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Record Nos. 6804, 6805

In the Supreme Court of Appeals of Virginia at Richmond

VIRGINIA STATE AFL-CIO v. Record No. 6804 COMMONWEALTH OF VIRGINIA, ET AL.

HENRY E. HOWELL, JR., ET AL. v. Record No. 6805 COMMONWEALTH OF VIRGINIA, ET AL.

FROM THE STATE CORPORATION COMMISSION

RULE 5:12—BRIEFS

§5. Number of Copies. Twenty-five copies of each brief shall be filed with the clerk of this Court and three copies shall be mailed or delivered by counsel to each other counsel as defined in Rule 1:13 on or before the day on which the brief is filed.

§6. Size and Type. Briefs shall be nine inches in length and six inches in width, so as to conform in dimensions to the printed record, and shall be printed in type not less in size, as to height and width, than the type in which the record is printed. The record number of the case and the names and addresses of counsel submitting the brief shall be printed on the front cover.

HOWARD G. TURNER, Clerk.

Court opens at 9:30 a.m.; Adjourns at 1:00 p.m.

IN THE

Supreme Court of Appeals of Virginia

AT RICHMOND

Record No. 6804

VIRGINIA:

In the Supreme Court of Appeals held at the Supreme Court of Appeals Building in the City of Richmond on Tuesday the 10th day of October, 1967.

VIRGINIA STATE AFL-CIO, Appellant,

against

COMMONWEALTH OF VIRGINIA AND NATIONAL BUREAU OF CASUALTY UNDERWRITERS, Appellees.

From the State Corporation Commission

Upon the petition of Virginia State AFL-CIO an appeal of right is awarded it from an order entered by the State Corporation Commission on the 23rd day of June, 1967, in a certain proceeding then therein depending, entitled: Application of National Bureau of Casualty Underwriters for a revision of automobile bodily injury and property damage liability insurance rates; upon the petitioner, or some one for it, entering into bond with sufficient security before the clerk of the said State Corporation Commission in the penalty of $500, with condition as the law directs.

IN THE

Supreme Court of Appeals of Virginia

AT RICHMOND

Record No. 6805

VIRGINIA:

In the Supreme Court of Appeals held at the Supreme Court of Appeals Building in the City of Richmond on Tuesday the 10th day of October, 1967.

HENRY E. HOWELL, JR., STANLEY E. SACKS, THOMAS W. MOSS, JR., GEORGE E. ALLEN, JR., CLIVE L. DUVAL, II, AND C. HARRISON MANN, JR., Appellants,

against

COMMONWEALTH OF VIRGINIA AND NATIONAL BUREAU OF CASUALTY UNDERWRITERS, Appellees.

From the State Corporation Commission

Upon the petition of Henry E. Howell, Jr., Stanley E. Sacks, Thomas W. Moss, Jr., George E. Allen, Jr., Clive L. DuVal, II, and C. Harrison Mann, Jr., an appeal of right is awarded them from an order entered by the State Corporation Commission on the 23rd day of June, 1967, in a certain proceeding then therein depending, entitled: Application of National Bureau of Casualty Underwriters for a revision of automobile bodily injury and property damage liability insurance rates; upon the petitioners, or some one for them, entering into bond with sufficient security before the clerk of the said State Corporation Commission in the penalty of $500, with condition as the law directs.

RECORD

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* * * * *

NATIONAL BUREAU OF
CASUALTY UNDERWRITERS

125 Maiden Lane, New York, N. Y. 10038
James M. Cahill, General Manager

February 10, 1967

Honorable T. Nelson Parker
Commissioner of Insurance
State Corporation Commission
Bureau of Insurance—Box 1157
Richmond, Virginia 23209

Re: Proposed Revision of Automobile Liability
Insurance Rates for Private Passenger Cars

Dear Commissioner:

On behalf of our member and subscriber companies, we hereby file the enclosed proposed revision of private passenger automobile bodily injury and property damage liability insurance rates for the Automobile Casualty Manual and corresponding changes of premium charges for the Special Package Automobile Policy Manual.

As explained in the accompanying filing memorandum, the proposed rates are based upon the experience of the companies that file their statistical data with the National Bureau of Casualty Underwriters. This departure from the prior practice of basing rates upon the aggregate experience of all companies in Virginia is necessary in order to achieve for the members and subscribers of the National Bureau a rating system that is appropriate for the method of operation of these companies. Determining rates in this manner is clearly in agreement with the purpose of the insurance laws of Virginia.

