



1-1-1989

The Impact of Proposition 103

George J. Alexander

Santa Clara University School of Law, gjalexander@scu.edu

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George J. Alexander, *The Impact of Proposition 103*, 29 SANTA CLARA L. REV. 521 (1989),
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**THE FUTURE OF TORT LITIGATION IN
CALIFORNIA
SANTA CLARA, CALIFORNIA, MARCH 11, 1989**

I. THE IMPACT OF PROPOSITION 103

A. *Essay—The Ramifications of Proposition 103*

George Alexander*

The battle over auto insurance rates proved to be the highlight of tort reform of the recent past. In its resolution, it involved all branches of state government and the people of the state as well. Everyone agreed that insurance rates, especially those for automobiles, were rising at an alarming rate. There was less agreement on the causes of the rate hikes. Spokesmen for the insurance industry indicated that the higher rates merely reflected higher costs,¹ while opponents claimed that the industry was making excessive profits. The insurance industry proposed limitations on litigation costs both by limiting recoveries for intangible loss and by limiting attorney fees.² Some were adopted. The insurance industry also suggested a form of no-fault insurance.³ The bar and some consumer groups proposed both more regulation and less protection of the in-

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* Professor of Law at Santa Clara University School of Law and Director of the school's Institute of International and Comparative Law; Dean of Santa Clara University School of Law 1970-1985; Professor and Associate Dean of Syracuse University School of Law 1960-1970; J.D., 1959, University of Pennsylvania; J.S.D., 1969, Yale University; author of *Commercial Torts* (1973, 2d ed. 1988), eleven other books and over fifty articles. Professor Alexander was of counsel to the Real Parties in Interest in *Calfarm Ins. Co. v. Deukmejian*. The author would like to thank Tim Barron and Christine Young, Editors of the *Santa Clara Law Review*, and Elizabeth Tweedie, his Research Assistant, for their assistance in writing this article.

1. Navarro, *Auto Insurance: Taking the Initiative, 100 & 103, Both Make Insurers Justify Rate Increase*, *San Francisco Chron.*, Oct. 30, 1988, at A18, col. 1.

2. CAL. BUS. & PROF. CODE § 6146 (West Supp. 1989).

3. Proposition 104, *Automobile and Other Insurance*. See, CALIFORNIA SECRETARY OF STATE, CALIFORNIA VOTERS PAMPHLET 102 (General Election, Nov. 8, 1988). See also Link, *What Happens if it Passes? The Insurance Industry's Initiative is More Than a No-Fault Measure*, *L.A. Daily J.*, July 25, 1988, at 4, col. 3.

dustry to curb profits.⁴ In a variety of forms, these proposals were arrayed as initiatives on the ballot in 1988 and Proposition 103 won by a narrow margin.⁵

Proposition 103 had many significant features. It removed the antitrust exemption of the insurance industry⁶ and subjected future rates to regulation by an elected commissioner⁷ among other things. Chief among its promoted features, however, was a provision which cut rates by twenty percent below their level on an earlier date.⁸ The initiative recited a finding that rates were excessive and that an across the board cut of twenty percent would result in reasonable profits.⁹ Proposition 103 also provided that the Insurance Commissioner could relieve a company from the rate requirements should the new rates put them in substantial danger of insolvency¹⁰ (a term that was not defined).

At the point of the passage of Proposition 103, neither the executive branch (through the power already delegated to the Insurance Commissioner with respect to rates)¹¹ nor the legislature had been able to achieve "reform" of the system. The initiative procedure provided a well-established process for "the People" to accomplish change more directly. After the passage of Proposition 103, the last remaining organ of government had its opportunity. The California Supreme Court's review of the initiative is the subject of this panel's discussion.

Although there are many issues surrounding the legality of Proposition 103, it is wise to eliminate the ones which are not in dispute. For example, it is clear that the immunity which the insurance industry had been given from antitrust enforcement could be revoked; the insurance industry did not bother to challenge that provision. The revocation merely subjects the insurance industry to the same rules of competition which most other industries face. Whether

4. See, e.g., Proposition 104, *supra* note 3.

5. Proposition 103 passed by a popular vote of 51%. San Francisco Chron., Nov. 10, 1988, at A1, col. 1.

6. Proposition 103, *Insurance Rates, Regulation, Commissioner*. See CALIFORNIA SECRETARY OF STATE, CALIFORNIA VOTERS PAMPHLET 98, § 3, at 99 (General Election, Nov. 8, 1988).

7. Proposition 103, *supra* note 6, § 4 at 140. At present, the California Insurance Commissioner is appointed by the Governor. CAL. INS. CODE § 12900 (West 1988).

8. Proposition 103, *supra* note 6, § 3, at 99.

9. Section 1 of Proposition 103 provides: "Enormous increases in the cost of insurance have made it both unaffordable and unavailable to millions of Californians." Further, section 2 indicates that the rates set will be "fair." Proposition 103, *supra* note 6, §§ 1-2, at 99.

10. Proposition 103, *supra* note 6, § 3, at 99.

11. CAL. INS. CODE § 12900 (West 1988).

it is wise to remove the exemption (and whether the removal was accomplished in a proper manner in this initiative), the People are free to revoke it. One cannot easily argue that it is unconstitutional for the People to require that the Insurance Commissioner be elected rather than appointed if they feel that the appointee has not served consumer ends.

Although arguments can be raised against public rate control of the industry, they are comparatively tame. Since the midst of the Great Depression of the thirties, courts have stopped interfering with public regulation of business on "due process" grounds.¹² There appears to be a uniform condemnation of the period dominated by the United States Supreme Court's *Lochner* opinion.¹³ With very rare exception, attempts to invoke that "due process theory" have failed in both the federal and state courts.

There is, however, a viable constitutional provision which bars confiscation without compensation.¹⁴ If the rate scheme in Proposition 103 amounted to taking the insurance companies' assets without compensating for them, it would be unconstitutional beyond cavil.¹⁵ The drafters of the initiative no doubt had that in mind when they provided for the exception in the event that the rate requirements created substantial threats of insolvency.

