Code, §§ 11346.8, subd. (a), 11346.9); and forward a file of all materials on which the agency relied in the regulatory process to the Office of Administrative Law (Gov. Code, § 11347.3, subd. (b)), which reviews the regulation for consistency with the law, clarity, and necessity (Gov. Code, §§ 11349.1, 11349.3).

The Department did not comply with the rulemaking procedures established by the APA. The mere issuance of notification **after** the fact would not provide the notice required by sections 11346.4 and 11346.5 of the Government Code, nor does it afford the public the opportunity to request a hearing pursuant to Government Code section 11346.8(a). The Department did not satisfy the requirements of an APA rulemaking when it issued the rules discussed herein.

A duty to notify every insurer once the Commissioner has made changes is a requirement ***in addition to***, the APA requirements. The State Water Resources Control Board, seeking to overturn a determination by OAL, made an argument very similar to the Department's assertion regarding the notice in this matter in *State Water Resources Control Board vs. The Office of Administrative Law* (1993) 12 Cal.App.4th 697, 702 [16 Cal.Rptr.2d 25]. The State Water Resources Control Board argued that the Porter Cologne Act did not require

[36] Response, p. 18.

rulemaking in that the Porter Cologne Act provided for noticed proceedings that created an "irreconcilable conflict [with] the APA's notice requirements." The Porter Cologne Act has far more stringent requirements for notice than does Insurance Code section 923. However, the court did not find the notice requirements to be inconsistent with the APA and stated:

> The Legislature has conferred upon the OAL the power to determine if administrative directives are in fact regulations. (Gov. Code, § 11347.5.) The OAL has made such a determination as to the portions of the water quality control program at issue here.
>
> The Boards, however, find an irreconcilable conflict in the APA's notice requirements and the Porter-Cologne Act's approval requirements.
>
> . . .
>
> Moreover, we do not see the kind of "irreconcilable conflict" here that might support a finding of implied exemption. That the Porter-Cologne Act establishes similar procedures is not persuasive. The APA was enacted to establish basic minimum procedural requirements. (*Grier v. Kizer, supra,* 219 Cal.App.3d at p. 431, 268 Cal.Rptr. 244.) Agencies are free to adopt additional procedural requirements (Gov.Code, § 11346). **Therefore, the mere fact that the Porter-Cologne Act has its own procedural requirements does not, in and of itself, create a conflict.** [Emphasis added.] (*State Water Resources Control Board, supra,* 12 Cal.App.4th 697, at p. 705.)

The same is true in the present case. The notice requirements of Insurance Code section 923 are in addition to the APA requirements and the APA requirements do not irreconcilably conflict with the Insurance Code.

**3. The Department contends that "rulemaking is not required when it would 'effectively eviscerate' a statute calling for streamlined agency action."[37]**

The Department contends that rulemaking pursuant to the APA would "effectively eviscerate" Insurance Code section 923. In support of the Department's contention, they refer to *Alta Bates Hospital v. Lackner* (1981) 118 Cal.App.3d 614 [175 Cal.Rptr. 196] (*Alta Bates Hospital* hereafter), and the proposition that "[c]ourts recognize that [APA] rulemaking is not required when it would 'effectively eviscerate' a statute calling for streamlined agency action."[38]

*Alta Bates Hospital, supra,* 118 Cal.App.3d 614, involved a class action suit by hospitals against a directive by the Director of the Department of Health that reduced by 10 percent Medi-Cal reimbursements for hospital outpatient services. The relevant statute specifically stated that: "[a]t any time during the fiscal year, if the director has reason to believe that the total cost of the program will exceed available funds, he may, first modify the method or amount of payment for services, provided that no amount shall be reduced more than 10 percent and no modification will conflict with federal law."[39] The statute in *Alta Bates*

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[37] Response, p. 21.
[38] Ibid, at p. 1.
[39] Welfare & Institutions Code section 14120.

*Hospital* requires far less interpreting than does Insurance Code section 923. Insurance Code section 923 provides for discretion of the Commissioner in requiring the filing of the financial statements. An interpretation of Insurance Code section 923 to allow the Commissioner the discretion to unilaterally disallow a class of assets from financial statements would not be similar to the duties of the Director of the Department of Health to ensure that costs do not override expenses in a program. In addition, the court put great weight on the fact that the statute called for consultation with "concerned provider groups" **before** the Director took any action.

The A*lta Bates Hospital supra,* 118 Cal.App.3d 614, case was specifically discussed in *State Water Resources Control Board, supra,* 12 Cal.App.4th 697, when it found *Alta Bates Hospital* to be an "unusual circumstance." The court in *State Water Resources Control Board,* in finding that the Water Board's actions were underground regulations, notes that the "otherwise applicable rule that a special statute controls a general statute" is overcome by the express language of the Legislature that Government Code section 11346 "shall not be superseded or modified by any subsequent legislation except to the extent that such legislation shall do so expressly." The Water Board claimed that the Legislature never intended the water quality control plans to be considered regulations and that they are impliedly exempt. The court in *State Water Resources Control Board supra,* 12 Cal.App.4th 697, stated at p. 704:

> The provisions of this article shall not be superseded or modified by any subsequent legislation *except to the extent that such legislation shall do so expressly.*" (Italics added.) Although section 11346 was added in 1980, after the adoption of the Porter-Cologne Act, it simply restates the provisions of Government Code former section 11420, which predated the act. **The statutory language could hardly be clearer. It therefore overcomes the otherwise applicable rule that a special statute controls a general statute.** (*Engelmann v. State Bd. of Education* (1991) 2 Cal.App.4th 47, 59 [3 Cal.Rptr.2d 264].) We do not agree with the Boards' argument that section 11346 somehow impermissibly limits or restricts the power of the Legislature. **If the Legislature desires to permit implied exemptions, it can amend section 11346 to so provide. Nor are we persuaded that section 11346 means something other than what it says because other courts may have recognized implied exemptions to the APA in unusual circumstances, or because the Legislature has not expressly stated otherwise. As to the last of these arguments, the Legislature has settled the issue by stating that unless expressly exempted, all administrative regulations must comply with the APA. Therefore, the mere fact that the Porter-Cologne Act has its own procedural requirements does not, in and of itself, create a conflict.** [Emphasis added.]

In addition, the Department's contention that rulemaking would "effectively eviscerate" Insurance Code section 923, does not appear to be the case. OAL notes there have been numerous rulemakings conducted previously by the Department that implement, interpret, or make specific Insurance Code section 923. Insurance Code section 923 is the subject of many rulemakings as evidenced by the numerous citations after Insurance Code section 923 in West's Annotated California Codes. (See, for instance, California

Code of Regulations, title 10, section 2300 (Ins. Code sec. 923 is cited as Authority), section 2302 (Ins. Code sec. 923 is cited as Authority), section 2303 (Ins. Code sec. 923 is cited as an Authority and as a Reference), section 2303.1 (Ins. Code sec. 923 is cited as Authority and as a Reference) and section 2303.10 (Ins. Code sec. 923 is cited as Authority and as a Reference).)[40] There are many more.

Accordingly, rulemaking would not "effectively eviscerate" Insurance Code section 923.

**4. The Department contends that it does not have time to conduct rulemakings when establishing the requirements for annual and quarterly financial statements.[41]**

The Department indicates that the challenged actions require such prompt action that even an emergency rulemaking is "not an option."[42] However, the Department's Response indicates that the Department hired a number of experts and spent "months of study" in determining what investments should be non-admitted.[43] Considering that an emergency rulemaking may be completed in less than twenty days, there appears to be adequate time to conduct a rulemaking that affords those being regulated the opportunity of input. In addition, the issue as to whether or not the agency has adequate time to conduct a rulemaking should be addressed to the Legislature. It is not a factor in determining whether the challenged action is an underground regulation and whether there is an exemption, which are the factors to which a determination is restricted.

**5. The Department contends that the challenged actions are merely accounting techniques which are exempt from the APA.**

The Department contends that "the Commissioner's directive for Iran-related financial reporting under Insurance Code section 923 involves an accounting method, the purpose of which is to ascertain the extent of insurers' Iran-related investments and the impact of those investments on insurers' surplus."[44] The Department contends that the challenged rules are therefore exempt pursuant to *Pacific Gas & Electric Co. v. Dept. of Water Resources* (2003) 112 Cal.App.4th 477, (*Pacific Gas & Electric Co.* hereafter) as merely an accounting technique. *Pacific Gas & Electric Co., supra,* 112 Cal.App.4th 477, held that a formula developed by the Department of Water Resources to determine the amount utilities had to reimburse for power contracts was not a regulation subject to the APA. The Department of Water Resources **entered into contracts** for the purchase and sale of electric power pursuant to statutory mandate. The court found that the individual contracts between the Department of Water Resources and each utility company did not constitute a standard of general

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[40] Government Code section 11349 defines Authority and Reference as follows:

> . . .
>
> (b) "Authority" means the provision of law which permits or obligates the agency to adopt, amend, or repeal a regulation.
>
> . . .
>
> (e) "Reference" means the statute, court decision, or other provision of law which the agency implements, interprets, or makes specific by adopting, amending, or repealing a regulation.

[41] Response, p. 18.

[42] Ibid, p 18 (Footnote 7).

[43] Ibid, p. 2.

[44] Ibid, p. 20.

application, and therefore, was not subject to the APA. The court in *Pacific Gas & Electric Co., supra,* 112 Cal.App.4th 477, 507, stated:

> DWR's revenue requirement is an accounting exercise to calculate the amount of DWR's reimbursable costs for a finite period of time, for categories specified by the Legislature, including (as stated in § 80134, fn. 6, *ante*) amounts necessary to cover the principal and interest on bonds, DWR's costs to purchase and deliver electric power, reserves and administrative costs, the pooled money investment rate on advanced funds, and repayment to the General Fund for appropriations made to the Electric Power Fund.

Thus, the determination did not constitute a standard of general application, but rather was the calculation of an amount of specific, reimbursable costs for a finite period of time pursuant to contracts. The court compared the Department of Water Resources' action to actions by the California Toll Bridge Authority concerning one particular bridge. The "general applicability" for the future wasn't there.

Similarly, in *City of San Joaquin vs. Bd. of Equalization* (1970) 9 Cal.App.3d 365 [88 Cal.Rptr. 12] (*City of San Joaquin* hereafter), the city was objecting to the manner in which the State Board of Equalization allocated sales taxes imposed by cities and counties on retail sales of deep well agricultural pumps. They entered into negotiated contracts on the subject. The court in *City of San Joaquin, supra,* 9 Cal.App.3d 365, at 375 stated:

> San Joaquin first contends that the Board's pooling procedure is a regulation within the meaning of the Administrative Procedure Act (ch. 4.5, part 1, div. 3, title 2, Gov. Code), and is invalid because it was not adopted in the manner prescribed by that act.
>
> We do not agree. The challenged pooling practice is not a regulation, order or standard of general application which was adopted by the Board "to implement, interpret or make specific the law enforced or administered by it, or to govern its procedure ...." (Gov. Code, § 11371.) According to the evidence, it is merely a statistical accounting technique to enable the Board to allocate, as expediently and economically as possible, to each city which has joined the uniform sales and use tax program, its fair share of sales taxes collected by the Board on that city's behalf. **Moreover, this accounting technique was worked out by the Board and the representatives of interested cities and counties and was made a part of the "standard" contract which San Joaquin ultimately signed, without protest or objection of any kind.** [Emphasis added.]

Cases finding no rule of "general application" in matters dealing with individual negotiated contracts and determining allocation of tax revenue for individual cities, are distinguishable from the challenged rules in this matter where 1) those being affected did not participate in the creation of the rules, and 2) the challenged actions amount to a mandatory denial of a class of assets on financial statements (i.e., applies generally). Cases such as those cited by the Department fall outside the definition of a regulation in that the rules do not apply generally. In this matter, the challenged actions apply against all current and future California insurers.

**6. The Department contends that the challenged rules fall outside the APA in that the decision of what security to exclude was done on a case-by-case basis.**

Even though the securities themselves may have been examined on a case-by-case basis, the rule of exclusion is being generally applied as against all California insurers. All 1300 or so insurance companies must classify the assets in the same way. They all must list them in the column "Non-admitted" on the financial statements. No insurer licensed in California can claim any of the companies on the List as an admitted asset. The rule applies generally to all California insurers. Therefore, the case-by-case claim does not apply with respect to the challenged rules.