The National Bureau of Casualty Underwriters strives to obtain for its companies approval of rating systems that best reflect the results of our research and are also compatible from state to state so that company operations may be carried

out efficiently and economically. One of these objectives is the introduction of the private passenger classification plan that is in effect for our members and subscribers in 35 other jurisdictions. It is our intent to submit promptly for your consideration the revised private passenger classification plan.

While we wish to have the revised class plan considered promptly, we do not want this additional aspect to delay consideration of the revision of rates proposed in this letter. Rather, we shall proposed an effective date for the revised class plan which will be several months later than the effective date that we shall propose for the revision of rates in order to give our companies sufficient lead time to introduce the procedural changes that are necessary for the administration of the revised class plan.

We are taking steps to consult with you, in cooperation with the other statistical agents, regarding statistical territories. The establishment of any additional territorial subdivisions that may result from this consultation could be accomplished without any effect upon rates.

page 2 } It is essential that this revision of rates and the forthcoming proposal of the revised private passenger classification plan be considered solely on behalf of the members and subscribers of this Bureau. The practice of viewing filings of this Bureau as potentially applicable to all companies in Virginia has delayed in the past the introduction of desirable innovations in the writing of automobile liability insurance. The National Bureau does not desire to impose its rating system upon other companies, nor do we feel it justified to be impeded in the pursuit of our objectives because they are not suitable for companies employing different methods of operation. We submit that a sound degree of diversity in rating systems will serve the public better than the heretofore maintained uniformity of manual rates and classifications.

We will complete this submission with a proposal as respects the effective date of the revised rates as soon as the date for a hearing before the State Corporation Commission can be ascertained. In the meantime, we respectfully solicit your review of the enclosed.

Very truly yours,
J. M. Cahill
General Manager

JMC:br
enclosures

page 3 } National Bureau of Casualty Underwriters

VIRGINIA
AUTOMOBILE LIABILITY INSURANCE
Private Passenger Cars

Index of Exhibits

Exhibit A—Family Automobile Policy and Basic Automobile Policy—Bodily Injury and Property Damage

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3 Determination of property damage factor to adjust accident year data for subsequent changes in claim costs.
4-6 Determination of rate level changes by territory.
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Sheet
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3, 4 Supplementary Rating Procedure

Exhibit C—Rules change—Elimination of the Compact Car discount.

page 4 } National Bureau of Casualty Underwriters
Exhibit A
Filing Memorandum

VIRGINIA
REVISION OF AUTOMOBILE LIABILITY
INSURANCE RATES
PRIVATE PASSENGER CARS

This memorandum and the attached exhibits present a revision of the automobile bodily injury and property damage liability rates for private passenger cars using Virginia experience on a $15,000/30,000/5,000 basis.

Statewide Rate Level Changes

The $15,000/30,000/5,000 premium level changes for Virginia determined in Exhibit A, Sheet 1, are as follows:

Bodily Injury	+ 5.6%
Property Damage	+18.5
Combined	+ 9.9

These changes are based upon a review of the latest available Virginia experience for private passenger cars (excluding assigned risks) for those carriers reporting data to the National Bureau of Casualty Underwriters.

The rate level changes have been based upon the experience indications for accident year 1965 with losses valued as of March 31, 1966, supplemented for property damage by a factor to reflect the subsequent change in average paid claim costs since the experience period. The experience does not reflect the credits and surcharges under the Safe Driver Insurance Plan. If they were, bodily injury and property damage combined indication would be +10.5%.

As in previous submissions, factors have been utilized to adjust the accident year data in recognition of continued changes in claim cost settlement levels in order to meet the statutory requirements that rates shall not be excessive, inadequate or unfairly discriminatory, for the period during which they are to apply. As in the last revision, a bodily injury factor of 1.000 has been used. The experience has been adjusted by an appropriate property damage trend factor to May 1, 1968, the approximate average date of accident for policies to be issued at the revised rates. The calculation is set forth on Exhibit A, Sheet 3.

Determination of Rate Level Changes by Territory

The rate level changes for the individual territories as determined in Exhibit A, Sheets 4-6 are based on the latest available $15,000/30,000/5,000 experience by territory for accident years 1963 through 1965.