The insurance companies claim that Proposition 103 is based on misinformation and that it would cause confiscatory cutbacks. They claim that their present rates are justified by their expenses. The insurance companies also argue that a uniform twenty percent rate cut could not reasonably reflect appropriate rates, and the new rates would merely be arbitrarily chosen without a factual basis.¹⁶

The initiative, on the other hand, made legislative findings that insurance rates were excessive and that the cutbacks were reasonable. The electorate theoretically adopted those findings when they

12. See, e.g., *Williamson v. Lee Optical*, 348 U.S. 483 (1955); *Wickard v. Filburn*, 317 U.S. 111 (1942); *United States v. Darby*, 312 U.S. 100 (1941).

13. G. GUNTHER, *CONSTITUTIONAL LAW* 453-58 (11th ed. 1980) (discussing *Lochner v. New York*, 198 U.S. 45 (1905)).

14. Confiscation without compensation is barred under the "just compensation" clause of the Fifth Amendment as applied by the "due process" clause of the Fourteenth Amendment. U.S. CONST. amends. V and XIV.

15. The issue can be stated either in terms of "just compensation" or as a matter of "substantive due process." Both theories lead to a similar analysis. See, e.g., *Willcox v. Consolidated Gas Co.*, 212 U.S. 19 (1909); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

16. Petitioner's Brief on the Merits at 1-2, *Calfarm v. Deukmejian*, 48 Cal. 3d 805, 771 P.2d 1247, 258 Cal. Rptr. 161 (1989) (No. S007838) (D. Cal. filed Dec. 19, 1988).

enacted the measure.¹⁷

The real issue that needs to be resolved is whether the rates set by the initiative are reasonable. If they are, there should not be constitutional impediment to its adoption. Although one can make many arguments about specific deficiencies in the manner in which Proposition 103 was drafted, the voters should be able to adopt this measure or another one which achieves the same end. If they are confiscatory, the law violates constitutional protection.

Resolving the issue of what constitutes fair profits is the hot potato of the process. In fact, there is considerable disagreement even on the meaning, interpretation, or calculation of profit data. The insurance code considers the relevant measure of the profitability to be the "underwriting profit," that is the difference between total expenses, loss payments and other costs, and premiums.¹⁸ The insurance code totally disregards investment income, the profits earned on premiums in the period between their collection and their use to pay claims. Investment income is substantial.¹⁹ One begins examination of the question recognizing that there is even disagreement on its meaning.

Before Proposition 103, the insurance industry was exempted from antitrust laws²⁰ so market forces could not be relied upon to set fair rates. The insurance industry was theoretically subject to administrative review in that the Commissioner of Insurance had authority to regulate rates which were found to be "excessive, inadequate or unfairly discriminatory."²¹ In fact, the reason for the Proposition 103 provision requiring the Commissioner to be publicly elected was the belief that the appointed Commissioner was not exercising regulatory power.²² In fact, in the ten years preceding the suit, only one rate had been struck down by her office.²³

The legislature held hearings on insurance rates but was unable to agree on legislative insurance reform. The political balance be-

17. Real Parties in Interest Brief on the Merits at 7, *Calfarm v. Deukmejian*, 48 Cal. 3d, 805, 771 P.2d 1247, 258 Cal. Rptr. 161 (1989) (No. S007838) (D. Cal. filed Jan. 12, 1989).

18. CAL. INS. CODE § 1861.04 (West Supp. 1989).

19. Zonana, *Fuzzy Profit Picture Clouds Auto Insurance Measures*, L.A. Times, Oct. 30, 1988, at 1, col. 2.

20. CAL. INS. CODE §§ 1853, 1853.6 (West 1972). See, e.g., *California League of Indep. Ins. Producers v. Aetna Cas. & Sur. Co.*, 175 F. Supp. 857 (D.D.C. 1959).

21. CAL. INS. CODE § 1852(a) (West 1972).

22. Proposition 103, *supra* note 6 at 98.

23. Telephone Interview with Joel Laucher, California State Dep't of Ins. (Sept. 15, 1989).

tween the consumer interests and those opposing reform in the legislature tilted in the direction of the latter. A key issue on which there was no agreement was whether insurance rates were excessive.²⁴

The framers of several proposed initiatives undertook the reform process. The winning proposition expressly "found" rates to be excessive and mandated a roll back, one year rate freeze, and across the board percentage reduction as a cure. Recognizing the constitutional problem faced, it expressly provided for procedures to adjust rates after a one year freeze and allowed immediate relief through the Insurance Commissioner for those companies "substantially threatened with insolvency" in the interim. The hot potato was thus thrust back at the Commissioner.

The posture of the case before the California Supreme Court offers that court the hot potato. While there are numerous technical issues on which the court could resolve the case,²⁵ eventually it can anticipate having to resolve the question of whether the rate structure in Proposition 103 (or a later version of the same sort) is confiscatory. It can do that in a number of ways. The court can follow the most frequently adopted practice and dismiss the case until the law has gone into effect and plaintiffs can show actual rather than anticipated injury, and then judge whether the claimed injury was constitutionally permissible.²⁶ The court can evaluate the "legislative findings" that the new structure is fiscally adequate. The court can evaluate the ability of the Commissioner to give appropriate relief if rates are otherwise below the constitutionally permissible level. Ultimately, the court is likely to be the final arbiter. Furthermore, with a majority of the court facing a reconfirmation election in 1990 and the recent experience of removing justices because of unpopular stances on a single issue,²⁷ it is not without political pressure in deciding.²⁸

24. Zonana, *supra* note 19, at 1.

25. Some of the grounds which Plaintiffs suggested the court could resolve the case upon, among others, were a violation of the state constitution's express limitation on taxation and the inseparability of Proposition 103's various provisions, should any be found unconstitutional. Petitioner's Brief on the Merits, *Calfarm v. Deukmejian*, 48 Cal. 3d 805, 771 P.2d 1247, 258 Cal. Rptr. 161 (1989) (No. S007838) (D. Cal. filed Dec 19, 1988).

26. See *Kaiser Aetna v. United States*, 444 U.S. 164, 175 (1979).

27. Carlsen, *Bird Out, Cranston Wins: Reynoso, Grodin Also Defeated*, *San Francisco Chron.*, Nov. 5, 1986, at 1, col. 4.