**7. The Department contends that the moratorium on investments in companies on the List was not regulatory in that it was voluntary.**

The Department also contends that the request not to invest in companies on the List was voluntary and that it was a permissible use of the Commissioner's "bully pulpit" to encourage this behavior.[45] OAL will find rules of general application that implement, interpret or make specific the law enforced or administered by the Department that have not complied with the APA to be underground regulations if the rule looks like a regulation, reads like a regulation, and acts like a regulation . . . whether or not the agency in question so labeled it. (See *State Water Resources Control Board, supra,* 12 Cal.App.4th 697.) As previously stated, all insurers were "required" to respond and were "required" to inform the Commissioner as to whether or not they would agree to the moratorium under pressure or repercussions. Compliance with the challenged rules was mandatory, not voluntary.

## PETITIONERS' REPLY

The Petitioners provided a Reply to the Department's Response which refutes the Department's contention that the decision by the Commissioner to exclude Iran-related assets from California financial statements was done on a case-by-case basis. They indicate that if the Commissioner sought to exclude investments and give them "no value" in the financial statements, then the statutory safeguards of a hearing on the issues presented would have been provided to each insurer according to the requirements in Insurance Code section 1202, which states:

> The commissioner may, in his discretion and after hearing, by written order require the disposal of any investments made in violation of the provisions of this article, pending which disposal pursuant to such order no value shall be allowed for such investment in any statement, required by any provision of this code, purporting to show the financial condition of the owner thereof, or in measuring the financial condition of the owner thereof for the purpose of determining whether such owner is solvent or insolvent. The commissioner may also, for good cause, require the disposal of any excess funds investments.

[45] Response, p. 4.

According to the Petitioners, no hearing was provided to any of the insurers subject to the exclusion of the Iran-related assets. The designation of the assets on the financial statements as "non-admitted" applies to all the insurers licensed to do business in California. The Petitioners also contend that the forms exemption was inapplicable and that whether the Commissioner has the authority to take the challenged action, with or without the applicability of the APA, has not been demonstrated.

## CONCLUSION

As previously indicated, OAL does not address in this Determination whether a challenged rule would meet the "Authority" standard of Government Code section 11349(b) when determining whether the rules are underground regulations. However, in accordance with the above analysis, we agree with the Petitioners that the challenged rules meet the definition of a regulation pursuant to Government Code section 11342.600 that should have been, but were not, adopted pursuant to the APA.

Date: October 11, 2010

SUSAN LAPSLEY
Director

Elizabeth A. Heidig
Staff Counsel

# Exhibit A

STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
Legal Division, Office of the Commissioner
45 Fremont Street, 23rd Floor
San Francisco, CA 94105

Steve Poizner, *Insurance Commissioner*

February 10, 2010

VIA ELECTRONIC AND U.S. MAIL

[COMPANY NAME]

SUBJECT: Identification of Companies Doing Business in Specified Iranian Economic Sectors; Treatment of Investments in Such Companies on Insurers' Financial Statements; Request for Moratorium on Future Iran-Related Investments

Dear [Name of CEO/Pres.]:

The Department of Insurance ("Department") received your company's response to Commissioner Poizner's July 2, 2009 data call ("Data Call) seeking information about investments in companies doing business with the Iranian oil and natural gas, nuclear, and defense sectors. Thank you for your response. The Department also independently reviewed your company's investments based on its financial statements on file with the Department.

## I. List of Companies Doing Business in Specified Iranian Economic Sectors

Following extensive research, analysis and consultation, the Department has developed a list of companies doing business with the Iranian oil and natural gas, nuclear, and defense sectors ("List"). The List is attached. The Department developed the List based on:

- Insurers' responses to the Data Call;
- Consultation with independent research firms KLD Research and Analytics, Inc. and Conflict Securities Advisory Group, Inc.;
- Consultation with reputational/financial risk experts at RWR Advisory Group; and
- Review of the lists of the California, Florida, and New York public pension funds.

The Department may in the future revise the List by adding companies found to be doing business with the Iranian oil and natural gas, nuclear, and defense sectors; removing companies that cease doing business with those sectors; or making changes based on other risk-related considerations. In addition, the List currently does not include banks. Based on subsequent research, analysis and consultation, the Department may supplement the List to include banks doing business with the Iranian oil and natural gas, nuclear, and defense sectors.

## II. Treatment of Specified Iran-Related Investments on Insurers' Financial Statements

The Commissioner has determined that companies on the List are subject to financial risk as a result of doing business with the Iranian oil and natural gas, nuclear, and defense sectors. Iran is economically and politically unstable. It faces wide-ranging international sanctions in response to its efforts to develop nuclear weapons and its sponsorship of terrorism. Companies doing

business with the Iranian oil and natural gas, nuclear, and defense sectors are subject to asymmetric reputational harm, and, accordingly, financial or market risk, stemming from the nature of their business activities in Iran.

Based on financial soundness considerations, the Department considers investments in companies on the List to be at risk.

**Accordingly, effective March 31, 2010, the Department will treat all investments by insurers holding a certificate of authority to transact insurance in California in companies on the List and affiliates owned 50% or more by companies on the List as non-admitted on the insurer's financial statements. For all financial statements filed with the Department for periods ending on or after March 31, 2010, each insurer must report all of its investment holdings on the List as not admitted assets.**

### III. Request for Moratorium on Specified Future Iran-Related Investments

In recognition of the financial risk presented by investments in companies on the List, the Commissioner requests that your company agree not to invest in the future in any of those companies or in any affiliates owned 50% or more by those companies until either (a) Iran is removed from the United States State Department's list of state sponsors of terrorism or (b) the company and its affiliates cease to do business with Iran's oil and natural gas, nuclear, and defense sectors and is removed from the List.

Attached to this letter is a form for your company's response to this request. **Your company must respond by March 12, 2010.** Please mail the response to the Department at the following address:

California Department of Insurance
Field Examination Division - 9th floor
300 S. Spring Street
Los Angeles, CA 90013
Attention: Al Bottalico, Division Chief

If your company does not respond to or declines the Department's request for a moratorium on future investments in companies on the List and affiliates owned 50% or more by those companies, the Department may publish your company's name on the Department's website.

Thank you for your attention to this matter.

Very truly yours,

Adam M. Cole
General Counsel

Attachments

CALIFORNIA DEPARTMENT OF INSURANCE
LIST OF COMPANIES DOING BUSINESS WITH THE IRANIAN PETROLEUM/NATURAL GAS, NUCLEAR, AND DEFENSE SECTORS
(AS OF FEBRUARY 9, 2010)

1. ABB Ltd. [Switzerland]
2. ACS, Actividades de Construccion Y Servicios, S.A. [Spain]
3. Alstom [France]
4. Ashok Leyland, Ltd. [India]
5. Aker Solutions [Norway]
6. China National Petroleum Corp. [China]
7. China Petroleum & Chemical Corp. [China]
8. CNOOC Ltd. [China]
9. CNPC (Hong Kong) Limited [Hong Kong]
10. Daelim Industrial Co., Ltd. [South Korea]
11. Dragon Oil PLC [Ireland]
12. Edison Spa [Italy]
13. Eni S.p.A. [Italy]
14. Everest Kanto Cylinder Ltd. [India]
15. Finmeccanica SPA [Italy]
16. GAIL (India) Limited [India]
17. Gas Natural SDG [Spain]
18. Gazprom Neft [Russia]
19. Gazprom OAO [Russia]
20. GS E&C (Engineering & Construction) [South Korea]
21. GS Holdings Corp. [South Korea]
22. Hyundai E&C (Engineering and Construction) Co., Ltd. [South Korea]
23. Hyundai Heavy Industries [South Korea]
24. Ina-Industrija Nafte DD [Croatia]
25. Indian Oil Corporation, Ltd. [India]
26. Linde AG [Germany]
27. Lukoil OAO [Russia]
28. Oil & Natural Gas Corp. (ONGC) [India]
29. OMV [Austria]
30. PetroChina Company Limited [China]
31. Petrofac Limited [United Kingdom]
32. Petroliam Nasional Bhd (Petronas) [Malaysia]
33. Petronas Gas Bhd [Malaysia]
34. PT Citra Tubindo Tbk [Indonesia]
35. PTT Exploration & Production PCL (PTTEP) [Thailand]
36. PTT Public Company Limited [Thailand]
37. Ranhill Bhd [Malaysia]
38. Repsol YPF [Spain]
39. Royal Dutch Shell Plc [United Kingdom]
40. Sasol Limited [South Africa]
41. Siemens AG [Germany]
42. StatoilHydro ASA [Norway]
43. Tatneft [Russia]
44. Technip S.A. [France]
45. Trevi-Finanziaria Industriale S.p.A. (Trevi Group) [Italy]
46. Total S.A. [France]
47. Welspun-Gujarat Stahl Rohren Limited [India]
48. Worley Parsons Ltd. [Australia]
49. Ulan-Ude Aviation Plant JSC [Russia]
50. ZiO-Podol'sk OAO [Russia]

# Exhibit B

STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
**Legal Division, Office of the Commissioner**
45 Fremont Street, 23rd Floor
San Francisco, CA 94105

Steve Poizner, *Insurance Commissioner*

## RESPONSE FORM

## INSURER AGREEMENT NOT TO INVEST IN COMPANIES DOING BUSINESS WITH THE IRANIAN OIL AND NATURAL GAS, NUCLEAR, AND DEFENSE SECTORS

**(MUST BE COMPLETED AND RETURNED TO THE DEPARTMENT OF INSURANCE ON OR BEFORE MARCH 12, 2010)**

In your capacity as an executive officer and on behalf of your Company, please mark an "X" in the appropriate category below.

---

CATEGORY A:
[ ]

My company has reviewed the list of companies determined by the California Department of Insurance ("Department") to be at risk for doing business with the Iranian oil and natural gas, nuclear, and defense sectors (list circulated **February 10, 2010**) ("List"). My company agrees not to invest in the future in any companies on the List or in any affiliates owned **50%** or more by companies on the List until either (a) Iran is removed from the United States State Department's list of state sponsors of terrorism or (b) the company and its affiliates cease to do business with Iran's oil and natural gas, nuclear, and defense sectors and is removed from the List.

---

CATEGORY B:
[ ]

My company does not agree to refrain from investing in the future in companies on the List or in affiliates owned **50%** or more by companies on the List.

---

(Signature of Executive Officer) (Printed Name of Officer)

Dated: _____ at _____
(Location City and State)

On behalf of:

(Company Name) (NAIC No.) (NAIC Group No.)

# Exhibit C



News Overview
Press Releases
2007 Press Releases
2008 Press Releases
2009 Press Releases
→2010 Press Releases
Studies, Reports & Publications

## NEWS: 2010 PRESS RELEASE

For Release: February 10, 2010
Media Calls Only: 916-492-3566

**Insurance Commissioner Poizner Protects California Policyholders from Risky Iran-Related Investments**

List of 50 Companies Doing Business with Iranian Nuclear, Energy & Defense Sectors Released

California Insurance Commissioner Steve Poizner today released a list of 50 companies doing business in the Iranian oil and natural gas, nuclear and defense sectors and announced that as of March 31, 2010, no investments that an insurer holds in any of those companies will be recognized on its financial statements in California.

"The deteriorating situation in Iran only underscores the need to take action to ensure that insurance company portfolios are not at risk from Iran-related holdings," said Commissioner Poizner. "After careful research and consultation, we have compiled a list of 50 companies that are doing business with the Iranian oil and natural gas, nuclear, and defense sectors. Those investments are subject to increased financial risk and insurers should avoid future investments in these 50 Iran-related companies."

Two insurance companies - one a major health insurer, the other a major personal lines carrier -- have stepped forward and agreed to divest Iran-related investments. These companies have asked the department not to reveal their identities. Negotiations continue with several other companies that have initiated discussions with the department on voluntary divestment.

"Investments in companies with certain ties to Iran encounter special reputational risks that can have an impact on share value, often in a manner that is asymmetric to the actual business activity in that country," said Roger Robinson, CEO of RWR Advisory Group, a Washington DC-based research and consulting firm that specializes in the assessment and management of global security risk. "Adverse public reaction brought on by corporate activity in Iran can cause an investment in such companies, including those identified by the Department, to take hits to corporate reputation and even share value when the size of the business transactions would otherwise be immaterial."

Commissioner Poizner set forth his actions in a letter sent to all 1,300 insurance companies that are licensed to do business in California. The letter, which is attached, contains three parts:

First, the letter shares with all insurers the indirect investment list. The 50 companies span 20 countries (all foreign) across four continents. The Department developed the list following extensive research and analysis; consultation with experts RWR Advisory Group and Conflict Securities Advisory Group (two research and consulting firms that specialize in the assessment and management of global security risk - i.e., risk associated with corporate ties to countries presenting security, terrorism or weapons proliferation concerns) and KLD Research and Analytics, Inc. (a firm specializing in corporations' Iran-related business activities); and review of lists developed by the California, Florida, and New York public pension funds. The list includes well-known companies such as Royal Dutch Shell Plc of the United Kingdom and Siemens AG of Germany, as well as lesser known companies such as Ulan-Ude Aviation Plant JSC of Russia, OMV of Austria and Dragon Oil PLC of Ireland. Of the 1,300 insurers licensed to do business in California, about 340 hold investments in companies on the list. Those investments total approximately $6 billion.