Determination of Classification Rates

The revised Class 1A rates by territory as shown in column (9) of Exhibit A, Sheets 4 and 5 were the basis for the revised rates for other classifications. The present Virginia rate class differentials were applied to the revised Class 1A rates with the results rounded to the nearest dollar.

Based on a review of the countrywide experience of all companies reporting to the National Bureau for policy years

1959-1961 combined, revised rate differentials for funeral cars and employers' non-ownership Class 1 are included in this filing. No change is made in hired cars and school bus differentials.

page 5 } National Bureau of Casualty Underwriters
Exhibit A
Filing Memorandum
Sheet 2

Determination of Classification Rates

For Employers' Non-Ownership Class 1, one schedule of rates is set forth in lieu of the present multi-schedule system. This change is introduced in order to facilitate more simplified procedures in the rating of these risks. Based upon the new lower differential for this class, rates of $2.50 and $1.50 for bodily injury and property damage, respectively, apply. The revised rates are shown on Exhibit A, Sheets 7 and 8.

Expense Provisions in Manual Rates

The expense provisions underlying the revised rates are the same as those underlying the present rates, except that the property damage factor to include unallocated claim adjustment expense in the experience has been reduced from 1.16 to 1.135.

VIRGINIA

AUTOMOBILE LIABILITY INSURANCE - PRIVATE PASSENGER CARS

Determination of Statewide Rate Level Changes

Voluntary Risks**

$15,000/30,000 Bodily Injury and $5,000 Property Damage

All Companies Reporting to N.B.C.U.

(1) Coverage	(2) Accident Year	(3) Earned Number of Cars	(4) $15,000/30,000 B.I. (Excl. Med.) and $5,000 P.D. Incurred Losses Incl. All Loss Adjustment*	(5) 15/30/5 Limits Pure Premiums (4)÷(3)
Bodily Injury	1965	418,600	$12,096,201	$28.90
Property Damage	1965	418,600	5,878,795	14.04

	B.I.	P.D.	Comb.
(6) Accident Year 1965 $15/30 B.I. (Excl. Med. Pay.) and $5,000 P.D. Pure Premiums [Col. (5)]	$28.90	$14.04	$42.94
(7) Factor to Adjust Accident Year Data for 34 months of subsequent change in Average Paid Claim Costs (see Sheet 3)	1.000	1.163	
(8) Rate Level Pure Premium [(6)x(7)]	$28.90	$16.33	$45.23
(9) Underlying Pure Premium#	$27.38	$13.78	$41.16
(10) Statewide Rate Level Changes [(8)÷(9)] - 1.000	+ 5.6%	+18.5%	+ 9.9%

See Notes on Sheet 2.

page 7 } Exhibit A—Sheet 2

VIRGINIA

*Including all loss adjustment; factors of 1.10 for bodily injury and 1.135 for property damage were applied to the incurred losses and allocated loss adjustment expenses to include unallocated loss adjustment. The incurred losses have been developed to 63 months for bodily injury and 39 months for property damage by application of the following 15/30/5 loss development factors derived from the latest available data for Virginia.

Accident Year	*B.I.*	*P.D.*
1965	1.087	.997

#The 15/30/5 pure premiums underlying present rates, statewide, are based upon the product of the expected loss and loss adjustment ratio of .646 and the respective present average rates for B.I. of $42.38 and P.D. of $21.33. These average rates take into account the application of the Private Passenger Classification Plan, the Two or More Automobiles Credit Rule, the Compact Car Rule and Driver Training Credits but do not reflect the Safe Driver Insurance Plan. The average rates are based upon the 1965 distribution of insured cars by classification and territory.

**Excluding all Uninsured Motorists and Special-Package Automobile Policy experience.

VIRGINIA

AUTOMOBILE LIABILITY INSURANCE - PRIVATE PASSENGER CARS

Determination of Property Damage Factor to Adjust
Accident Year Data for Subsequent Change in Claim Costs
(Based on Twelve Month Average Paid Claim Cost Data)