28. Since this symposium was held, the California Supreme Court has ruled on *Calfarm v. Deukmejian*, 48 Cal. 3d 805, 771 P.2d 1247, 258 Cal. Rptr. 161 (1989). In its decision, the Supreme Court passed the "hot potato" back to the Commissioner and to the insurance industry. The court struck the substantial incompetency review as inadequate to protect against confiscation, announced that the constitution required a fair return on investment, and left it to

B. *Transcript—The Impact of Proposition 103*

1. *Introduction—Professor George Alexander*

Academic panels potentially suffer several problems: topics seem interesting when the program is planned, and then grow old and stale as time goes on. Worse yet, issues that seem to be problematic are resolved; however, those individuals who want to talk about them still have speeches to make. Expert speakers in the field make appearances and end up agreeing with each other. This results in a situation of speakers sitting through the panel nodding at each other while everybody in the audience just nods. At least this much I can promise about the upcoming panel: you will have none of the above. The issues involved in Proposition 103 go to the heart of tort reform as they center on substantive due process, a theory that has rarely been successfully invoked in recent times. The battle between economic reform and constitutional protection of property rights is certainly not limited to the insurance rate reform to be discussed today.

In fact, the current litigation is probably fairly well shaped by a case decided thirteen years ago, again based on an initiative which set rent control in Berkeley, the *Birkenfeld* case.²⁹ The court in that case stated "It is now settled California law that legislation regulating prices or otherwise restricting contractual or property rights is within the police power if its operative provisions are reasonably related to the accomplishment of a legitimate governmental purpose."³⁰ This indicates a very strong anti-interventionist standard in a case which, as many of you know, resulted in the initiative being declared unconstitutional. The 103 case will provide an important precedent to shape reforms of other sorts.

insurance companies to charge whatever rates they consider meet that standard. Since the rollback and reduction provisions were upheld, insurers risk having to refund excessive charges with interest. In the meantime, insurers are left to settle with the Commissioner what constitutes a fair return. *Calfarm v. Deukmejian*, 48 Cal. 3d 805, 771 P.2d 1247, 258 Cal. Rptr. 161 (1989).

29. *Birkenfeld v. City of Berkeley*, 17 Cal. 3d 129, 550 P.2d 1001, 130 Cal. Rptr. 465 (1976).

30. *Id.* at 158, 550 P.2d at 1022, 130 Cal. Rptr. at 486.

* We are indebted to Professor George Alexander for moderating this discussion.

** Partner Cotchett & Illston, Burlingame, CA; Board of Governors of the California State Bar Association (1972-1975); California Commission on Judicial Performance (1985-1989); L.L.B., 1964, Hastings College of the Law; lead counsel for the defense in *Calfarm Ins. Co. v. Deukmejian*; candidate for Attorney General of the state of California 1989.

2. *The Panelists' Discussion**

a. *Joseph W. Cotchett, Jr.***

As I look out in the audience, I see members of the judiciary, defense counsel, and plaintiffs' counsel. I do not think, George, that Proposition 103 really went to the heart of tort reform. While we are going to talk about Proposition 103 and its impact on California insurance law, if you will, or the tort program, I am not sure that Proposition 103 really deals with "tort reform." I don't want to get off on the subject of tort reform, but let me tell you in the bigger picture how I see 103.

First, let me tell you that during the recent hearing in the *Calfarm* case, I represented Harvey Rosenfield, Ralph Nader, and Voter Revolt. You will hear from the other panelists who they represented, but I had the role of defending the Proposition as written. This may come as a shock to Ralph sitting here. Was it written entirely the way we wanted it? Of course not. Could we have drafted it better? Of course. But the role that I was put in was to stand there, if you will, with Professor Manheim, and argue logically to the court that all of the provisions, tied in a bundle, could be held constitutional.

The insurance industry hired perhaps one of the finest trial lawyers, not just in the state of California, but in the country. He is a member of today's panel. I don't consider my good friend, Frank Rothman, to be a constitutional scholar. Rather, I consider him to be a very street-wise trial lawyer. The first thing he talked about in court the other day was the "bait and switch." You won't find that language in many constitutional cases. But you know what? It grabbed the attention of a number of supreme court justices. That is why the insurance industry hired Frank Rothman—he doesn't talk in legalese about footnote 32 of *Permian Basin*.³¹ Frank talks in language that people understand, that consumers understand, that justices of the supreme court understand. Following Frank Rothman's argument that the whole matter should be set aside as unconstitutional, came Attorney General John Van de Kamp's argument. He did an outstanding job of discussing the will of the People and the constitutional parameters.

That left us with twenty-two minutes. After fifteen minutes for Professor Manheim, also representing Voter Revolt, who spoke about footnote 32 of *Permian Basin* in a very scholarly way, I was

31. *In re Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

left with seven minutes to try and rebut everything that Frank Rothman said as to why Proposition 103 was unconstitutional. I tried to plug holes quickly, because I knew that Justice Kaufman was going to pounce on me. I had to quickly take the offense and say to the court: "Wait, stop. If you believe that a portion of Proposition 103 is unconstitutional, take a pen or take a pair of scissors and excise it." And I could see the smile coming on Frank Rothman's face as I said that. I said to the court: "Implement the will of the People. Uphold the entire bundle of insurance (and by the way, this is insurance reform, as I distinguished from tort reform); let it all stand if you can. If not, take a pair of scissors and cut out the unconstitutional parts." I saw clearly, as I am sure many other people did, that the court was disturbed by certain portions of Proposition 103. I am sure that Frank Rothman will talk about that when he addresses you.

The bottom line is that Proposition 103 is the tip of the iceberg. For you people who are here this morning representing the insurance industry, there is more to come. When I say there is more to come, I mean that even if the court in its wisdom excises certain portions of Proposition 103, I predict that the public will come back with a new version. A similar thing happened on the capital punishment issue; the will of the People was such that they kept coming back with initiatives and with laws until something was actually done. Bear in mind that the insurance premium bill keeps coming to your household. That awakens the public.

Somebody asked me the other day: "Is this the most important case of the decade?" I said: "Well, I don't know that it is the most important, but certainly, it is something that the public is looking at." And they said: "Well, what about Proposition 13?" I said Proposition 13 was fine as far as it went, but remember, not everybody owns a house. Not everybody owns a piece of property. There are hundreds of thousands of people in California who live in apartments. But they all have something in common. Virtually everyone in this state gets a bill for an insurance premium. Not everyone gets a tax bill for real property. But everybody wakes up one morning and finds a premium notice in the mailbox. So that is the difference between Proposition 13 and Proposition 103: Proposition 13 excited the people who owned property, but Proposition 103 excited everyone.