Second, the letter announces that effective March 31, 2010, the Department will not give statement credit for investments in companies on the List. The Commissioner has determined that companies on the List are subject to financial risk as a result of doing business with the Iranian oil and natural gas, nuclear and defense sectors. Iran is economically and politically unstable. It faces wide-ranging international sanctions in response to its efforts to develop nuclear weapons and its sponsorship of international terrorism, with many countries contemplating adopting additional sanctions.

The elimination of statement credit for investments in companies on the list will mean that insurers will be required to reduce the capital and surplus reported on their financial statements by the amount of investments in these 50 companies. California law requires insurers to carry a minimum level of capital and surplus in order to continue to be licensed to sell insurance in this state.

Third, the Commissioner's letter requests that all insurers licensed to do business in California agree not to make future investments in any companies on the list or in any affiliates owned 50 percent or more by those companies until either (a) Iran is removed from the United States State Department's list of state sponsors of terrorism or (b) the company and its affiliates cease to do business with Iran's oil and natural gas, nuclear and defense sectors and is removed from the list.

Attached is the Department's form which all insurers must complete and return to the Department by March 12, 2010 indicating whether they will agree not to invest in the future in companies on the list.

The Department's analysis of the approximately $6 billion invested by insurers in companies on the list shows that:

- The approximately $6 billion in Iran-related investments accounts for only 0.15 percent of the total estimated $4 trillion in investments by insurance companies licensed to do business in California.
- Insurers acquired $1.8 billion in Iran-related investments in 2008 and $2.4 billion during the first quarter of 2009.
- Companies on the list by geographic breakdown:
- Asia: 22
- Europe: 20
- Russia: 6
- Africa: 1
- Australia: 1

The Department continues to investigate banks that may be doing business with the Iranian petroleum and natural gas, nuclear and defense sectors and may supplement its list in the future.

Earlier this month, Commissioner Poizner announced that 100 percent of the 1,327 insurance companies licensed in California responded to his request to provide data on their investments with companies doing business with Iran's oil and natural gas, nuclear, and defense sectors.

Commissioner Poizner first announced his Terror Financing Probe in June 2009 to review compliance with a recent California law that prohibits insurers from investing in designated state sponsors of terror. As part of a data call issued by the Commissioner, insurance companies were required to identify their direct investments in designated sectors of the Iranian economy and indirect investments in companies doing business in those sectors. In December, the Department announced that insurers reported no direct investments in Iran and therefore are in full compliance with state law prohibiting those investments. But the Department uncovered billions of dollars of indirect investments in companies doing business with the Iranian oil and natural gas, nuclear and defense sectors.

List of 50 companies can be found by selecting this link.

Letter form sent to companies can be found by selecting this link.

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Please visit the Department of Insurance Web site at www.insurance.ca.gov. Non media inquiries should be directed to the Consumer Hotline at 800.927.HELP. Callers from out of state, please dial 213.897.8921. Telecommunications Devices for the Deaf (TDD), please dial 800.482.4833.

If you are a member of the public wishing information, please visit our Consumer Services.

# Exhibit D

CALIFORNIA DEPARTMENT OF INSURANCE
LEGAL DIVISION
Office of the Commissioner
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Attorneys for California Department of Insurance



**BEFORE THE CALIFORNIA**

**OFFICE OF ADMINISTRATIVE LAW**

In the Matter of the Review of the Petition for Determination Re:

California Department of Insurance Communications to Insurers Dated February 10, 2010 and March 4, 2010

File No. CTU2010-0329-02

**RESPONSE OF THE CALIFORNIA DEPARTMENT OF INSURANCE TO PETITION FOR DETERMINATION**

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**OTHER AUTHORITIES**

## I. Introduction

The Insurance Commissioner of California must ensure that assets in insurance companies' portfolios are financially sound. Financial soundness is a bulwark for policyholders, ensuring that insurance companies will be able to pay their customers' claims. In recognition of this critical function, California law gives the Commissioner broad discretion to act quickly and flexibly to safeguard insurer assets and the interests of policyholders.

For example, the Commissioner may take prompt action against all insurers that report inadequate levels of "risk based capital." (Ins. Code §§ 739 to 739.12.) The Commissioner may similarly take prompt action against all insurers that have inadequate required deposits. (*Id.* §§ 939 to 956.) The Commissioner may take immediate action through cease and desist orders against all insurers that are in financially hazardous condition. (*Id.* § 1069.2.)

Noticeably absent from these provisions is a requirement that the Commissioner undertake a rulemaking proceeding before taking action to secure insurers' portfolios. Rulemaking serves an essential purpose where it applies. But the Legislature understood that not all agency action must be accompanied by rulemaking. Such a requirement would hamper critical consumer protection functions where speed and flexibility are called for. Courts recognize that Administrative Procedure Act rulemaking is not required when it would "effectively eviscerate" a statute calling for streamlined agency action. (See, e.g., *Alta Bates Hospital v. Lackner* (1981) 118 Cal.App.3d 614, 621.) Moreover, not all agency action is a "rule" or "regulation." An agency's own analysis and research of a problem, its request for information, and its use of the bully pulpit to encourage behavior – these are not "regulations."

In this case, the Commissioner did just what the law directs. He took action to safeguard insurers' portfolios from risk arising out of investments in companies doing business with the Iranian nuclear, defense, and energy sectors. Iran's pursuit of nuclear weapons, its support of international terrorism, and its despotic rule not only render ***it*** unstable politically and economically, but put at risk ***any company*** that does business with the Iranian nuclear, defense, and energy sectors. As a leading expert, Roger W. Robinson, Jr., explains:

> [P]ublicly traded companies that do business in U.S.-sanctioned countries, such as Iran, are exposed to "global security risk," even if such activities are legal and commercial in nature. Such risks can be material and impact adversely on share value and corporate reputation. Among the risks to which companies doing business in terrorist-sponsoring states are exposed include: new U.S., U.N., or other official sanctions that affect a company's operations; sanctions violations; negative publicity; law suits by victim's rights and other groups; and opposition-oriented shareholder activism, including divestment campaigns.[1]

The Commissioner retained Mr. Robinson to assist in determining whether the portfolios of any insurers are subject to financial risk from investments in companies doing business with the Iranian nuclear, defense, and energy sectors.

With assistance from Mr. Robinson and other experts, the Commissioner evaluated thousands of investments on a security-by-security basis. After months of study, the Commissioner issued a list of 51 companies that are doing business with the Iranian nuclear, defense, and energy sectors, and are subject to financial risk as a result of those dealings (the "List").

The Commissioner requested that all insurers doing business in California indicate whether they will voluntarily agree not to invest in companies on the List in the future. The Commissioner prepared a form for insurers to fill out and return indicating their willingness (or not) to forgo investing in these companies in the future.

The Commissioner also directed insurers to submit financial statements identifying their Iran-related holdings. He directed that they use a special column, labeled "Nonadmitted Assets," to list investments in companies on the List. The Commissioner advised that effective March 31, 2010, he would treat those investments as "non-admitted." Insurers may continue to hold those investments in their portfolios, but for purposes of California financial statements, the assets will not count toward the insurers' surplus. Insurers are not required to divest those holdings.

All but a handful of the 1,300 insurers admitted to do business in California responded to

---

[1] Testimony of Roger W. Robinson, Jr. before Joint Subcommittee Hearing: Subcommittee on Domestic and International Monetary Policy, Trade and Technology (FSC) and the Subcommittee on Terrorism, Nonproliferation and Trade (HCFA) (Apr. 18, 2007) (available at foreignaffairs.house.gov/110/rob041807.htm).

the Commissioner's request for a response to his request about future investments. More than 1,000 insurers returned the Commissioner's form or sent their own version of a letter indicating that they do not intend to make future investments in companies on the List. Although not required to do so, some insurers voluntarily divested from companies on the List. The Commissioner has not entered orders against any insurers in connection with Iran investment matters.

No individual insurer has challenged the Commissioner's actions addressing financial soundness of Iran-related investments. But five trade associations of insurance companies – the American Council of Life Insurers, the American Insurance Association, the Association of California Insurance Companies, the Association of California Life and Health Insurance Companies, and the Personal Insurance Federation of California – petition OAL to declare the Commissioner's actions impermissible "underground regulations."

As we show below, none of the actions challenged by the trade associations is an underground regulation.

*First*, the Commissioner was permitted without rulemaking to consult experts to prepare a list of companies doing business with the Iranian nuclear, defense, and energy sectors, and to determine whether those companies are subject to financial risk as a result of those dealings. These actions further the Commissioner's statutory mandate to ensure that investments in insurers' portfolios are financially sound. Neither the development of a list nor the Commissioner's assessment of financial risk presented by investment in companies on the list is a "regulation." The list and assessment were the result of a case-by-case evaluation and are not a "standard of general application." (Gov. Code § 11342.600.) Moreover, by themselves, neither the list nor the assessment of financial risk imposes any obligation or has any effect on insurers. Rather, the list and assessment memorialize the Commissioner's factual research about individual securities. The Commissioner was not required to do that research through a rulemaking proceeding. (This is Issue B in OAL's May 27, 2010 letter.)

*Second*, the Commissioner's request that insurers voluntarily agree not to invest in companies on the List in the future and the form he prepared for insurers to indicate their position

on future investments are not regulations. The Commissioner's request was not an "order." It was a permissible use of his bully pulpit to encourage behavior. Further, requesting information from insurers about investment activities was a lawful exercise of the Commissioner's power to "examine the business and affairs" of insurers. (Ins. Code § 730(a).) In addition, the Commissioner was permitted to prepare a form for insurers to complete as a means to respond to his request without undertaking a rulemaking proceeding. (Gov. Code § 11340.9(c) [rulemaking is not required for "[a] form prescribed by a state agency or any instructions relating to the use of the form . . ."].) Finally, although most insurers responded by completing and returning the form, some responded with their own letters, not using the form. The Commissioner did not take any action against insurers that responded in their own chosen format to his request. (This is Issue C in OAL's May 27, 2010 letter.)

*Third*, the Commissioner was not required to undertake a rulemaking to require insurers to file financial reports on their Iran-related holdings and to safeguard insurers' portfolios by treating investments in companies on the List as "non-admitted" on insurers' financial statements. Insurance Code Section 923 gives the Commissioner broad authority to specify the use of forms and methods of financial reporting without undertaking rulemaking. Section 923 provides: "The commissioner may make changes from time to time in the form of the statements and the number and method of filing reports ***as seem to him or her best adapted to elicit from the insurers a true exhibit of their condition***" (emphasis added). Section 923 authorizes the Commissioner to prescribe a form of reporting for Iran-related assets and to treat those assets as "non-admitted" on insurers' financial statements as the method "best adapted to elicit from the insurers a true exhibit of their condition." Given the need for swift action to address financial solvency concerns, Section 923 creates a flexible framework for the Commissioner to address financial reporting issues. Section 923 contains its own "notice" requirement providing that the Commissioner "shall notify each insurer of any changes" from industry-wide forms "which the commissioner has determined pursuant to this section to be appropriate." Requiring rulemaking before the Commissioner can specify financial reporting for Iran-related holdings would "essentially eviscerate" Section 923. (This is Issue A in OAL's May 27, 2010 letter.)

The APA does not endorse turning every agency action into a regulation. Indeed, the APA expressly admonishes that there are ***too many*** regulations. "The Legislature finds and declares as follows: (a) There has been an unprecedented growth in the number of administrative regulations in recent years. . . . (c) Substantial time and public funds have been spent in adopting regulations, the necessity for which has not been established." (Gov. Code § 11340.) "It is the intent of the Legislature that the purpose of . . . review [by OAL] shall be to ***reduce*** the number of administrative regulations." (*Id.* § 113401.1(a) [emphasis added].) As a mechanism to reduce rulemaking, the APA requires showings of "necessity" and "nonduplication," among other things, before a regulation will be accepted. (Gov. Code § 11349(a) & (f).)

The Petitioners' effort to bridle the Department with regulatory proceedings that are both unnecessary and duplicative of the Commissioner's existing authority runs counter to the goals of the APA.

## II. Background

### A. Data Call

In April 2009 or shortly thereafter, the Commissioner[2] commenced an effort to monitor and evaluate Iran-related investments held by insurers doing business in California. The effort began with a "data call" to insurers requesting information about Iran-related holdings in their portfolios. (See Ins. Code § 730(a) [the Commissioner may "examine the business and affairs" of an insurer whenever the Commissioner "deems [it] necessary"].) In July 2009, the Department requested that all insurers holding a certificate of authority to do business in California[3] identify companies in their investment portfolios that do business with the Iranian nuclear, defense, energy, and banking sectors. Insurers began submitting responses as early as July 2009. By December 31, 2009, virtually all of the 1,300 insurers licensed to do business in California had filed responses.