All Companies Reporting to N.B.C.U. Voluntary and Assigned

Property Damage - Total Limits				
(1)	(2)	(3)	(4)	(5)
			Average Paid Claim Costs	
Year Ended	Paid Losses*	Number of Paid Claims	Actual (2)÷(3)	Line of Best Fit
6/30/63	$4,652,208	31,644	$147	$142.50
9/30/63	4,706,118	31,996	147	144.94
12/31/63	4,829,870	32,481	149	147.38
3/31/64	5,035,464	33,520	150	149.82
6/30/64	5,158,036	34,828	148	152.26
9/30/64	5,351,871	35,623	150	154.70
12/31/64	5,500,890	35,999	153	157.14
3/31/65	5,569,344	35,514	157	159.58
6/30/65	5,641,845	34,889	162	162.02
9/30/65	5,748,276	34,904	165	164.46
12/31/65	5,911,138	35,066	169	166.90
3/31/66	6,067,575	34,884	174	169.34

(6) Average annual dollar change in Paid Claim Costs based upon Line of Best Fit. $+ 9.76

(7) Average dollar change in Paid Claim Cost in 34 Month Period (Line 10 times 2.83) $+27.62

(8) Average change in Paid Claim Costs in 34 Month period expressed as percent (7) ÷ Col. (5) for 3/31/66 +16.3%

(9) Factor to adjust accident year data to reflect 34 Months of subsequent change in Average Paid Claim Costs: 1.163

* Excluding all loss adjustment expenses.

VIRGINIA

AUTOMOBILE LIABILITY INSURANCE - PRIVATE PASSENGER CARS

Determination of Rate Level Changes by Territory

(1) Territory	(2) Accident Year Ended 12/31/65 Earned Number of Cars	(3) $15,000/ 30,000 Limits Present Average Rate	(4) $15,000/30,000 Limits Pure Premium (Incl. All Loss Adj.) for Accident Years Ended 12/31/63-65	(5) Loss & Loss Adj. Ratio at Present Rates (4)÷(3)	(6) Col.(5) as Ratio to Statewide Average	(7) Territorial Rate Level Change [(6) x 1.043] -1.0	(8) Ratio of Present Average Rate to Class 1A Rates	(9) 10/20 1A Rate [(3)÷1.09]x [1.0+(7)] ÷ (8)
			BODILY INJURY					
01 Arlington & Fairfax Cos.	76,764	$39.08	$27.77	.711	1.041	+ 8.6%	1.195	$33
02 Norfolk	51,768	61.08	35.34	.579	.848	-11.6	1.192	42
03 Richmond	45,725	55.68	38.85	.698	1.022	+ 6.6	1.161	47
09,10,11 Lynchburg, Newport News, Roanoke	42,197	45.58	28.67	.629	.921	- 3.9	1.195	34
07 Remainder of State	202,146	35.17	25.55	.726	1.063	+10.9	1.113	32.
ENTIRE STATE	418,600	42.38	28.94	.683				

See Exhibit A, Sheet 6, for notes.

VIRGINIA

AUTOMOBILE LIABILITY INSURANCE - PRIVATE PASSENGER CARS

Determination of Rate Level Changes by Territory

(1) Territory	(2) Accident Year Ended 12/31/65 Earned Number of Cars	(3) $5,000 Limits Present Average Rate	(4) $5,000 Limit Pure Premium (Incl. All Loss Adj.) for Accident Years Ended 12/31/63-65	(5) Loss & Loss Adj. Ratio at Present Rates (4)÷(3)	(6) Col.(5) as Ratio to Statewide Average	(7) Territorial Rate Level Change [(6) x 1.171] -1.0	(8) Ratio of Present Average Rate to Class 1A Rate	(9) $5,000 1A Rate (3) x [1.0+(7)] ÷ (8)
			PROPERTY DAMAGE					
01 Arlington & Fairfax Cos.	76,764	$26.29	$16.58	.631	.995	+16.5%	1.195	$26
02 Norfolk	51,768	23.85	14.20	.595	.938	+ 9.8	1.192	22
03 Richmond	45,725	25.54	16.45	.644	1.016	+19.0	1.161	26
09,10,11 Lynchburg, Newport News, Roanoke	42,197	21.51	13.69	.636	1.003	+17.5	1.195	21
07 Remainder of State	202,146	17.80	11.47	.644	1.016	+19.0	1.113	19
ENTIRE STATE	418,600	21.32	13.51	.634				

See Exhibit A, Sheet 6, for notes.

page 11 } Exhibit A—Sheet 6

VIRGINIA
AUTOMOBILE LIABILITY INSURANCE—PRIVATE PASSENGER CARS

Notes Pertaining to Determination of Rate Level Changes by Territory

Column (3):

Average of present rates ($15,000/30,000 B.I., $5.000 P.D.) based on accident year 1965 distribution by class in each territory, reflecting the application of the private passenger classification plan, the two or more automobiles credit rule, the driver training credit rule, and the discount for compact cars, but not reflecting the Safe Driver Insurance Plan. The entire state average rate is a weighting based upon column (2).