Frank Rothman made the very astute argument to the court that the public went into the booth and voted for Proposition 103 only because they wanted to get a quick check back the following day. Now, Frank compared Proposition 103 to the other propositions

that went down to defeat, like Proposition 100, and he said that the only real difference was that Proposition 103 would give the instant rebate.

I do not think that is a fact. The *Los Angeles Times* did an exit poll which showed that one out of every four people voted for Proposition 103 because Ralph Nader supported it. One out of every ten people voted for Proposition 103 because they felt there ought to be an elected Insurance Commissioner. Let me tell you that there are two things the insurance industry fears the most: one is the exemption from the anti-trust laws, which will cause them to open their books, and the other is the elected Insurance Commissioner.

Let me close by telling you what I see to be the impact of Proposition 103. I see Proposition 103 as a message from the people of this state saying: "Stop the merry-go-round. We want a fair shake. I can no longer pay \$2000 for insurance on my spouse's second car. I can no longer pay \$2000 for my apartment rental insurance."

I think Proposition 103 has now focused public attention on insurance reform. This will lead to positive tort reform. And if there are any plaintiffs' lawyers or other lawyers out there who do not think we need tort reform, they have their heads in the sand. We do know that there are phony accidents reported on the streets of Los Angeles. We do know that there are those few members of the medical profession who send phony bills. Good lawyers understand that the insurance industry is correct in saying that unless we clean up those problems, premiums are going to rise. It is a fact that we are going to have to live with. Unless we deal efficiently with the costs of our tort program, and unless we get to the heart of prevention, as Ralph was saying, we will not be able to reduce insurance costs over the long run. It is shocking to hear, for example, that the insurance industry would not support the 55 mile an hour speed limit. Both common sense and documented studies show what happens above 55 miles an hour in a collision.

I heard a statistic last night which I think is very significant. In America today, the wage of the average individual working is 70 times less than the wage of the executive in that same industry. The executive's salary is 70 times greater than the worker's salary. In Japan, the same comparison is only 7 times.

How does that relate to Proposition 103? It relates to the big economic picture that moved the public in the last election. Yes, Frank, they did vote their pocketbook, but what they said was: "Somehow, some way, we have to bring a semblance of order, a semblance of balance, because I simply can't afford these premiums any-

more." And I think when all is said and done, and when the supreme court speaks on Proposition 103, we are going to see a continued movement over the next few years in California and across the country. As Ralph said, it is going to move to the east. You can disagree with many of the things that Ralph or Harvey will say, but it is a fact that Proposition 103 is going to go across this land, in one form or another. Whatever the Supreme Court does the message is that somehow, some way, we are going to have insurance reform and we are going to have tort reform. The Ivan Boeskys of the world are not going to be allowed to run wild, with an economic system that does not allow a person to make reasonable wages and/or to buy insurance.

I will close with this. We look at insurance as private business, which it is, but as the *Egan*³² case makes clear, it is a business affected with a very real public interest. Because of this, the industry has been and must be regulated. When you turn on your tap water in the morning to shave, you know how the rates are set for your water. When you pick up your telephone and make a long distance call or a local call, you know how those rates are set because you have a right to go before the Public Utilities Commission and argue about them. When you turn on your lights, you know what your electrical bill will be at the end of the month, and if you do not like it you have a right to go before the Public Utilities Commission.

In *King v. Meese*³³ our supreme court said that when you leave this conference today, you cannot leave in a car unless you have insurance. In other words, you cannot turn on the tap, turn on the electricity, or use your gas, and at the same time you cannot drive your car, unless you have insurance. My friends, and I say to you with all due respect, the time has come when insurance companies have to understand that there must be a form of prior approval on their rates.

b. *Frank Rothman**

I hope, in the few minutes that I have allotted to me, I can make it clear that I am a lawyer and I am exceedingly proud of being a lawyer.

32. *Egan v. Mutual of Omaha*, 24 Cal. 3d 809, 598 P.2d 452, 157 Cal. Rptr. 482 (1979).

33. 43 Cal. 3d 1217, 743 P.2d 889, 240 Cal. Rptr. 829 (1987).

* Partner, Skadden, Arps, Slate, Meagher & Flom, Los Angeles, CA; Chairman of the Board and C.E.O. of MGM/UA Communications; L.L.B., 1951, University of Southern California; lead counsel for the plaintiffs in *Calfarm Ins. Co. v. Deukmejian*.

I am charged with the responsibility of reading the Constitution of California, the Constitution of the United States, as well as Proposition 103, and attempting to determine whether or not those three documents can be reconciled. While I think it is quite interesting, and indeed, important, to discuss sociological issues which Mr. Nader did so well this morning and which Joe just did a few minutes ago, there are, after all, in this country, a set of rules that we live by, rules we must live by, and rules which govern the law of the country. I do not know why we would ever conclude, as lawyers or as people interested in the application of the law, that simply because a majority of the people, in this case 51%, voted for a proposition that is automatically insulated with complete and full legality. To me that is as repugnant to our American way of life as anything could possibly be. What about the rights of the other 49%? Have we forgotten about that? And suppose, just suppose, that the public were to decide by a vote perhaps of 51% that indeed, all admissions to law school should be increased insofar as tuition is concerned, by 20%. Indeed, there are many people in America who are hungry and that is a great human tragedy. So will we put an initiative on the ballot that will require all grocery stores to cut their rates back to what they were in November of 1987, and then 20% on top of that? We would say to ourselves, you know, that it may be a good sociological concept, because people now can afford food, but what about our Constitution? What about the rights of those people who are affected by those cuts?

So I say to you this morning, as I hope I said to the supreme court, there is nothing to be ashamed of when you stand as a lawyer before a great court and argue the principles of constitutional law. You need not be ashamed because you are arguing a principle which seems to have been voted against by an uninformed and non-understanding electorate. On Tuesday, I read to the court a statement made by another court in California when it was about to examine the constitutionality of an initiative that had passed. If I read this very short passage to you, I will then be able to get into Proposition 103 and make some observations about it. The court in that case said:

It is well to be clear at the outset what this case is and is not about. First, the issue before the court is one of law, not policy; it is whether the Act is constitutional, not whether it is necessary or wise . . . this case is not about whether the will of the people shall be heeded. The Act is not the only relevant expres-

sion of popular sentiment in this case.³⁴

That court understood clearly that we are a government of laws.