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[2] We use the words "Commissioner" and "Department" (for "California Department of Insurance") interchangeably.

[3] We will refer to insurers holding a certificate of authority to do business in California as insurers "licensed in California" or "admitted in California." (Ins. Code § 24.)

### B. The Department's Creation of a List of Companies Doing Business with the Iranian Nuclear, Defense, and Energy Sectors, and Subject to Financial Risk

The Department evaluated responses on a case-by-case basis. In addition, the Department consulted with experts in the area of Iranian investments by multinational companies. The Department consulted with:

- KLD Research and Analytics, Inc. ("KLD"). KLD is an investment research firm that provides management tools for monitoring risks related to international, environmental, social, and governance issues, including risks related to Iran. KLD is a leading authority on social and environmental research and indexes for institutional investors.
- Conflict Securities Advisory Group, Inc. ("CSAG"). CSAG is a research and consulting firm that assesses global security risk – i.e., risk from corporate ties to countries posing security threats, engaged in terrorism, or developing unconventional weapons. CSAG provides impartial risk assessment tools and services to people and organizations interested in global security-related market risk factors. CSAG has expertise analyzing and understanding countries such as Iran, which have been designated as state sponsors of terrorism by the U.S. State Department.
- RWR Advisory Group ("RWR"). RWR is a risk management and advisory firm, specializing in evaluating risk to corporate reputation and share value stemming from business ties to security-sensitive countries, such as Iran. RWR's personnel have consulted and published extensively on security-related risk in the global capital markets. The President of RWR is Roger W. Robinson, Jr.

The States of California, Florida, and New York have directed their public employees' pension funds to divest from holdings in companies doing business with various sectors of the Iranian economy. (See Cal. Gov. Code § 7513.7; Fla. Stats. § 215.473; Office of N.Y. State Comptroller, Nov. 14, 2007 Press Release[4].) The Department reviewed lists prepared by the

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California Public Employees' Retirement System (CalPERS), the Florida Retirement System Trust Fund, and the New York State Comptroller of companies doing business with various sectors of the Iranian economy.[5]

Based on a company-by-company analysis, consultation with KLD, CSAG and RWR, and review of lists prepared by the California, Florida, and New York pension funds, the Department developed a list of 50 companies doing business with the Iranian nuclear, defense, and energy sectors.[6] Insurers requested that the Department make that list public. The Department did so on February 10, 2010. On April 16, 2010, the Department added one company to the list. The current list ("List") identifies 51 companies.

By way of example, following are three companies on the List with a brief description of the financial risk they face:

- Ulan-Ude Aviation Plant JSC is a Russian company that provides equipment to the Iranian military. Ulan-Ude's military support of a terrorist regime with nuclear weapons ambitions subjects Ulan-Ude to reputational and financial risk. If Iran fires a weapon at another country and parts of the weapon are found and bear the label "Ulan-Ude," the financial condition of Ulan-Ude could collapse.
- Royal Dutch Shell has worked with the Iranian regime in developing oil and gas projects in the Persian Gulf. With the increased opprobrium Iran is coming under as a result of sanctions legislation such as the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (22 U.S.C. §§ 8501 *et seq*), companies such as Royal Dutch Shell face reputational harm and financial risk for continued support of the Iranian energy sector.

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[4] New York State Comptroller Thomas P. DiNapoli's announcement may be viewed at http://www.osc.state.ny.us/press/releases/nov07/111407.htm.

[5] See (1) www.calpers.ca.gov/eip-docs/investments/reports/iran-related-investments.pdf; (2) http://www.sbafla.com/fsb/ProtectingInvestmentsAct/tabid/402/Default.aspx; and (3) http://www.osc.state.ny.us/press/releases/june09/063009a.htm.

[6] At the request of insurers, and given the difficulty of researching the issue, the Department agreed not to include on the List companies doing business with the Iranian banking sector and multinational banks doing business in Iran.

- ZiO-Podol'sk OAO is a Russian company that manufactures power machinery for power plants, including nuclear power plants. Among the products developed by ZiO-Podol'sk are heat-recovery steam generators for a nuclear power plant in Iran. The ability of Iran to develop nuclear power is a substantial global threat. ZiO-Podol'sk's collaboration with Iran to develop nuclear power plants presents financial and reputational risk to ZiO-Podol'sk.

The Department made determinations about the financial soundness of investments in the 51 companies on a security-by-security basis, following careful research on each security, and with the assistance of experts. Based on consultation with RWR, the Department determined that companies on the List are subject to financial risk (referred to as "asymmetric risk") because of their involvement with the Iranian nuclear, defense, and energy sectors.

Several companies on the List contacted the Department stating that they do not believe they belong on it. The Department has communicated on a company-by-company basis to be sure it correctly placed each company on the List. The Department's analysis to date indicates that all 51 companies continue to do business with the Iranian nuclear, defense, and energy sectors and belong on the List.

### C. The Commissioner's Request That Insurers Voluntarily Agree Not to Make Iran-Related Investments in the Future and the Form for Their Response

Given the financial risk from investments in companies on the List, the Department requested that insurers licensed to do business in California voluntarily agree not to invest in companies on the List in the future. The Department directed that insurers notify the Department by April 2, 2010 whether they agree to refrain from making future investments in companies on the List until either (a) Iran is removed from the United States State Department's list of state sponsors of terrorism or (b) the company and its affiliates cease doing business with Iran's nuclear, defense, and energy sectors and the Department removes the company from the List. The Department provided a form for insurers to fill out and send to the Department indicating whether they agree to the requested moratorium.

More than 1,250 of the 1,300 insurers licensed in California returned the form or

responded with personalized letters. More than 1,000 insurers stated that they do not intend to invest in companies on the List in the future.

**D. The Department's Direction to Insurers to File Financial Statements Listing Iran-Related Investments and the Department's Treatment of Those Assets as "Non-Admitted"**

To address financial hazard posed by investments in companies on the List, the Department directed insurers to submit financial statements identifying investments in companies on the List. In addition, the Department directed insurers to report such investments in "Column 2" of their Annual Statements. Insurers must file Annual Statements, in which they publicly identify all investments. Column 2 is labeled "Nonadmitted Assets." The Department advised that effective March 31, 2010, it will treat such investments as non-admitted. Insurers may continue to hold Iran-related investments in their portfolios, but for purposes of their California financial statements, the assets will not count toward the insurers' surplus.

Placement of insurers' Iran-related investments in Column 2 does not require insurers to divest from those holdings. Nonetheless, some insurers voluntarily divested from companies on the List. "Non-admission" of investments has not impaired any insurer's surplus to trigger any action by the Department.

**E. The Petition**

On March 29, 2010, the five trade associations filed a Petition for Determination ("Petition") asking OAL to find that the Department's actions are improper "underground regulations." The Department responded by notifying OAL that Petitioner's counsel, Bill Gausewitz, served as former Special Counsel to the Commissioner, worked on the Department's Iran investment efforts, and had a conflict of interest. The Department requested that OAL not consider the Petition in light of the conflict. (1 C.C.R. § 270(c).)

On May 27, 2010, OAL sent a letter to the Commissioner and Mr. Gausewitz advising that OAL would consider the Petition notwithstanding the conflict. OAL explained that it "does not possess the technical expertise to evaluate the underlying ethical issues raised by the Commissioner. . . . Such matters are within the purview of the State Bar and the courts." (May 27, 2010 letter at p. 2. fn. 2.) On June 29, 2010, Mr. Gausewitz's firm sent a letter to OAL

announcing that it had withdrawn. The letter stated that "the five trade associations on whose behalf the petition was filed should be regarded as the petitioners."

### F. Issues to Be Addressed

OAL's May 27 letter identifies three specific alleged underground regulations which OAL will consider:

A. A statement in a letter dated February 10, 2010, which states: "Accordingly, effective March 31, 2010, the Department will treat all investments by insurers holding a certificate of authority to transact insurance in California in companies on the List and affiliates owned 50% or more by companies on the List as non-admitted on the insurer's financial statements. For all financial statements filed with the Department for periods ending on or after March 31, 2010, each insurer must report all of its investment holdings on the List as not admitted assets." The February 10, 2010, letter is attached hereto as Exhibit A.

B. A determination in the Department's letter of February 10, 2010, that companies on the List referenced in A, above, are "subject to financial risk as a result of doing business with the Iranian oil and natural gas, nuclear, and defense sectors."

C. A document titled "Response Form" that requires insurers to agree or not to agree by March 12, 2010, that they will refrain from investing in companies on the List or affiliates owned 50% or more by companies on the List until either (a) Iran is removed from the United States State Department's list of state sponsors of terrorism or (b) the company and its affiliates cease to do business with Iran's oil and natural gas, nuclear, and defense sectors and is removed from the List. The Response form is attached hereto as Exhibit B.

We address each of these issues below, though in a different order reflecting the chronological sequence of actions taken.

## III. OAL Issue B: The Commissioner Was Not Required to Use Rulemaking to Create a List of Companies Subject to Financial Risk Based on Iran-Related Activities

### A. The Commissioner's Creation of a List of Companies Subject to Financial Risk Was Not a Regulation

The APA defines "regulation" as:

> "Regulation" means every rule, regulation, order, or standard of general application or the amendment, supplement, or revision of any rule, regulation, order, or standard adopted by any state agency to implement, interpret, or make specific the law enforced or administered by it, or to

govern its procedure. [Gov. Code § 11342.600.]

As the Supreme Court elaborated in *Tidewater Marine Western, Inc. v. Bradshaw* (1996) 14 Cal.4th 557:

> A regulation subject to the APA thus has two principal identifying characteristics. First, the agency must intend its rule to apply generally, rather than in a specific case. The rule need not, however, apply universally; a rule applies generally so long as it declares how a certain class of cases will be decided. Second, a rule must "implement, interpret, or make specific the law enforced or administered by [the agency], or . . . govern [the agency's] procedure." (*Id.* at p. 571 [citations omitted].)

For five reasons, the Department's identification of companies subject to Iran-related financial risk is not a regulation.

*First*, the List is not a "rule, regulation, order, or standard of general application." Rather, it is a memorialization of research conducted by the Department. The Commissioner's duty to safeguard insurer portfolios by making determinations about investment soundness, quality, liquidity and diversification (see, e.g., Ins. Code §§ 717(b), 706.5, 1196(a) & 1215.5(f)(6)) and his authority to disseminate accurate information to insurers and the public (*id.* § 12921.3(d)) require the Commissioner to perform research and do studies from time to time. A study and assessment of risks are not a regulation, because they are not, in the language of the APA, a "guideline, criterion, bulletin, manual, instruction, order, standard of general application, or other rule . . . ." (Gov. Code § 11340.5(a)). In the language of *Tidewater*, they do not "declare[] how a certain class of cases will be decided." They are, instead, a compilation of information – a summary of the Commissioner's research findings. The Commissioner was not required to use rulemaking to undertake his study, prepare the List, and make an assessment of companies on it.

*Second*, the List reflects a case-by-case analysis of specific companies' activities, not a "standard of general application." The Department reviewed the characteristics of specific companies, based on consultation with experts and the Department's own research. The Department made a company-by-company assessment of geopolitical risk each company faces. No single criterion or methodology applies uniformly to each company on the List. The Department continues to examine the circumstances of individual companies, and may remove a

company if, based on relevant sources of information, the Department finds that the company no longer maintains a level of contact with Iran presenting financial risk. This process bears no relation to a "standard of general application." (See, e.g., *Tidewater, supra,* 14 Cal.4th at p. 571 [interpretations that arise in the course of case-specific adjudication are not regulations].)

*Third*, in and of themselves, the List and assessment of risk have no effect on insurers. They set neither a "performance standard" that specifies an objective with achievement criteria (Gov. Code § 11342.570) nor a "prescriptive standard" that "specifies the sole means of compliance" (*id.* § 11342.590). They set no standards at all. They require no compliance. They impose no obligations. They require insurers to do nothing. They are, instead, a summary of the Commissioner's research findings.

*Fourth*, the List is an exercise of the Commissioner's power to "disseminate" information to the public.

> The commissioner may in person or through employees of the division meet with persons, organizations and associations interested in insurance for the purpose of securing cooperation in the enforcement of the insurance laws of this State and may ***disseminate information concerning the insurance laws of this State for the assistance and information of the public.*** (Ins. Code § 12921.5 (emphasis added].)

The Commissioner is not required to undertake a rulemaking to disseminate information.

*Fifth*, companies on the List are not subject to the Department's oversight. The List therefore does not "regulate" those businesses at all.