Column (6):

Ratio of the territorial loss and loss adjustment ratio at the present rates, as set forth in Column (5), to the statewide loss and loss adjustment ratio at present rates in the same column.

Column (7):

Column (6) adjusted by the indicated statewide rate level changes decreased to reflect the increase in premium level of 1.2% which will result from the elimination of the compact car rule. viz:

Bodily Injury: 1.000 plus line (10) of sheet 1 + 1.012 = 1.043

Property Damage: 1.000 plus line (10) of Sheet 1 + 1.012 = 1.171

Column (8):

Column (3) divided by the present 15/30 bodily injury manual 1A rates.

Column (9):

The present average rate (divided by 1.09 for bodily injury to adjust from a 15/30 to a 10/20 basis) was multiplied by 1.0 plus the indicated territorial rate level change as set forth in column (7) to produce the revised average rate. This average rate was then divided by the ratio shown in column (8) to obtain the revised class 1A rate, the final result rounded to the nearest dollar.

The revised rates for the remaining classification were then determined by the application of the present differentials, as set forth below, to the class 1A rates. (See Sheets 7 and 8 of this exhibit for rates).

Differentials to Class 1A

Class	*Differential*
1A	1.00
1B	1.15
2A	1.90
2C	3.05
3	1.45
1AF	.75
2AF	1.65
2CF	2.80

VIRGINIA

AUTOMOBILE LIABILITY INSURANCE - PRIVATE PASSENGER RATE REVISION

Revised Rates

For Limits of $10,000/20,000 B.I. and $5,000 P.D.

Type and Class	Arlington and Fairfax Cos. Terr. 01		Norfolk Terr. 02		Richmond Terr. 03		Lynchburg, Newport News, Roanoke Terr. 09,10,11	
	B.I.	P.D.	B.I.	P.D.	B.I.	P.D.	B.I.	P.D.
Private Pass. Class 1A	$ 33.	$ 26.	$ 42.	$ 22.	$ 47.	$ 26.	$ 34.	$ 21.
Class 1B	38.	30.	48.	25.	54.	30.	39.	24.
Class 2A	63.	49.	80.	42.	89.	49.	65.	40.
Class 2C	101.	79.	128.	67.	143.	79.	104.	64.
Class 3	48.	38.	61.	32.	68.	38.	49.	30.
Class 1AF	25.	20.	32.	17.	35.	20.	26.	16.
Class 2AF	54.	43.	69.	36.	78.	43.	56.	35.
Class 2CF	92.	73.	118.	62.	132.	73.	95.	59.
Hired Car	.95	.75	1.20	.65	1.35	.75	1.00	.60
Employers Non-Ownership Class 1 ...	2.50	1.50	2.50	1.50	2.50	1.50	2.50	1.50
Funeral Car	48.	30.	61.	26.	68.	30.	49.	24.
School Buses: Priv. Pass.	50.	38.	63.	32.	71.	38.	51.	30.
Comm. or Bus. 0-30 Pass.	32.	24.	40.	20.	45.	24.	32.	19.
31-60 Pass.	39.	29.	49.	25.	55.	29.	40.	23.
Over 60 Pass.	46.	35.	58.	29.	65.	35.	47.	27.

See Exhibit A, Sheet 9 for the explanation of the determination of rates for miscellaneous classes.

VIRGINIA

AUTOMOBILE LIABILITY INSURANCE - PRIVATE PASSENGER RATE REVISION

Revised Rates

For Limits of $10,000/20,000 B.I. and $5,000 P.D.

Type and Class	Remainder of State Terr. 07	
	B.I.	P.D.
Private Pass.		
Class 1A	$ 32.	$ 19.
Class 1B	37.	22.
Class 2A	61.	36.
Class 2C	98.	58.
Class 3	46.	28.
Class 1AF	24.	14.
Class 2AF	53.	31.
Class 2CF	90.	53.
Hired Car	.90	.55
Employers Non-Ownership Class 1 ...	2.50	1.50
Funeral Car	46.	22.
School Buses: Priv. Pass.	48.	28.
Comm. or Bus. 0-30 Pass.	30.	18.
31-60 Pass.	37.	22.
Over 60 Pass.	44.	25.