Now let us look at Proposition 103. What did it do? The first thing it said was that all insurance rates, or substantially all, automobile, casualty, property damage, malpractice, were going to be cut back to rates in November of 1987. And then, just to stick it in a little bit, we are going to cut another 20%. Why 20%? Nobody knows. The people who sat down and drafted this, I suppose in some dark alley some place, could have chosen any percentage and they chose twenty. So you have to roll rates back down to November of 1987, and then you have got to take off 20%, no matter who you are. You could be an auto casualty insurer, you could be a property insurer, fire insurer, it did not matter. They did not care. The word is *arbitrary*.

The drafters of Proposition 103 then said: "Now that you have got this tremendous cut, we are going to protect you if you get hurt. If you get hurt by this in the first year you can come in and ask for relief. But in order to get relief you have to show that you are threatened, substantially threatened by insolvency." Well, isn't that nice? Mr. Cotchett stands up and says we must figure out a way to see that insurance companies get a fair return on their capital. Now we find ourselves knocked back twenty-odd percent, and we are told if we want any relief in that first year, we must show that we are substantially threatened with insolvency.

Ladies and gentlemen, lawyers, prospective lawyers, the Constitution protects against that kind of conduct. That is a confiscatory taking. That violates due process of both the California and the federal Constitutions. But I respectfully submit that under any sense of fairness you might ask yourself what in the world were these drafters thinking about? I want to leave you on this subject with one thought. There has never been a case cited in the history of American jurisprudence which permitted an arbitrary rate roll-back such as we have in Proposition 103.

Now, the drafters of Proposition 103 were not satisfied. They had not stuck it to the insurance companies enough yet. So they said "Any policies that you have in effect must always be renewed. They can never be cancelled." The drafters then set forth some reasons for why you could cancel, but essentially the policies are permanent. The drafters went one step further. "We have cut you back; we have

34. *People's Advocate, Inc. v. Superior Court*, 181 Cal. App. 3d 316, 322, 226 Cal. Rptr. 640, 642 (1986).

ripped you apart; we have given you this insolvency standard; you cannot cancel. Now when a good driver applies for insurance, (anybody who has had only one ticket in three years) his or her rate must be 20% lower than anybody else.”

In the Constitution of the United States and in California there is a provision which protects us against the impairment of contracts. The insurance companies wrote policies prior to the enactment of Proposition 103 which said that you are insured for a period of time, either six months or one year. Under California law, at the end of that period, either six months or a year, the insurance companies had the right, if they chose, not to insure you again. That was their decision. Now the companies are told under Proposition 103, despite the fact that you entered into those policies under those considerations, that they do not count anymore. You are stuck with those policies. Forever! We respectfully argued to the supreme court that that was an impairment of our contract right. It is the equivalent of you sitting down today and entering into a contract in which you employ me for six months. I agree to work for you for six months and then tomorrow a law is passed that says you must employ me for one year. It cannot be done.

Now, after all of these things happened, and all of these things were pointed out in various briefs, lawyers on the other side said “Well, maybe this was drafted too hastily. Maybe the people who drafted it were not lawyers. Maybe the people who drafted it got a little overtaken with their zeal and things like insolvency were wrong. So why don’t we just knock out all the bad parts and save the good parts. In law, this is severability.” I suppose that has some kind of surface interest.

I am not going to discuss with you the provisions of Proposition 103 that deal with taxation or the provisions of 103 that deal with the creation of a private corporation and their effect on severability. But what I will say to you is this, and I would like to leave on this note. It is sometimes helpful to step back and say: “Well now, what do we have here?” And if there is any fair-mindedness in the world, you will all say: “I am convinced that Proposition 103 was presented to the voters of California as a proposition which would return to you 20% on your insurance. That is why people accepted Proposition 103.” The pages and pages of Proposition 103 dealing with antitrust exemptions, dealing with banks going into the insurance business, dealing with rebates being allowed, repealing fifteen sections of the previous code were not understood by the average voters. I suspect many of you very sophisticated people do not even know what I

am talking about.

The fact is, the People went to the polls and voted for 103 because they wanted that rebate. And if those 51% now find out that the rebate is unconstitutional, it is fair, I believe, to conclude that nobody knows what would have happened to the balance of that initiative. It should not be severed.

While I do not want to infringe on anybody else's time here, I did use the expression "bait and switch" before the court. I used it because I was very concerned about the problem. You should be too. The problem is our initiative process, which leads to this kind of a situation. Someone with bad motives can put on the ballot, by way of initiative, a bill that provides that all schools in California shall be free, knowing full well that that might be unconstitutional. Then he or she may slip many other things in small print onto the ballot. When the People pass it because they are so interested in free schools, and the court rules that the free school provision is unconstitutional, their answer is: "Save everything else. Sever it." That is a bait and switch. It does not serve us well to have that kind of a initiative process.

And so I say, in conclusion, while I do not mean to suggest that I speak to an audience who is happy about losing rebates, you will be far better off when the Constitution of this state is carried forward in the manner in which it was intended.

c. *Assistant Attorney General Michael Strumwasser**

I am Michael Strumwasser, however, at the moment you may wish to think of me as Rod Serling. I am the fellow who comes on at the end of an episode of the "Twilight Zone" to tell you that everything you just heard was fiction, to reassure you that gravity does, indeed, pull down, that the sky is up, and that the People can, in fact, adopt insurance reform.

Now I do not propose to respond in detail to each of the comments of the other panelists, but several things that Mr. Rothman said require a response. In doing so, I hasten to add that I have great admiration for Mr. Rothman, who is not only a superb lawyer but also a man of principle who is concerned about many of the same issues that trouble us all.

First, he suggested that somehow, in the process of briefing and

* Special Assistant to California Attorney General John Van de Kamp, advising on a wide range of regulatory, environmental and tort reform issues; J.D., 1973, University of California, Los Angeles.

argument, the proponents of Proposition 103 and the Attorney General conceded that portions of the initiative are unconstitutional. That is simply not true. Attorney General Van de Kamp said unambiguously to the supreme court that the entire initiative, every provision of Proposition 103, can and should be upheld.

The other statement by Mr. Rothman that I wanted to respond to is his description of the voters as an "uninformed, non-understanding electorate." On the contrary, the electorate was well informed, and knew exactly what it was doing.

If you begin with the assumption that the electorate was misinformed, you may claim support for that proposition from the inherent sparseness of any initiative and its supporting documentation. Fortunately, that is not where you begin constitutional analysis of an initiative. You begin with the presumption that the initiative is not only constitutional, but that it is based on findings by the voters of every fact necessary to uphold the legislation. Only if there is no conceivable set of facts that would justify the initiative's provisions could the court disregard the voters' findings.