### B. The Commissioner's Development of a List of Companies Subject to Financial Risk Was Not a "Quasi-Legislative" Act

The purpose of the APA is to make the rulemaking process applicable to the exercise of any "quasi-legislative" power. (Gov. Code § 11346(a).) As the Court explained in *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 10, quasi-legislative rules represent "an authentic form of substantive law-making." At its core, an agency using its quasi-legislative power is "truly 'making law'" and its rules "have the dignity of statutes." (*Ibid.*) The APA also applies to "interpretive" regulations. (See *Tidewater, supra,* 14 Cal.4th at pp. 574-575

["policy that an agency intends to apply generally . . . and that predicts how the agency will decide future cases is essentially legislative in nature . . ."].)

The Commissioner's creation of a list of companies subject to financial risk because of their associations with Iran does not fall within the spectrum of quasi-legislative action. The list and assessment do not bear the characteristics of law-making which define quasi-legislative acts. Further, the list and assessment do not even achieve the status of an "interpretive regulation" because they are neither a statement of policy nor a mechanism that "predicts how the agency will decide future cases." Under even the broadest interpretation of a "quasi-legislative" action described in *Tidewater*, the list and assessment of risk do not meet the test.

## IV. OAL Issue C: The Commissioner Was Not Required to Use Rulemaking to Prepare a Form for Insurers to Respond to His Request for a Moratorium on Iran-Related Investments

### A. The Form Is an Exercise of the Commissioner's Examination Power, Which Does Not Require Rulemaking

The Commissioner has broad authority to examine and obtain information from insurers. "[W]henever he or she deems necessary," the Commissioner may "examine the business and affairs" of an insurer. (Ins. Code § 730(a) & (b).) The examination process is broad. The Commissioner may examine "any company as often as the commissioner in his or her discretion deems appropriate." (*Id.* § 730(b).) Examinations may be of "any person, or the business of any person, insofar as the examination or investigation is, in the discretion of the commissioner, necessary or material to the examination of the company." (*Id.* § 730(c).) The Commissioner's examination power applies to all insurers transacting business in California (*id.* §§ 729(a) & 730(b)), ensures "free access to all the books and papers of the company," and covers "all its affairs" so the Commissioner may ascertain "its condition and ability to fulfill its obligations" and whether "it has complied with all laws applicable to its insurance transactions" (*id.* § 733). As necessary, the Commissioner's power of examination includes the power to issue subpoenas, administer oaths and examine persons under oath "as to any matter pertinent to the examination." (*Id.* § 734.) The Commissioner may even conduct examinations "at the expense of the insurer, organization or person examined." (*Id.* § 736.)

The scope of an examination is extremely broad. Examinations can include almost every sort of inquiry.

> "Examine" or "examination" as used in Code Section 730 includes an examination or review ***of any nature, scope or frequency*** by the Department of a licensed insurer, regardless of the location of the review or examination. (10 C.C.R. § 2303.2(j) [emphasis added].)

Significantly, the examination sections of the Insurance Code do not include any provision for rulemaking, unlike many other sections of the Code.

Here, the Department engaged in an examination to ascertain the financial condition of insurers. Investments in Iran-related businesses are subject to asymmetric financial risk. While insurers may, under certain circumstances, invest in Iran-related businesses, the Department must monitor those investments to ensure the safety of insurers' portfolios.

Although the Commissioner would have been within his right to conduct an on-site examination of each insurer or even issue subpoenas and solicit testimony under oath to determine whether insurers intended to invest in certain Iran-related businesses and bill each insurer for the cost of this effort, the Department chose a much less obtrusive approach. The Department elected instead to issue a survey of all insurers, requiring each company to "assist the [Department] and aid in the examination" by notifying the Department of the insurer's plans with regard to particular investments in the future. The answers to the survey provided the Department with information so that the Department could determine which insurers were likely to possess investments with risks tied to Iran. This information, in turn, enables the Department to allocate its limited resources to direct its focus to only those companies with a stated intention to continue to invest in such assets.

The Department's response form is not an underground regulation. The Department's examination did not have the essential character of a regulation, which is to establish rules applicable to future conduct or cases. Instead, the examination was a gathering of information.

Indeed, had the Department adopted a regulation to conduct its examination, the regulation would have been improper because it would duplicate the examination statutes and regulation. (See Gov. Code § 11349(f) [a regulation may not "serve the same purpose as a state

or federal statute or another regulation"].)

In sum, the Commissioner's preparation of a response form for insurers was authorized by the Commissioner's statutory examination authority, is not a "rule, regulation, order or standard of general application," and does not require rulemaking.

**B. The Form is Not "Quasi-Legislative" Action**

As with the List, the form created by the Commissioner for insurers to indicate whether they agree to an investment moratorium is not quasi-legislative action. (See, *supra*, Section III.B.) Not only does the form not bear the characteristics of "law-making," its use does not constitute a "standard" or "rule." Nor does the form achieve the status of an "interpretive regulation" since it is neither a statement of policy nor a mechanism that "predicts how the agency will decide future cases." Under even the broadest interpretation of a "quasi-legislative" action described in *Tidewater*, the Commissioner's form does not meet the test.

**C. Creation of Forms Is Exempted from APA Rulemaking**

The requirements of the APA do not apply to:

> A form prescribed by a state agency or any instructions relating to the use of the form, but this provision is not a limitation on any requirement that a regulation be adopted pursuant to this chapter when one is needed to implement the law under which the form is issued. [Gov. Code § 11340.9(c).]

The form exemption applies here. The Commissioner created the form as a means to gather information regarding insurers' plans for Iran-related investments. The Commissioner was permitted to gather that information as an exercise of his examination authority (see *supra* Section IV.A) and his use of the bully pulpit. Accordingly, the Commissioner was permitted to prepare a form to record the results of that effort. Because the form only gathered information as authorized by the examination statute, it was not an instance of using a form to substitute for a regulation as described in the second clause of Government Code Section 11340.9(c).

## V. OAL Issue A: The Commissioner's Directive to Insurers to File Financial Statements Identifying Iran-Related Investments and the Department's Treatment of Iran-Related Assets as "Non-Admitted" Are Not Underground Regulations

### A. Insurance Code Section 923, on Which the Commissioner Based His Actions, Does Not Require Rulemaking

#### 1. Section 923 and Its Legislative History

Insurance Code Section 923 provides:

> The commissioner shall require every insurer which is required to file an annual or quarterly statement to use the statement blanks and instructions thereto for the appropriate year ***adopted by the National Association of Insurance Commissioners***. The statements shall be completed in conformity with the Accounting Practices and Procedures Manual adopted by the National Association of Insurance Commissioners, to the extent that the practices and procedures contained in the manual do not conflict with any other provision of this code. ***The commissioner may make changes from time to time in the form of the statements and the number and method of filing reports as seem to him or her best adapted to elicit from the insurers a true exhibit of their condition.*** The commissioner ***shall notify*** each insurer of any changes from the National Association of Insurance Commissioners' statement blanks ***which the commissioner has determined*** pursuant to this section to be appropriate. [Emphasis added.]

In crafting Section 923, the Legislature understood that financial statements do not constitute static and unalterable reports that may only be changed through a full-fledged rulemaking process. Since 1872, the Commissioner has had discretion to specify the form of insurers' annual statements. Political Code Section 615, the predecessor of today's Section 923, provided:

> The Insurance Commissioner must cause to be prepared, and furnish to each person and to each of the companies incorporated in this State, and to the attorneys of each of the companies incorporated or chartered by other States or foreign governments, printed forms of the statements herein required; and he may make such changes from time to time in the form of the same as seem to him best adapted to elicit from the companies a true exhibit of their condition in respect of the several points hereinbefore enumerated. [Political Code of 1872, § 615.]

The language vesting discretion in the Commissioner to determine the form of annual statements has remained essentially intact each time the statute has been revised: The

Commissioner "may make such changes from time to time in the form of such statements . . . as seem to him . . . best adapted to elicit from the [insurers] a true exhibit of their condition. (Stats. 1907, ch. 119, § 615, p. 159; Stats. 1935, ch. 145, § 615, p .145; Stats. 1992, ch. 614, § 3, p. 2731; Stats. 2004, ch. 599, § 2, p. 4729.) In fact, the only significant change was to broaden the statute (in 1907) by eliminating the original qualifying reference to "in respect of the several points hereinbefore enumerated." From early in its history, the language was understood to "give[] the Insurance Commissioner very broad powers in determining the form that such statements . . . shall take." (Opinion of the Attorney General, No. 4841 (1923).)

However, in the most recent revision, the scope of the Commissioner's Section 923 power – still expressed in the unqualified 1907 language – was expanded to include the form of insurers' quarterly statements, as well as their annual statements. The Legislature intended both that the Commissioner should continue to make whichever changes to the forms of the statements seem to him or her best adapted to elicit from insurers a true exhibit of their condition *and* that he or she should receive those documents more frequently and without delay. According to an Assembly Insurance Committee analysis, the change was necessary to protect the public: "Under current law it is possible, and not uncommon, for an insurance company operating in a financially hazardous manner to fail to file or to delay filing of, financial documents. Enacting this bill will improve the ability of both [the Department] and [the National Association of Insurance Commissioners] to identify financially risky insurance companies, and to protect the public from unnecessary exposure to risk." (Assem. Insurance Com., Analysis of Assem. Bill No.1728 (2003-2004 Reg. Sess.), as amended June 17, 2004, p. 3)

In providing that financial statements must conform to the "statement blanks and instructions . . . for the appropriate year adopted by the National Association of Insurance Commissioners" ("NAIC"), the Legislature was aware of the need for evolution and alteration of financial statements from time to time. Not only did the Legislature recognize the need for the Commissioner to make changes to bring financial statements into "conformity" with the NAIC's Accounting Practices and Procedures Manual, but the Legislature also vested in the Commissioner *additional* discretion to make other changes to the financial statements "from time

to time" in order to "elicit a . . . true exhibit of [the insurers'] condition" and in the manner "as seem to [the Commissioner] best adapted" to reflect the financial condition of insurers. (Ins. Code § 923.)

Cognizant of the importance of providing insurers with advance warning of changes to financial reporting requirements, the Legislature created a specific notification process to inform insurers of "any changes from the National Association of Insurance Commissioner's statement blanks which the Commissioner has determined pursuant to this section to be appropriate." (*Id.*) As the Legislature recognized and in view of the Department's need for an evolving financial statement reporting process that can quickly adapt to the complexities of the financial market, the requirements of the Administrative Procedure Act do not work here.

**2. Rulemaking Is Inconsistent with Section 923**

The APA establishes a formal process for state agencies to adopt regulations. The agency must give public notice of proposed regulatory action. (Gov. Code §§ 11346.4, 11346.5.) The agency must prepare and issue a complete text of the proposed regulation with a statement of the reasons for it. (*Id.* § 11346.2(a) & (b).) The agency must give interested members of the public at least 45 days to comment on the proposed regulation. (*Id.* §§ 11346.4(a) & 11346.8.) The agency must respond to each comment in writing. (*Id.* §§ 11346.8(a) & 11346.9.) At the close of this process, the agency must deliver the rulemaking file to OAL, which has 30 working days to review the file and approve or disapprove it. (*Id.* § 11349.3(a).) When one factors in the time necessary to draft text, summarize and digest comments, and deliberate internally, the fastest an agency possibly can start and finish a rulemaking is three months. It is a rare rulemaking that is completed so quickly.[7]

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[7] "Emergency" rulemaking is not an option for financial statement oversight. The standards for justification of emergency rulemaking are high. (See Gov. Code § 11346.1(b)(2) [expediency, convenience, best interest, general public need or speculation are not adequate to justify an "emergency" for rulemaking purposes]; 1 C.C.R. § 50(a)(5)(B)(1) & ( 2) [facts describing emergency must demonstrate by substantial evidence that emergency rulemaking is necessary to avoid "serious harm to the public peace, health safety or general welfare" and that adoption of an emergency regulation will alleviate that harm].) Changes to financial statements, while related to the welfare of the public, will not necessarily and always rise to the level of averting "serious harm." Indeed, one purpose of revising financial statement reports is to address changed circumstances *before* they cause harm.

Requiring rulemaking as a precondition to reporting changes would be inconsistent with Section 923 for at least three reasons.

First, as noted in the preceding section, Section 923 prescribes specific procedures for notifying insurers of changed reporting requirements. Those requirements differ from what the APA would dictate. Moreover, the phrase, "any changes from the [NAIC] statement blanks which the Commissioner has determined pursuant to this section to be appropriate" reflects that at the point when insurers are notified, the Commissioner *already will have made* the decision to change the reporting requirements. The statutory language thus indicates that APA-type notice and comment are not to be used in the specific arena of insurance accounting and reporting directives.