See Exhibit A, Sheet 9 for the explanation of the determination of rates for miscellaneous classes.

page 14 } Exhibit A—Sheet 9

VIRGINIA
AUTOMOBILE LIABILITY INSURANCE
Determination of Rates for Miscellaneous Classes

The present relativities to Class 3 for the miscellaneous classes are continued, with the exception of Non-Ownership Class 1 and Funeral Car, as follows:

Hired Cars
The rates are 2% of the private passenger Class 3 rates, rounded to the nearest five cents.

Non-Ownership Class 1
The rates for this class are 5% of the private passenger class 3 rates. In order to facilitate machine handling of this class, one schedule of rates has been established based upon the lower differential.

Funeral Cars
The rates are 100% of private passenger class 3 rates for bodily injury and 80% for property damage, rounded to the nearest dollar.

School Buses
The rates are determined by applying the following ratios to the private passenger class 3 rates, and rounding to the nearest dollar.

Type	*Ratios to Private Passenger Class 3 Rates*	
	B.I.	*P.D.*
Private Passenger	1.04	1.00
Commercial or Bus:		
0-30 Passengers	.66	.63
31-60 Passengers	.81	.77
Over 60 Passengers	.95	.91

VIRGINIA

AUTOMOBILE LIABILITY INSURANCE
CLASSIFICATION EXPERIENCE AND REVISION OF
MISCELLANEOUS CLASS RATE DIFFERENTIALS

Total Limits Experience for those Classes Related to Private Passenger Cars
Countrywide Excluding New York and Massachusetts - Policy Years 1959-61 Combined

All Companies Reporting to N.B.C.U. — Bodily Injury and Property Damage Combined

(1) Rate Class	(2) Earned Premium	(3) Incurred Losses Including All Loss Adjustment	(4) Actual Loss and Loss Adjustment Ratio	Differential to Business Use Class (5) Present B.I.	(5) Present P.D.	(6) Revised B.I.	(6) Revised P.D.
Hired Car(b)	$ 9,750,733	$4,765,148	.489	.02	.02	.02	.02
Employers' Non-Owner Class 1	10,186,328	3,958,531	.389	.07	.07	.05	.05
Funeral Car							
B.I.	1,693,685	1,005,155	.593	1.10	-	1.00	-
P.D.	666,698	293,333	.440	-	1.00	-	.80
Total	2,360,383	1,298,488	.550				
School Buses							
Private Pass. 5915(c)	976,289	585,830	.600	1.04	1.00	1.04	1.00
Commercial or Bus Type							
0-30 Pass. (5912 & 5916)	1,618,080	942,334	.582	.66	.63	.66	.63
31-60 Pass. (5913 & 5917)	8,833,251	5,983,162	.677	.81	.77	.81	.77
Over 60 Pass. (5914 & 5918)	1,690,066	1,352,464	.800	.95	.91	.95	.91
Total	12,141,397	8,277,960	.682				

VIRGINIA
REVISION OF AUTOMOBILE LIABILITY INSURANCE

Expense Provisions in Manual Rates—Private Passenger Cars

The expense provisions underlying present and revised rates for private passenger cars are as follows:

Item	*Provision*
General Administration	5.5%
Inspection and Bureau*	1.2
Total Production Cost Allowance	20.0
Taxes, Licenses and Fees	3.7
Underwriting Profit and Contingencies	5.0
Total Service and Overhead	35.4
Expected Loss and Loss Adjustment Ratio	64.6
Grand Total	100.0

Factor to adjust losses (including allocated loss adjustment) to include all loss adjustments:

Bodily Injury	1.10
Property Damage	1.135

*Including 0.2% for Virginia Automobile Rate Administrative Bureau.

The above provisions are supported by the customary review of expense indications reported in the countrywide Insurance Expense Exhibit for Member Companies of the National Bureau of Casualty Underwriters. The mean of (1) the present provisions, and (2) the mean indications for calendar years 1963, 1964 and 1965 are:

General Administration	5.7%
Inspection and Bureau*	1.2

Factor to adjust losses (including allocated loss adjustment) to include all loss adjustment:

Bodily Injury	1.100
Property Damage	1.146†

*Including 0.2% for Virginia Automobile Rate Administrative Bureau.