The fundamental finding of the voters was that the insurance industry had been lavished with special interest laws that left the companies unregulated, sheltered from competition, and protected from the grievances of their customers, customers who sometimes were delivered to the companies by the law itself. The voters found that this legal environment had created a hothouse of inefficiency and that rates were at least twenty percent higher than they would have been in a regulated, competitive environment.

Therefore, they adopted the reform that follows logically from that finding. To prevent anticipatory rate increases during the campaign, they rolled rates back to November 1987 levels. Then, to correct for the deficiencies of the legal environment, they reduced rates twenty percent for one year. In effect, they were putting insurance companies on a one year diet to shed their accumulated fat. After the year, the public provided a strong system of rate regulation, in which the companies are prohibited from charging rates that are excessive, inadequate, or unfairly discriminatory. However, to make sure that the insurance companies can make it to that promised land, the voters wisely provided in the interim that any company substantially threatened with insolvency could obtain relief from the Insurance Commissioner.

Manifestly, the court could not find that there is no conceivable set of facts to support the people's findings. However, the Attorney General did not want to leave that to chance, so we provided the

court with evidence, in the form of a declaration by J. Robert Hunter, Federal Insurance Administrator under two presidential administrations, demonstrating that the People were entirely correct in their finding that rates were excessive by at least that amount and required a legislative reduction.

Rather than further numb you with the legal issues, I would like to turn briefly to the question of how Proposition 103 will be implemented, on the assumption that the initiative is upheld by the California Supreme Court. In particular, I would like to discuss what I consider to be the most critical issue in determining whether Proposition 103 will realize its promise of insurance reform, what I will call "normative ratemaking."

Around the country, most states regulate insurance rates. Until Proposition 103, California had been the only industrial state that did not. In most of those states, the companies have become the masters of regulation. The way they get rate hikes is to show the Insurance Commissioner that they have spent a certain amount of money and to ask for rates to recover that amount. Their philosophy is: "We spent it, we are entitled to it." If Proposition 103 is implemented in that spirit, it will become a little more than a vacuum cleaner to suck dollars from consumers' pockets.

In order to make Proposition 103 work, the Insurance Commissioner must ask the hard questions about the insurance company expenditures. For example, why is it that the average California insurer spends about 32 cents per passenger premium dollar on administrative overhead while USAA spends only 20 cents and consistently is found by Department of Insurance studies to provide a high quality of service? Why is it that the Insurance Commissioner, in her annual survey of selected rates, found that a male driver in his twenties in Compton can get insurance from Mercury for \$1,000, while Aetna charges the same driver, in the same vehicle, \$3,000 for the same coverage?

Those of you familiar with the demography of Southern California may suspect the answer lies in the population characteristics of Compton. It may be that Aetna simply does not want to sell insurance to the kind of people who live in Compton. If that is true, it illustrates the wisdom of another of Proposition 103's provisions, making the Unruh Civil Rights Act applicable to insurance companies for the first time.

Now I must tell you that the concept of normative ratemaking, of telling insurance companies how much they reasonably should be spending rather than leaving it to the companies' unfettered discre-

tion, will not come easily to the Insurance Commissioner. She comes from the insurance industry, and she believes that the only people who know how to run an insurance company are those who run the companies. That is a common reaction to the intrusion by outsiders into an area of claimed expertise. Ralph Nader spoke of that phenomenon earlier, the reaction of manufacturers and doctors to having lawyers interrogate them on their business. It is more than just a question of dollars; it is a cultural barrier to reform.

But in the implementation of insurance reform, the insider philosophy of deference to the judgment of the company is simply at odds with the fundamental philosophy of Proposition 103.

Now in the remaining few minutes I would like to address the other topic on the conference's agenda, tort reform. The unspoken assumption of this conference is that Proposition 103 may represent, in some cases, a model for tort reform just as it has been a model for insurance reform. I would like to explicitly address that assumption, and to do so with a hypothetical. "Hypothetical" is the kind of word a bureaucrat uses when he is attempting to achieve deniability.

So let us hypothetically consider application of Proposition 103 to the most frequently addressed topic of tort reform, attorney's fees. We learned last year during the campaign that a plaintiff's attorney gets forty percent of any recovery. So let's roll that back to November 1987 levels. Forty percent. Now, let's reduce that level by twenty percent. Twenty percent of forty percent is eight percent, so we would roll contingency fees back to thirty-two percent. Interestingly, that is within one and a third percent of a figure Ralph Nader told you should be the maximum contingency fee that should be permitted.

During the first year of this rollback, lawyers would be excused if they could persuade the judge that they were substantially threatened with insolvency. And, after the first year, a lawyer dissatisfied with a fee could seek to have it changed if he or she thought the resulting figure was excessive, inadequate, or unfairly discriminatory.

Obviously, not many plaintiffs' lawyers are going to complain that their rates are excessive. They could complain that their rates are inadequate, and the court could rule upon that claim. What about "unfairly discriminatory?" How would that work?

Well, in every lawsuit, there will be at least two lawyers. If the thirty-two percent contingency fee produced a sum that was less than the defendant's attorney collected, for a fee that did not depend on the outcome of the case, the plaintiff's attorney would have a good

claim that his or her rate was discriminatory. That is the point that all fee-limitation bills, all attorney's fees initiatives ignore. But without recognition of the important relationship between plaintiff's and defendant's attorney's fees, such legislation will amount to little more than unilateral disarmament for accident victims.

So there you have it, Proposition 103 as a model for tort reform. If you like it, you are welcome to it. But just remember, you did not hear it here.

d. *Justice Otto Kaus**

I shall state my bias and interest at the outset. My firm, although I myself am only tangentially involved, represents the Automobile Club of Southern California, which has filed an action in superior court attacking Proposition 103. However, whatever I say here today represents my own views and not necessarily those of my client. In any event, I really do not want to talk about the issue that is shaking up everybody, whether or not Proposition 103 or parts thereof are unconstitutional. However, I do want to use Proposition 103 as a case study in the defects of the initiative process.