In *Paleski* v. *State Dep't. of Health Services* (2006) 144 Cal.App.4th 713, 727-31, the court held that the existence of specific statutory provisions for notifying licensees of agency requirements meant that APA procedures did not apply. The court held that the APA did not apply to drug authorization criteria developed by the Department of Health because the governing statute prescribed different notice requirements. "The necessary effect of this subdivision is to exempt the criteria from the APA. It would make little sense to require that the criteria be published only in the provider manuals, which are of limited availability, if the broader notice requirements of the APA had to be met." (*Id.* at p. 729.) The court explained that the specific provisions of the statute prevailed over the more general provisions of the APA. (*Ibid.*)

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More fundamentally, Section 923 and the Department's insolvency statutes (see, e.g., Ins. Code § 706.5) are intrinsically incompatible with emergency rulemaking because those sections make the agency's action dependent *only* on the Commissioner's discretion. For the Commissioner to act under Section 923, all that is required is that a change to financial reporting "*seem*" to him "best adapted to elicit from the insurers a true exhibit of their condition."

By way of analogy, the Commissioner may order an insurer to stop writing new business "whenever, *in his judgment*" the investments of the insurer are not sufficiently liquid, unless certain other specified conditions are met. (Ins. Code § 706.5 [emphasis added].) The court in *Alta Bates* explained of similar language: "Inherent in this language is the inescapable conclusion that the Legislature intended the level of factual proof to be lower than that normally intended to apply to administrative decisions contemplated by the [APA]." (*Alta Bates, supra*, 118 Cal.App.3d at p. 622.)

Emergency rulemaking under the APA imposes numerous procedural hurdles on an agency. That is precisely what Section 923 seeks to prevent.

Second, requiring rulemaking would be inconsistent with the timing for filing reports, which the Commissioner may change with prior notice to insurers. The Department receives reports of financial information on a quarterly, as well as annual, basis. (See, e.g., Ins. Code §§ 920 & 923.) Despite the fact that any regulation adopted via APA rulemaking would require at least three months to complete, financial statement information requires real-time analysis and review. If APA rulemaking were required before the Department could revise a quarterly financial statement filing (i.e., every three months), the APA would turn the financial statement process on its head. The Department could never implement a reporting change that would become effective for the next quarterly statement. Section 923 does not contemplate this result.

Accounting procedures implemented under statutory authorization are not considered regulations subject to the APA. In *Pacific Gas & Electric Co. v. Dept. of Water Resources* (2003) 112 Cal.App.4th 477, 503-07, the court held that that a formula developed by the Department of Water Resources to determine the amount utilities had to reimburse for power contracts was not a regulation subject to the APA, despite the general applicability of the formula to a regulated class involving dozens of long-term contracts, because the formula was a "cost-accounting exercise" performed pursuant to statutory authority. The court canvassed leading cases finding certain agency actions to be exempt from the APA. In particular, the court relied on *City of San Joaquin v. Bd. of Equalization* (1970) 9 Cal.App.3d 365, 375, which held that an inter-agency sales tax allocation process was not a regulation because the process was "merely a statistical accounting technique." (*PG&E, supra,* 112 Cal.App.4th at. p. 505.) *PG&E* also observed that not all generally applicable agency actions are "quasi-legislative." (*Id* at pp. 502-503.)

As with the challenged actions in *PG&E* and *San Joaquin*, the Commissioner's directive for Iran-related financial reporting under Section 923 involves an accounting method, the purpose of which is to ascertain the extent of insurers' Iran-related investments and the impact of those investments on insurers' surplus. The accounting method in this case has much less impact on licensees than the procedures in *PG&E* and *San Joaquin.* In those cases, the "accounting exercise" actually determined how much money the affected parties paid or received, while the Department's requirement does not have such an effect.

Third, reading the APA to require rulemaking under Section 923 would conflict with well settled principles of statutory construction. Words must be construed in context, keeping in mind the nature and purpose of the statute, and the various parts of a statutory enactment must be harmonized by considering the particular clause in the context of the statutory framework as a whole. (*People v. Black* (1982) 32 Cal.3d 1, 5.) Courts endeavor to construe statutes in a manner that comports most closely with the Legislature's intent, to promote the statute's general purpose and avoid a construction that would lead to absurd consequences. (*Smith v. Superior Court* (2006) 39 Cal.4th 77, 83.) "An interpretation that renders statutory language a nullity is obviously to be avoided." (*Williams v. Superior Court* (1993) 5 Cal.4th 337, 357.) Implied exemption from the requirements of the APA logically and necessarily applies to financial statement reporting. Indeed, courts have recognized the need for implied exemption in contexts that are similar to those at issue here.

### 3. A Requirement of Rulemaking Would "Effectively Eviscerate" Section 923

Courts refuse to treat statutorily authorized agency action as a "regulation" if doing so would "effectively eviscerate" the agency's enabling statute. In *Alta Bates Hospital v. Lackner* (1981) 118 Cal.App.3d 614, hospitals challenged a directive of the Director of the Department of Health to reduce Medi-Cal reimbursements paid to hospitals for outpatient services by 10%. (Alta Bates, *supra*, 118 Cal.App.3d at p. 616.) The hospitals contended that the challenged directive constituted a "regulation" within the meaning of the Government Code that had not been adopted in accordance with the APA. (*Id.* at pp. 619-620.) The Court of Appeal, reversing the trial court's finding that the APA applied, focused on the language of the statute as well as the practical effect that the APA would have on the Director's power to address a fiscal emergency.

The Court noted that the Legislature gave the Director "wide discretion over Medi-Cal eligibility." (*Alta Bates*, supra, 118 Cal.App.3d at p. 620.) The relevant statute required the Director to reduce payments "at any time during the fiscal year" when the total amounts actually paid in a fiscal year exceeded the amounts scheduled to be paid. (*Ibid.*) Notably, the statute also contained a provision requiring the Director to "consult with representatives of concerned

provider groups" before reducing reimbursements to hospitals. (*Id.* at p. 620.) Although the statutes implemented by the Director did not contain an express exemption from the APA, the Court recognized the incongruity of the APA's procedures when applied to the Director's discretion to undertake prompt action to address a fiscal emergency.

The Court acknowledged that, pragmatically, if the Director were required to follow the APA, the procedural mechanics would "effectively eviscerate" the Director's ability to make the necessary fiscal determinations and projections which call for action when the cost of the Medi-Cal program exceeded available funds. (*Alta Bates*, *supra*, 118 Cal.App.3d at p. 621.) The Court noted that, "[a]side from the delays which [the APA] procedure would entail, it is apparent that since the Legislature did not spell out that the [APA] should be followed, the legislative body recognized that the director is apt to be uniquely in possession of the only factual data pertaining to the problem." (*Id.* at p. 622.) The Court went on to recognize the importance of the statute's requirement that the Director consult with representatives of concerned provider groups before reducing reimbursement to those providers. (*Ibid.*) Finally, noting that the APA was "a general law containing general provisions applicable . . . to the promulgation of regulations by administrative agencies," the Court applied "well-established principles of statutory construction" to exempt the specific provision relating to the narrow subject of the Director's duties from the general requirements of the APA. (*Id.* at pp. 622-623.)

Similarly, in *Paleski, supra,* 144 Cal.App.4th, at pp. 727-731, the court explained that a factor in determining whether an agency action is a regulation is whether the APA process would impair the operation of the agency's enabling statute. The court held that the Department of Health's drug authorization criteria were not regulations for the reasons described above (see Section V.A.2) and because requiring APA rulemaking would delay the rapid response needed "when a drug is being abused or raises cost problems" (*id.* at p. 729), in contravention of the requirements of the agency's enabling statute.

Consistent with these authorities, the California Attorney General issued an opinion that an agency's changes to Medi-Cal drug price schedules did not require rulemaking, in part because applying the APA would run counter to the agency's statute. (Attorney General Opinion

No. 83-909, "Adjustment of Drug Product Prices Pursuant to Welfare & Institutions Code § 14105.7," 67 Att. Gen'l Ops. 50 (1984).) "It would be unreasonable to suggest that the complex and time-consuming APA review process should apply to the frequent updating of prescription drug prices . . . ." (*Id.* at p. 54.) Thus, treating this process as an exception was needed to "effectuate the obvious intent of the legislature." (*Ibid.*) The opinion reached this conclusion despite recognizing that the price change process "would thus constitute a 'regulation' in the broad sense . . ." because under the *Alta Bates* rationale "the provisions of [the law] do not lend themselves to the APA review procedure." (*Ibid.*)

Like the Medi-Cal provisions in *Alta Bates*, Insurance Code Section 923 gives the Department of Insurance broad discretion. If the general provisions of the APA were interpreted to trump the specific requirements of Section 923, the result would be to "effectively eviscerate" the Department's ability to modify financial statements in the manner the Legislature intended. As in *Alta Bates*, the specific provisions of Section 923 must be treated as controlling over the general provisions of the APA.

Moreover, Section 923 expressly requires the Commissioner to "notify each insurer of any changes" in the financial statement reporting requirements. The additional notice and opportunity for comment procedures provided in the APA are superfluous when superimposed over the financial statement procedures developed by the Legislature in Section 923. The APA's requirements -- including the minimum 45-days' notice, the receipt and summary of public comments, and delays relating to such requirements -- directly conflict with the less restrictive notice requirements of Section 923.

If the Department were required to promulgate a regulation before it could capture data relating to new financial risks to licensees under its regulatory review, financial statement analysis would become rudimentary and porous. If, for example, financial statement reporting criteria for credit default swap transactions, mortgage-backed securities, and investments in businesses such as Enron Corporation, WorldCom or Lehman Brothers could not occur without a regulation, the data collected in financial statements would become yesterday's news. Such a process would defeat the legislative goals of authorizing the Department to develop and augment

financial reporting requirements and the review of those reports in real-time with notice to reporting entities.

Here, the Commissioner has determined that companies engaged in specific business dealings in Iran undertake real and potentially volatile financial risk that could threaten investors. The Commissioner's ability to monitor the solvency of insurers conducting business in California includes the ability to remove risky investments from the "admitted asset" column of financial statements. By authorizing the Commissioner to make changes to financial statements "from time to time" to ensure a financial report that will "elicit from the insurers a true exhibit of their condition," the Legislature exempted the Commissioner's financial reporting requirements from APA rulemaking.

### B. The Commissioner's Notification on Financial Statement Reporting Involves a Form and Is Not Subject to the APA

The Commissioner's notification about financial statement reporting involves a form and is exempt from APA rulemaking. (Gov. Code § 11340.9(c).) The Commissioner modified reporting forms for financial statements so that insurers may identify any investments in companies identified by the Department as conducting Iran-related business. The APA is inapplicable to the development of this form. The APA expressly permits the use of forms without rulemaking so long as those forms are not required in order to implement the law under which the form is issued. *(Id.)* As explained above, no regulations are required in order to implement the Commissioner's financial statement reporting form.

The Commissioner has authority to make changes to the form and method of financial statement reports "from time to time" and in the manner "as seem to him or her best adapted to elicit from the insurers a true exhibit of their condition." (Ins. Code § 923.) A regulation is not required "pursuant to this chapter . . . to implement the law under which the form is issued" because the statute expressly gives that power to the Commissioner.

## VI. Conclusion

For the foregoing reasons, none of the actions challenged by Petitioners is a regulation. The requirements of APA rulemaking do not apply.

Dated: July 26, 2010

CALIFORNIA DEPARTMENT OF INSURANCE

By _____

Adam M. Cole

**PROOF OF SERVICE**

**IN RE CALIFORNIA DEPARTMENT OF INSURANCE COMMUNICATIONS TO INSURERS DATED FEBRUARY 10, 2010, AND MARCH 4, 2010**
**OAL File No. CTU 2010-0329-02**

I am over the age of eighteen years and am not a party to the within action. I am an employee of the Department of Insurance, State of California, employed at 45 Fremont Street, 19th Floor, San Francisco, California 94105. On July 26, 2010, I served the following document(s):

**RESPONSE OF THE CALIFORNIA DEPARTMENT OF INSURANCE TO PETITION FOR DETERMINATION**

on all persons named on the attached Service List, by the method of service indicated, as follows:

If **U.S. MAIL** is indicated, by placing on this date, true copies in sealed envelopes, addressed to each person indicated, in this office's facility for collection of outgoing items to be sent by mail, pursuant to Code of Civil Procedure Section 1013. I am familiar with this office's practice of collecting and processing documents placed for mailing by U.S. Mail. Under that practice, outgoing items are deposited, in the ordinary course of business, with the U.S. Postal Service on that same day, with postage fully prepaid, in the city and county of San Francisco, California.