†Since the last Virginia filing the countrywide property damage factor was amended to 1.150. Using that as the present provision in lieu of 1.160, a factor of 1.141 would result.

page 17 } Exhibit B—Filing Memorandum

VIRGINIA
AUTOMOBILE LIABILITY INSURANCE—PRIVATE PASSENGER CARS

Revision of Special-Package Automobile Policy Premiums

The following is a brief history of how Special-Package rates have been made in Virginia:

At the time of introduction on June 1, 1961, the premium charges for the Special-Package Automobile Policy were related by formula to the rates established in the Automobile Casualty Manual for the separate coverages, viz. Bodily Injury and Property Damage liability, Medical Payments and Protection Against Uninsured Motorists Coverage. On April 1, 1963, the rates of the Automobile Casualty Manual were increased 9.7% for Bodily Injury coverage and 3.4% for Property Damage coverage; Special-Package Policy rates were not changed.

Effective July 1, 1964, the premium charges were determined by formula from the rates established in the Automobile Casualty Manual for the separate coverages of Bodily Injury and Property Damage liability, Medical Payments, and Protection Against Uninsured Motorists Coverage. The liability portion of the rate structure was adjusted, however, to eliminate the effect of the rate level increases approved effective April 1, 1963 for the Automobile Casualty Manual because those increases were not applied to the rate structure for the Special-Package Automobile Policy. The overall increase in rate level for the Special-Package Automobile Policy was 18%.

At the last revision, effective January 5, 1966, the existing relationship by territory between the liability rate structure for the Family and Special Policies was maintained. The rate provision for medical payments coverage was increased from 50% to 75% of the comparable rate for the Family Policy

as a result of the elimination of the subrogation provision for this coverage. Protection Against Uninsured Motorists was included as a separate $2.00 charge in all policy premiums. The overall increase in rate level was 10.3%.

A comparison of the latest available (accident year 1965) Special-Package Automobile Policy and Family Automobile Policy data for all companies reporting to the National Bureau follows:

	Special Package		*Family*	
Subline	*Earned Premium at Present S.P.A.P. Rates†*	*Loss Ratio**	*Earned Premium at Present F.A.P. Rates*	*Loss Ratio**
Bodily Injury ($15,000/30,000)	$2,049,790	.696	$17,741,375	.682
Property Damage ($5,000)	1,002,090	.683	8,926,945	.659
	$3,051,880	.692	$26,668,320	.674

†Split by formula based upon the relativity of the present Family Automobile Policy rates.

*Losses include all loss adjustment and are developed to an ultimate settlement basis.

page 18 } Exhibit B—Filing Memorandum

Calculation of the Class 1A $35,000 *Semi-Annual Premiums*

Based upon the comparable results and the significantly lower volume of data available under the Special Package Automobile Policy to date, the present difference in level between the two policies is maintained. Therefore, the Class 1A $35,000 semi-annual premiums have been calculated as follows:

(1) The present average package discount of 15% is to be maintained.

(2) The sum of the revised comparable Family Automobile Policy rates (viz: the $10,000/20,000 bodily injury rate, the $5,000 property damage rate and the $1,000 Medical Payments rate) by territory was discounted by the 15% package discount and divided in half to produce semi-annual Class 1A $25,000 premiums (excluding Protection Against Uninsured Motorists Coverage). These were converted to a $35,000 basis

by application of the increased limits factor of 1.05, with the results rounded to the nearest dollar.

Calculation of the $35,000 *Semi-Annual Premiums for the Other Rate Classes*

The revised premiums (excluding Protection Against Uninsured Motorists Coverage) for the other private passenger classes were calculated by applying to the revised Class 1A premiums the present differentials that are used in calculating the rates for the Automobile Casualty Manual.

Calculation of Semi-Annual Premiums for Higher Limits

The factors to determine the premiums (excluding Protection Against Uninsured Motorist Coverage) for higher limits in a package are the same as those underlying the present rates except that they have been applied to the revised $35,000 semi-annual premiums.