As you all know, California has been in the grip of initiatives, most of them launched by what I would call the populist right, such as Proposition 13, Proposition 8, and the Gann spending limit. Some initiatives coming from the same direction never made it to the ballot such as the Sebastiani Reapportionment Initiative or the so-called "Balanced Budget" initiative. One that did make it to the ballot was the most pernicious of all; it would have cut the pension of retired judges. We beat that one. Then there were two AIDS initiatives launched by Lyndon Larouche, both of which were defeated.

I would like to look at Proposition 103 from points of view which seem to be peculiar to the initiative process. First, the *ex parte* nature of the proceeding and second, the number of uncertainties, almost deliberate uncertainties. Lastly, I would like to expose the myth that Proposition 103, or that indeed any initiative, represents the will of the People. That does not mean it is not legal. I am perfectly willing to play by the rules of the game. But the idea that Proposition 103 represents the considered will of the People just does not hold up under scrutiny.

* Partner, Hufstedler, Miller, Kaus & Beardsley, Los Angeles, CA; Associate Justice of the Supreme Court of California 1981-1985; Justice of the Second District Court of Appeal 1964-1981; Judge of the Superior Court for Los Angeles County 1961-1964; L.L.B., 1949, Loyola Marymount University, School of Law.

First, consider the *ex parte* nature of an initiative. Obviously if a private citizen, such as Mr. Nader or Mr. Rosenfield, launches an initiative effort like Proposition 103, the insurance industry, which is the target so to speak, does not get an opportunity to present its case to the authors. I dare say, even if it were given an opportunity, it would not take it. Now, if a proposed law were before the Legislature, at least the industry would get a hearing. Naturally, it would not prevail on all points, but it would be able to make certain points which might ameliorate the legislation or at least make it workable.

With respect to Proposition 103, if the insurers had cooperated in the drafting and seen the handwriting on the wall, I think they might have said to the proponents: "All right, if you are going to make the driving safety record of an individual the criterion for the premium that he or she is charged, then will you please put in some provisions as to how we can find out about that driving record." Keep in mind that the insured under an automobile policy is not necessarily the owner of the car. Under the omnibus clause, which is mandatory for every automobile policy, in a home with four teenage sons, the insured is each one of the four teenage sons.

The same problems will arise with respect to the good driver discount. How do we find out what the record of a particular person is so that he may be entitled to that discount? Incidentally, I have heard estimates that about 85% of the drivers in California may qualify for that discount. How do we determine whether a person has become a worse risk than he was when he originally applied for and received a policy, so that we can cancel him, permissibly, even under Proposition 103? We have no subpoena power with respect to the insured and we depend on the good faith and cooperation of the insureds in letting us have that information.

If the insurance industry had helped draft this statute, it would have had something to say about section 1861.10, which says that any person may initiate or intervene in any proceeding permitted or established by Proposition 103, challenge any action of the Commissioner, and enforce any provision of this article.³⁵ Does that make everybody a cop?

I dare say that it is just bad writing, but the insurance industry could have conveyed the experience it had, for example, with the *Cumis*³⁶ case. It is an innocent enough case, which says that when an

35. CAL. INS. CODE § 1861.10 (West 1989).

36. San Diego Navy Fed. Credit U. v. Cumis Ins., 162 Cal. App. 3d 358, 208 Cal. Rptr. 494 (1984).

insured is sued on two causes of action, one of which is covered, one of which is not covered, then the insurance company must pay independent counsel to represent the insured so that the attorney hired by the insurance company cannot steer the plaintiff in the direction of the uninsured cause of action.³⁷ That is all very well and good, but there has been incredible abuse. Section 1861.10 is an invitation, it seems to me, to unscrupulous people to make a fast buck for themselves, rather than achieve something worthwhile for the public.

Now, about the uncertainties. Having been on the bench for twenty-four years, I have struggled with my share of poorly worded legislation, but the disease seems to be particularly virulent in the case of initiatives. I have run into the death penalty initiative with typographical errors and cross-references to wrong sections. Proposition 8 had one goof which luckily was so obvious that one could easily correct it because one knew what the authors meant to say. It had another possible goof which was not nearly so obvious. In step with that tradition, Proposition 103 reads to me like a first draft of a statute that you have after a meeting when you have decided what you want to achieve. So many terms are not defined that it reaches the point where the uncertainty becomes overwhelming.

What is the meaning of the phrase "substantially threatened with insolvency"? What are "similarly situated risks," a phrase that applies to new business when you do not know what to charge them by way of rates? What is a "moving violation"? Is it the same as the violations listed in Insurance Code section 11828(3)C(2)? Who knows? But whether or not you have been convicted of more than one moving violation in the last three years determines, in part, whether or not you get your 20% good driver discount. Proposition 103 says that while applications for increased rates may be made before November 8, 1989, the Commissioner may not approve them until then. Can she signal approval? If the approval of the new rate is not announced until November 8, 1989, you cannot put it into effect, I am told, for about six weeks. So that should have been clarified and probably would have been if the industry had been consulted. I personally believe it means that you can announce it, but that it does not go into effect. Why not say so? What is a "substantial increase in the hazard," another phrase in Proposition 103? Rate review, starting in November of this year, must result in rates which are neither excessive or inadequate. That is like being not too good or not too bad. What does it really mean?

37. *Id.* at 361, 208 Cal. Rptr. at 496.

Finally, and this seems to me to be schizophrenic, in the area of rating classifications, the Unruh Act,³⁸ and Proposition 103 simply cannot co-exist. Please understand I have absolutely nothing against making the Unruh Act applicable to practices such as red-lining. However, insurance rates are based on actuarial predictions. Proposition 103 tells us that in rate setting the insured's driving safety record is to be paramount. All right, fine. We have discussed the problems of finding out about the insured's driving safety record. But let's assume that we can do it. You are still going to have a premium for that particular group into which the insured belongs, good drivers, bad drivers, medium drivers, and so on. You cannot have a different premium for every insured. Yet the Unruh Act is based upon the proposition that each living human being is an individual. A landlord cannot forbid Adam Wolfson from living in the Marina Point apartment complex because he belongs to a class which is actuarially a damn nuisance in an apartment building, namely, kids. You have to look at the particular child. This kind of individualized treatment is simply impossible in setting insurance premiums.

Actually, today in California we have permitted discrimination in rate setting. For example, Insurance Code section 11628, the so-called Rosenthal-Robbins Auto Insurance Non-Discrimination Law, does not prohibit premium discrimination in automobile insurance based on sex. The Rosenthal Law also allows discrimination between localities; it just does not permit discrimination within a locality, a very carefully defined concept. Finally, it allows differential rates for handicapped drivers if there is actuarial evidence to support the differential. Query whether you can get away with any of that under the Unruh Act.