If **OVERNIGHT SERVICE** is indicated, by placing on this date, true copies in sealed envelopes, addressed to each person indicated, in this office's facility for collection of outgoing items for overnight delivery, pursuant to Code of Civil Procedure Section 1013. I am familiar with this office's practice of collecting and processing documents placed for overnight delivery. Under that practice, outgoing items are deposited, in the ordinary course of business, with an authorized courier or a facility regularly maintained by one of the following overnight services in the city and county of San Francisco, California: Express Mail, UPS, Federal Express, or Golden State overnight service, with an active account number shown for payment.

If **FAX SERVICE** is indicated, by facsimile transmission this date to fax number stated for the person(s) so marked.

If **PERSONAL SERVICE** is indicated, by hand delivery this date.

If **EMAIL** is indicated, by electronic mail transmission this date to the email address(es) listed

If **INTRA-AGENCY MAIL** is indicated, by placing this date in a place designated for collection for delivery by Department of Insurance intra-agency mail.

Executed this date at San Francisco, California. I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Raquel Cano

**SERVICE LIST**

**IN RE CALIFORNIA DEPARTMENT OF INSURANCE COMMUNICATIONS TO INSURERS DATED FEBRUARY 10, 2010, AND MARCH 4, 2010**
**OAL File No. CTU 2010-0329-02**

| Name/Address | Phone Number | Method of Service |
|---|---|---|
| Susan Lapsley<br>Kathleen Eddy<br>Elizabeth Heidig<br>Office of Administrative Law<br>300 Capitol Mall, Suite 1250<br>Sacramento, CA 95814-4339<br>slapsley@oal.ca.gov<br>keddy@oal.ca.gov<br>eheidig@oal.ca.gov | (916) 323-6225<br>(916) 323-6225<br>(916) 323-6225 | OVERNIGHT SERVICE & EMAIL<br>EMAIL<br>EMAIL |
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| Samuel Sorich<br>Association of California Insurance Companies<br>1415 L Street, Suite 670<br>Sacramento, CA 95814<br>samuel.sorich@acicnet.org | (916) 449-1370 | U.S. MAIL<br>EMAIL |
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# Exhibit E



## NEWS: 2010 PRESS RELEASE

For Release: March 26, 2010
Media Calls Only: 916-492-3566

**Insurance Commissioner Steve Poizner Announces That 460 Insurers Have Already Agreed To Forgo Future Investments In Iran-Related Companies**

Insurance Commissioner Steve Poizner announced today that 460 insurers have agreed in writing to a moratorium on future investments in 50 companies identified by the California Department of Insurance (CDI) to be doing business with the Iranian energy, nuclear and defense sectors.

"This level of participation in the moratorium signals tremendous progress in our initiative to ensure that California policyholder dollars are not put at risk through investments in companies doing business with the Iranian nuclear, defense and energy sectors," said Commissioner Poizner. "We already know that 1,000 out of the 1,300 insurance companies licensed in California have no investments in any of the 50 Iran-related companies. Now, more than one third of the insurance companies have pledged not to make new investments in those risky companies helping to prop up the Iranian regime. It's up to the other two thirds of the industry to do the right thing and agree to forgo future investments in Iran-related companies."

Insurers that have agreed to the moratorium include such well-known companies as Mercury Insurance, a prominent auto insurer; Zenith Insurance, a significant workers' compensation insurer; and Anthem Blue Cross, the largest insurer in the individual health insurance market in California.

On Feb. 10, Commissioner Poizner released a list of 50 companies doing business in the Iranian oil and natural gas, nuclear and defense sectors.

Two significant milestones in the CDI Iran Initiative will be reached next week. First, as of March 31, no investment held by an insurer in any company on the list will be recognized on that insurer's financial statements in California. Second, the Commissioner requested that all insurers licensed to do business in California agree to a moratorium on future investments in any of the companies on the list or in any affiliates owned 50 percent or more by those companies until either (a) Iran is removed from the United States State Department's list of state sponsors of terrorism or (b) a specified company and its affiliates cease to do business with Iran's oil and natural gas, nuclear, and defense sectors and is removed from the list. Commissioner Poizner initially asked insurers to respond to the moratorium request by March 12. At the request of the insurance industry, he extended that deadline to April 2.

CDI will release additional information regarding the insurance industry response to the request for an investment moratorium in the coming weeks along with other data on insurance industry investments in Iran.

Earlier this year, Commissioner Poizner announced that 100 percent of the 1,327 insurance companies licensed in California responded to his request to provide data on their investments with companies doing business with Iran's oil and natural gas, nuclear and defense sectors.

Commissioner Poizner first announced his Terror Financing Probe in June 2009 to review compliance with a recent California law that prohibits insurers from investing in designated state sponsors of terror. As part of a data call issued by the Commissioner, insurance companies were required to identify their direct investments in designated sectors of the Iranian economy and indirect investments in companies doing business in those sectors. In December 2009, the Department announced that insurers reported no direct investments in Iran and therefore are in full compliance with state law prohibiting those investments. But the Department uncovered billions of dollars of indirect investments in companies doing business with the Iranian oil and natural gas, nuclear and defense sectors.

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Please visit the Department of Insurance Web site at www.insurance.ca.gov. Non media inquiries should be directed to the Consumer Hotline at 800.927.HELP. Callers from out of state, please dial 213.897.8921. Telecommunications Devices for the Deaf (TDD), please dial 800.482.4833.

If you are a member of the public wishing information, please visit our Consumer Services.

# Exhibit F

News Overview
Press Releases
2007 Press Releases
2008 Press Releases
2009 Press Releases
2010 Press Releases
Studies, Reports & Publications

**NEWS: 2009 PRESS RELEASE**

For Release: December 2, 2009
Media Calls Only: 916-492-3566

**Terror Financing Probe Results in Insurance Industry Reporting $12 Billion in Investments Tied to Iran**

Commissioner Poizner Calls for Complete Divestment, Subpoenas 10 Insurance Companies that Failed to Respond to Data Call

Insurance Commissioner Steve Poizner today announced that insurance companies licensed to do business in California have admitted to holding $12 billion in investments in companies that do business with the Iranian energy, nuclear, banking and defense industries.

"I launched this effort six months ago to ensure insurance industry compliance with a new state law that prohibits California insurance companies from investing in countries designated as state sponsors of terrorism," said Commissioner Poizner, "I also wanted to determine the amount of insurance premium dollars, if any, paid by California consumers that end up invested in companies that do business with the energy, nuclear, banking and defense sectors of the Iranian economy.

"As a result of this probe, insurance companies have reported $12 billion in investments in companies that do businesses with the Iranian energy, nuclear, banking and defense industries. Independent of the data call, at least $6 billion of insurer investments has been verified by my staff. With this new information, I call upon the insurance industry to do what's right and divest themselves of these investments. If they do not do it voluntarily, I will use every tool at my disposal to force divestment."

Specifically, the Department of Insurance (CDI) will soon provide a list of companies that are doing business with the Iranian energy, nuclear, banking and defense industries to insurance companies licensed to do business in California. Many of these companies are based in South America, China, Russia and Europe. They include such companies as Siemens, Statoil, Petroleo Brasileiro and Total SA. The list will be created using information from the data call and input from outside consultants and other experts.

At that point, insurance companies will be given 30 days to notify CDI in writing that they will comply with the divestment request and disclose the value of the identified investments. Insurers will be given 90 days to eliminate those holdings from their portfolios.

For companies that do not voluntarily agree to divest, CDI will make public a list of these companies and provide the name and value of their Iran-related investments. Commissioner Poizner will also subpoena high-ranking executives of these insurance companies to testify under oath and ask them why they believe it is in the interest of California policyholders for their premium dollars to be invested in companies propping up Iran's energy, nuclear, defense and banking sectors.

If after this hearing an insurer still refuses to divest, Commissioner Poizner will take all legal action available to him to effectuate divestment.

"The government of Iran continues its oppressive crackdown against its own people, and thumbs its nose at the international community over its expanding nuclear program," said Commissioner Poizner. "Iran's ambition to dominate the region under a nuclear umbrella is a very serious threat to this country and to people all over the world. It's just wrong for consumers here in California to find out that their hard-earned money that they pay in insurance premiums are propping up the regime in Iran. We need to do whatever it takes to put maximum pressure on Iran to change its behavior."

Non-Responding Insurance Companies

Out of 1,327 insurance companies licensed in California and required to respond to the probe, 1,111 have complied, but 216 did not respond at all. Commissioner Poizner will subpoena a representative sample of 10 of the non-responders to explain why they ignored this critical data call. That hearing will be held on January 12 in Los Angeles.

The 10 companies facing a subpoena are Travelers Indemnity Co., PMI Mortgage Insurance Company, Thrivent Financial for Lutherans, Farmington Casualty Company, Old Republic General Insurance Corporation, American Home Assurance Company, Anthem Blue Cross Life and Health Insurance Company, Insurance Company of the West, Medical Insurance Exchange of California and Sequoia Insurance Company. The Commissioner will pursue additional actions to ensure that the remaining 206 companies respond to the data call.

Terror Financing Probe - By the Numbers

- Total Indirect Investments Reported by Insurance Companies: $12 billion
- Breakdown by Sector:

| | |
|---|---|
| Banking | $6,150 million |
| Defense | $40 million |
| Energy | $3,994 million |
| Nuclear | $147 million |
| Unclassified | $1,803 million |
| Total | $12 Billion |

- Number of Companies Required to Respond to Data Call: 1,327
- Number of Companies Yet to Respond: 216
- Total Reported Direct Investments in Iran: $0
- The California Department of Insurance has so far independently verified $6 billion in indirect investments, according to 2008 filings made by insurance companies.
- Number of Companies holding the $6 billion in Indirect Iranian Investments based on 2008 filings: 341

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# Exhibit G

**NEWS: 2010 PRESS RELEASE**

For Release: May 13, 2010
Media Calls Only: 916-492-3566

**Insurance Commissioner Poizner Announces More Than 1000 Insurers Agree to Voluntary Sanctions Against Iranian Government**

List of Insurers who Refuse Moratorium Revealed; $6 Billion in Current Holdings Disqualified from Insurer Financial Statements for Iran Ties

California Insurance Commissioner Steve Poizner today announced that 1,010 insurance companies - more than 75 percent of insurers licensed to do business in California -- have agreed to forgo future investments in 50 companies identified as doing business with Iran's nuclear, energy or defense sectors.

"This is a great victory for California consumers and sends a strong message to the regime in Iran," said Commissioner Poizner. "More than 1,000 insurance companies have done the right thing and agreed that not another dime of their investments will go towards propping up that oppressive regime."

As of March 31, 2010, the California Department of Insurance (CDI) disqualified an estimated $6 billion in holdings in the 50 Iran-related companies. This estimate is based on 2008 data, the most recent available information to be analyzed.

"With Tehran continuing its headlong rush to go nuclear, with Holocaust denier Ahmadinejad threatening genocide against Israel, with millions of Iranian people seeking to free themselves from the yoke of the Ayatollahs, it is outrageous that these companies have decided that it's business as usual and will continue to invest in companies that actively support the Iranian government," said Rabbi Abraham Cooper, associate dean of the Simon Wiesenthal Center. "Commissioner Poizner should be commended for his leadership on this issue. All we have seen from the United Nations and the Obama administration and Congress is mostly talk. In California, we have real action and tangible results."

Insurer investment in the 50 companies on the CDI investment lists totaled $1.8 billion during 2008 and averaged approximately $1 billion per year from 2005-07. Given this record, the decision by more than 1,000 licensees to agree to the investment moratorium means hundreds of millions of investment dollars will likely be diverted from these companies in the coming years.

California has the 4th largest insurance market in the world - and as a whole, insurers are the largest investor group in the global economy, with an estimated $3 to $4 trillion in investments.

Commissioner Poizner also released a list of companies who would not agree to the moratorium. These insurance companies include MetLife, Safeco and Hartford. The complete list can be found by selecting this link.

Earlier this year, Commissioner Poizner announced that 100 percent of the 1,327 insurance companies licensed in California responded to his request to provide data on their investments with companies doing business with Iran's, nuclear, defense, and energy sectors.

Commissioner Poizner first announced his Terror Financing Probe in June 2009 to review compliance with a recent California law that prohibits insurers from investing in designated state sponsors of terror. As part of a data call issued by the Commissioner, insurance companies were required to identify their direct investments in designated sectors of the Iranian economy and indirect investments in companies doing business in those sectors. In December 2009, the Department announced that insurers reported no direct investments in Iran and therefore are in full compliance with state law prohibiting those investments. But the Department uncovered billions of dollars of indirect investments in companies doing business with the Iranian oil and natural gas, nuclear and defense sectors.

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Please visit the Department of Insurance Web site at www.insurance.ca.gov. Non media inquiries should be directed to the Consumer Hotline at 800.927.HELP. Callers from out of state, please dial 213.897.8921. Telecommunications Devices for the Deaf (TDD), please dial 800.482.4833.