The problems of reconciliation between the Unruh Act as it applies to rating and the powers of the Commissioner under Proposition 103 and existing statutes are going to be enormous. I have to believe that the Legislature would have been more careful. Again I submit that the process of legislating through initiative has certain inherent defects, which unfortunately have not been avoided.

Finally, I believe that the "will of the People" argument is much more of a myth in the field of initiatives than the "will or intent of the Legislature" argument is in the area of statutes. I understand the latter is also, to some extent, mythical. But at least you have, if not legislators, trained staff members going over these things, knowing what they are doing and telling the boss: "That's all right,

38. CAL. CIV. CODE § 51 (West Supp. 1987).

Senator, you can vote for that.”

Let me ask you a few questions. As people emerged from the voting booth last November, was it their will that Government Code section 6254(d) not be applied to Proposition 103? Probably not, because Government Code section 6254(d) is not anywhere in Proposition 103, not even in one of the repealed sections. The voter would have had to find a set of statutes to find out what he was not making applicable. Was it really the People’s intent to repeal Article 5 of the Insurance Code relating to unlawful rebates? Here you could at least say that they had the repealed law right in front of them. In fact, they had pages and pages of material that were hyphenated out, if they could read it. I had to enlarge my copy of Proposition 103 in order to read what we repealed in November.

Was it really the People’s intent that the Commissioner was to accept, amend, or reject rating decisions only under the provisions of sections 11517(a) and (e) of the Government Code? They were not told what was in those sections. Subsection (e) doesn’t even apply to accepting, amending, or rejecting decisions; it applies to publishing them.

Was it the will of the People that section 11513.5 of the Government Code apply to the Commissioner? That section which makes a lot of sense, because it puts upon an administrative law judge the same duties of confidentiality as those on a real judge. However, when the Insurance Commissioner acts as an agent in administrative proceedings, she just isn’t a judge. She is an administrative agent subject to all of the restraints and possessed of all the freedoms of a member of the executive. If you look at section 11513.5 very carefully, you will see certain concepts which simply cannot be applied to a Commissioner of Insurance.

Was it the will of the People that judicial review be in accordance with section 1858.6 of the Insurance Code? That section was certainly not before the People. I had to look it up. It provides for what amounts to a trial de novo on the record in the superior court, which has full power to make fact findings even though there is substantial evidence to support the findings of the Commissioner and the administrative law judge. Just think what this is going to do to rate applications which are displeasing to somebody; either the insurance company, the corporation that is to be formed, or to any one of the 25 million ombudspersons that have been created by Proposition 103.

Was it the will of the People that Proposition 103 not apply to lines of insurance listed in section 1851? Section 1851 was not before

the People. Sure, if you want to know what lines of insurance it does not apply to, you can look it up, but how many voters did?

When professionals, however defective their aims, goals and methods may be, get down to the job of legislating they at least bring a certain amount of technical expertise to the process. If Proposition 103 does nothing else than to spur a movement to improve the process of legislating by initiative, it will have served a very worthwhile purpose.

e. Panel Discussion

Joseph W. Cotchett, Jr.

Justice Kaus said to you: "They didn't have a chance to present their case. They spent \$70 million presenting their case and lost it." He also said that the anti-trust laws applying the unfair business practices to insurance companies is like apply anti-trust laws to OPEC? However, a federal court has just said in Philadelphia that the only reason we can't apply antitrust laws to OPEC is because we can't get jurisdiction over them. "And I question that," so said that judge, "because I think if they do business here we can get jurisdiction over them." And there are 600 insurance companies that do business in California and the anti-trust laws can apply to them as well.

Frank Rothman

It is interesting to listen to the great jury lawyers, and those who are, I suspect, embarking on political campaigns, to quickly forget that we still have obligations to the law. Now, it does not make any sense to talk about the will of the People for this, or the will of the People for that. We have here a statute. It has four corners to it. As the Attorney General and everybody on the other side has been saying, they're all functionally inter-related. One is related to the other. And they're now asking the court to take out a red pencil, a blue pencil, a green pencil and five or six erasers and try to rewrite this mess. Lawyers do not talk that way.

Now we have been threatened this morning. When this court finds this to be unconstitutional, Mr. Cotchett says, we will get another initiative. Well that is fine. But let's learn from this one. Let me leave you with one last thought. In the Berkeley case that was decided by the supreme court which was alluded to this morning,

*Birkenfeld*³⁹ is its name, the court found that rent control initiative to be unconstitutional. It refused to sever any provisions and knocked out the entire statute. Then the voters went back and created a new rent control initiative, but they did it right. They learned from *Birkenfeld*. Then the supreme court in *Fisher*,⁴⁰ the follow-up case, said now we hold the statute to be constitutional because every vice we found in *Birkenfeld* has now been corrected. The law has been satisfied.⁴¹ And so Mr. Rosenfeld, wherever you are, and you drafters, wherever you are, listen carefully, learn, and if you are coming back a second time, do it right. Thank you.

Justice Otto Kaus

I am sorry I was obviously quite misunderstood. I never said that Proposition 103 was unconstitutional, certainly not for the reasons that I brought up. I simply talked about Proposition 103 as a statute which could have been much, much better if it had not been the product of the initiative process but had gone through the regular professional legislative process. There the "victim," the insurance company, would have been permitted to have a say. Even though the industry could not have swayed the proponents of the statute from their main goal, it could have corrected certain obvious deficiencies and uncertainties. Then, I simply directed myself to the proposition that the "will of the People" argument is somewhat fictitious, and even more fictitious in the area of initiatives than it is in the area of representative legislation. That does not mean that I am not willing to abide by the rules of the game that we live by. If an initiative passes by one vote, and all the people who voted in favor of it were dead drunk when they went to the polls, that's the way it goes. Thank you.

39. *Birkenfeld v. City of Berkeley*, 17 Cal. 3d 129, 550 P.2d 1001, 130 Cal. Rptr. 465 (1976)

40. *Fisher v. City of Berkeley*, 37 Cal. 3d 644, 693 P.2d 261, 209 Cal. Rptr. 682 (1984).

41. *Id.* at 690, 693 P.2d at 297, 209 Cal. Rptr. at 718.