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# Exhibit H

STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
Legal Division, Office of the Commissioner
45 Fremont Street, 23rd Floor
San Francisco, CA 94105

Steve Poizner, *Insurance Commissioner*

April 16, 2010

*VIA ELECTRONIC MAIL*

TO: **All Admitted Insurance Companies** (Life, Fraternal, P&C and Title)

SUBJECT: **Supplemental Filing on Iran Related Investments**

On February 10, 2010, Insurance Commissioner Steve Poizner sent a letter to all insurers holding a certificate of authority to transact insurance in California: (1) listing companies doing business with the Iranian energy, nuclear and defense sectors ("List"); (2) informing insurers of the treatment of investments in those companies on insurers' statutory financial statements; and (3) requesting a moratorium on future investments in companies on the List and their 50% or more owned affiliates.

A copy of the List is provided at the end of this letter. Also provided at the end of this letter is a supplemental list identifying an additional company doing business with the Iranian energy sector.

Effective March 31, 2010, the Department treats all insurer investments in companies on the Lists as non-admitted. At the request of insurers, the Department modifies its prior statement that investments in affiliates owned 50% or more by companies on the List will be disqualified. Statement disqualification will not apply to those affiliates. Statement disqualification will apply only to investments in the 51 companies on the Lists.

The Department of Insurance is informing your company of its quarterly and annual reporting requirement to provide a supplemental financial filing on Iran related investments. The Department of Insurance has developed an Iran Related Investments Supplemental Filing Workbook. Please complete and return the Workbook to the Department no later than: **MAY 31, 2010**. Instructions for retrieving the required forms are provided in the following section.

## HOW TO RETRIEVE THE IRI-2010 SUPPLEMENTAL FILING

***Hardcopies, facsimile copies and/or Adobe (pdf) versions of the IRI-2010 Supplemental Filing workbook will not be accepted. Only electronic copies of the data workbook, in Microsoft Excel format, will be accepted.***

To retrieve the IRI-2010 supplemental filing workbook, please follow the instructions below:

- Go to the Department of Insurance website at http://www.insurance.ca.gov
- Select the **INSURERS** tab at the top of the web page.
- From the INSURERS: OVERVIEW page, select the link entitled "**More >>**" located at the bottom of the page.
- Select the link entitled "**Applications, Forms & Filings** "
- Select **IRAN RELATED INVESTMENTS SUPPLEMENTAL FILING** link. To view instructions and download form.

**"How To Fulfill Your Company's Reporting Obligation:**

**Step 1:** Review the IRI-2010 reporting instructions from the California Department of Insurance's "SUPPLEMENTAL FINANCIAL FILING ON IRAN RELATED INVESTMENTS (IRI-2010)" website.

**Step 2:** Download the IRI – 2010 Supplemental Filing Workbook.

**Step 3:** Enter the information in the IRI – 2010 Supplemental Filing Workbook.

**Step 4:** E-mail the completed IRI-2010 Supplemental Filing Workbook to the California Department of Insurance. E-mail instructions are contained in the workbook. **Submissions are due by MAY 31, 2010.**

| For any legal questions concerning the reporting of investment information, please contact: | Should you have an extension requests, and/or questions related to the reporting instructions or data workbook, please address your inquiries or concerns to the contact persons indicated below. |
|---|---|
| **Peter Conlin**<br>**Counsel to the Commissioner**<br>California Department of Insurance<br>Policy & Regulations Branch<br>300 Capitol Mall, 17th Floor<br>Sacramento, CA 95814<br><br>Email: ConlinP@insurance.ca.gov | **Leo Lara**<br>**Project Manager**<br>California Department of Insurance<br>Statistical Analysis Division<br>300 South Spring Street, 14th Floor<br>Los Angeles, CA 90013<br><br>Email: laral@insurance.ca.gov |

**NON-COMPLIANT COMPANIES:** Companies that fail to submit a completed IRI-2010 Supplemental Filing by the due date requested will be considered in non-compliance and will be referred to the Department of Insurance's Legal Division for further action.

Sincerely,

Adam M. Cole
General Counsel

# CALIFORNIA DEPARTMENT OF INSURANCE
# LIST OF COMPANIES DOING BUSINESS WITH THE IRANIAN PETROLEUM/NATURAL GAS, NUCLEAR, AND DEFENSE SECTORS
# (AS OF FEBRUARY 9, 2010)

| | |
|---|---|
| 1. ABB Ltd. [Switzerland] | 26. Linde AG [Germany] |
| 2. ACS, Actividades de Construccion Y Servicios, S.A. [Spain] | 27. Lukoil OAO [Russia] |
| 3. Alstom [France] | 28. Oil & Natural Gas Corp. (ONGC) [India] |
| 4. Ashok Leyland, Ltd. [India] | 29. OMV [Austria] |
| 5. Aker Solutions [Norway] | 30. PetroChina Company Limited [China] |
| 6. China National Petroleum Corp. [China] | 31. Petrofac Limited [United Kingdom] |
| 7. China Petroleum & Chemical Corp. [China] | 32. Petroliam Nasional Bhd (Petronas) [Malaysia] |
| 8. CNOOC Ltd. [China] | 33. Petronas Gas Bhd [Malaysia] |
| 9. CNPC (Hong Kong) Limited [Hong Kong] | 34. PT Citra Tubindo Tbk [Indonesia] |
| 10. Daelim Industrial Co., Ltd. [South Korea] | 35. PTT Exploration & Production PCL (PTTEP)[Thailand] |
| 11. Dragon Oil PLC [Ireland] | 36. PTT Public Company Limited [Thailand] |
| 12. Edison Spa [Italy] | 37. Ranhill Bhd [Malaysia] |
| 13. Eni S.p.A. [Italy] | 38. Repsol YPF [Spain] |
| 14. Everest Kanto Cylinder Ltd. [India] | 39. Royal Dutch Shell Plc [United Kingdom] |
| 15. Finmeccanica SPA [Italy] | 40. Sasol Limited [South Africa] |
| 16. GAIL (India) Limited [India] | 41. Siemens AG [Germany] |
| 17. Gas Natural SDG [Spain] | 42. StatoilHydro ASA [Norway] |
| 18. Gazprom Neft [Russia] | 43. Tatneft [Russia] |
| 19. Gazprom OAO [Russia] | 44. Technip S.A. [France] |
| 20. GS E&C (Engineering & Construction) [South Korea] | 45. Trevi-Finanziaria Industriale S.p.A.(Trevi Group) [Italy] |
| 21. GS Holdings Corp. [South Korea] | 46. Total S.A. [France] |
| 22. Hyundai E&C (Engineering and Construction) Co., Ltd. [South Korea] | 47. Welspun-Gujarat Stahl Rohren Limited [India] |
| 23. Hyundai Heavy Industries [South Korea] | 48. Worley Parsons Ltd. [Australia] |
| 24. Ina-Industrija Nafte DD [Croatia] | 49. Ulan-Ude Aviation Plant JSC [Russia] |
| 25. Indian Oil Corporation, Ltd. [India] | 50. ZiO-Podol'sk OAO [Russia] |

**CALIFORNIA DEPARTMENT OF INSURANCE**
**SUPPLEMENTAL LIST OF COMPANY DOING BUSINESS WITH THE IRANIAN ENERGY SECTOR**
**(AS OF APRIL 16, 2010)**

The Department's February 9, 2010 list is supplemented with the following company:

51. Shell International Finance B.V.

# Exhibit I

**Insurers Overview**

Insurers

- Applications, Forms & Filings
- Bulletins & Notices
- Programs
- Officially Filed Reports of Examination

OASIS

Legal Information

Data & Reports

COIN

P&C Rate Filing

Individual Health Rate Filings

**Quick Links**

-For Insurers-

## INSURERS: SUPPLEMENTAL FINANCIAL FILING ON IRAN RELATED INVESTMENTS (IRI-2010)

The purpose of this Website is to provide your company with the information and related forms needed for the supplemental financial filing on investments in companies doing business with the Iran energy, nuclear and defense sectors.

**The following sections of this Website contain information regarding the IRI-2010.**



### Regulatory Authority

On February 10, 2010, Insurance Commissioner Steve Poizner sent a letter to all insurers holding a certificate of authority to transact insurance in California: (1) listing companies doing business with the Iranian energy, nuclear and defense sectors ("List"); (2) informing insurers of the treatment of investments in those companies on insurers' statutory financial statements; and (3) requesting a moratorium on future investments in companies on the List and their 50% or more owned affiliates.

Effective March 31, 2010, the Department treats all insurer investments in companies on the Lists as non-admitted. At the request of insurers, the Department modifies its prior statement that investments in affiliates owned 50% or more by companies on the List will be disqualified. Statement disqualification will not apply to those affiliates.

**Statement disqualification will apply only to investments in the 51 companies on the Lists.**

A copy of the List is provided in the following sections of this Webpage. Also provided in this page is a supplemental list identifying an additional company doing business with the Iranian energy, nuclear or defense sectors.

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### List of Companies Doing Business in Specified Iranian Economic Sectors

The Department has developed a list of companies doing business with the Iranian oil and natural gas, nuclear, and defense sectors. Select the link below to view the list of companies.

- List of Companies Doing Business with the Iranian Energy, Nuclear, and Defense Sectors
- Supplemental List of Companies Doing Business with the Iranian Energy, Nuclear, and Defense Sectors

The Department may in the future revise the list by adding companies found to be doing business with the Iranian oil and natural gas, nuclear, and defense sectors; removing companies that cease doing business with those sectors; or making changes based on other risk-related considerations.In addition, the List currently does not include banks.

Based on subsequent research, analysis and consultation, the Department may supplement the List to include banks doing business with the Iranian oil and natural gas, nuclear, and defense sectors.

### Who is Required to Report?

The IRI-2010 reporting requirements pertain to **All California Admitted Insurers**

The following link will provide you with a list of companies identified as subject to the IRI-2010 Supplemental Financial Filing: Admitted Insurers Subject to IRI-2010 (source: California Department of Insurance, IDB Database)

### Non-Compliance

Companies that fail to submit a completed IRI-2010 Supplemental Financial Filing by the due date requested will be considered in non-compliance and will be referred to the Department's Legal Division for further action.

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**Download IRI-2010 Reporting Forms**

Select the link to access required forms:

**2010 - 1st Quarter ** Due May 31, 2010 ****
2010 - 2nd Quarter ** Due August 15, 2010 **
**2010 - 3rd Quarter**
**2010 4th Quarter**

**Special Instructions for Microsoft Excel 2007 Users:**

Entering Data and Saving the File:

- Underneath the toolbar/menu bar, you will see "Security Warning Macros have been disabled" and an "Options" button.
- Select the "Option" button.
- A new window will open "Security Alert - Macro" which show two options. Please select "Enable this content." Then Select "OK."
- After you have entered your information onto the data workbook file, please make sure that you use the "File/Save As" feature on your toolbar/menu bar.
- Select "**Save As**"
- Choose "Excel 97-2003 Workbook"

NOTE: Please do not "save" your file in MS Excel 2007 format, as the department will be unable to open, process and load your company's information. **Files Saved Under Microsoft 2007 (*.XLSX) Format Will Be Returned and Applicable Penalties May Apply.**

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**IRI-2010 CONTACTS**

Questions regarding the reporting instructions or data workbook, please contact:

**California Department of Insurance**
**Statistical Analysis Division**
**Leo Lara, Project. Mgr.**
**300 South Spring Street, 14th Floor**
**Los Angeles, CA 90013**

Leo.Lara@insurance.ca.gov

Question regarding substantive matters, or legal requirements, please contact:

**California Department of Insurance**
**Policy & Regulations Branch**
**Peter Conlin, Counsel to the Commissioner**
**300 Capitol Mall, 17th Floor**
**Sacramento, CA 95814**

Peter.Conlin@insurance.ca.gov

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**2010 - 1st Quarter**

The links provided below will allow you to download the IRI-2010 forms and related instructions.

**IRI-1Q-2010 Circular Letter[1]**

**IRI-1Q-2010 Data Workbook[2] (Due May 31, 2010)**

Attention: Microsoft Excel 2007 - Users please read these special instructions: view special instructions.

[1] Adobe Acrobat Document - This document is in Adobe Acrobat (pdf) format. To download a free copy of Adobe Acrobat Reader, visit our: free document readers page.

[2] Microsoft Excel Document - These forms were saved as Microsoft Excel 2003 files. To download a free copy of Microsoft Excel Viewer, visit our: fee document readers pager.

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**2010 - 2nd Quarter**

The links provided below will allow you to download the IRI-2010 forms and related instructions.

**IRI-2Q-2010 Circular Letter[1]**

**IRI-2Q-2010 Data Workbook[2] (Due August 15, 2010)**

ATTENTION: Microsoft Excel 2007 - Users please read these special instructions: view special instructions.