The factors utilized in these calculations are as follows:

Combination	*Single Liability Limit*	*Expense for Medical Services*	*Factor*
1.	$ 35,000	$1,000	1.00
2.	50,000	2,000	1.07
3.	100,000	3,000	1.17
4.	200,000	4,000	1.22
5.	300,000	5,000	1.27

Special-Package Semi-Annual Premiums

The revised semi-annual premiums (excluding Protection Against Uninsured Motorists Coverage) are set forth on Sheets 1 and 2.

Protection Against Uninsured Motorists Insurance

The $2.00 charge for Protection Against Uninsured Motorists Insurance will continue to be set forth separately on the manual premium sheets and included in all policies.

Exhibit B—Sheet 1

VIRGINIA

AUTOMOBILE LIABILITY INSURANCE

SPECIAL PACKAGE AUTOMOBILE POLICY

Revised Six-Month Premium

Territory	Class	SINGLE LIMIT LIABILITY PREMIUM INCLUDING MEDICAL EXPENSES AND $1,000 DEATH BENEFIT				
		$35,000 Liab. $1,000 Med.Exp.	$50,000 Liab. $2,000 Med.Exp.	$100,000 Liab. $3,000 Med.Exp.	$200,000 Liab. $4,000 Med.Exp.	$300,000 Liab. $5,000 Med.Exp.
01	1A	$ 29	$ 31	$ 34	$ 35	$ 37
	1B	33	35	39	40	42
	2A	55	59	64	67	70
	2C	88	94	103	107	112
	3	42	45	49	51	53
	1AF	22	24	26	27	28
	2AF	48	51	56	59	61
	2CF	81	87	95	99	103
02	1A	33	35	39	40	42
	1B	38	41	44	46	48
	2A	63	67	74	77	80
	2C	101	108	118	123	128
	3	48	51	56	59	61
	1AF	25	27	29	31	32
	2AF	54	58	63	66	69
	2CF	92	98	108	112	117
03	1A	37	40	43	45	47
	1B	43	46	50	52	55
	2A	70	75	82	85	89
	2C	113	121	132	138	144
	3	54	58	63	66	69
	1AF	28	30	33	34	36
	2AF	61	65	71	74	77
	2CF	104	111	122	127	132
07	1A	26	28	30	32	33
	1B	30	32	35	37	38
	2A	49	52	57	60	62
	2C	79	85	92	96	100
	3	38	41	44	46	48
	1AF	20	21	23	24	25
	2AF	43	46	50	52	55
	2CF	73	78	85	89	93

VIRGINIA

AUTOMOBILE LIABILITY INSURANCE

SPECIAL PACKAGE AUTOMOBILE POLICY

Revised Six-Month Premium

Territory	Class	SINGLE LIMIT LIABILITY PREMIUM INCLUDING MEDICAL EXPENSES AND $1,000 DEATH BENEFIT				
		$25,000 Liab. $1,000 Med.Exp.	$50,000 Liab. $2,000 Med.Exp.	$100,000 Liab. $3,000 Med.Exp.	$200,000 Liab. $4,000 Med.Exp.	$300,000 Liab. $5,000 Med.Exp.
09,10,11	1A	$ 28	$ 30	$ 33	$ 34	$ 36
	1B	32	34	37	39	41
	2A	53	57	62	65	67
	2C	85	91	99	104	108
	3	41	44	48	50	52
	1AF	21	22	25	26	27
	2AF	46	49	54	56	58
	2CF	78	83	91	95	99

SPECIAL PACKAGE AUTOMOBILE POLICY MANUAL

VIRGINIA

Supplementary Rating Procedure

Rule 3

Additional liability coverage combinations may be afforded as follows:

Combination	Single Limits Bodily Injury and Property Damage Liability	Expenses for Medical Services	Death Benefit
6	$ 500,000	$5,000	$1,000
7	1,000,000	5,000	1,000

The semi-annual premiums for these additional liability coverage combinations by territory and class are as follows:

Supplementary $500,000 and $1,000,000 Liability Rates

Type and Class	Terr. 01		Terr. 02		Terr. 03	
	$500,000	$1,000,000	$500,000	$1,000,000	$500,000	$1,000,000
Private Pass.						
Class 1A	$ 38	$ 41	$44	$ 47	$ 49	$ 53
1B	44	47	50	54	57	61
2A	73	78	83	89	92	99
2C	116	125	133	143	149	160
3	55	60	63	68	71	77
Farms						
Class 1AF	29	31	33	36	37	40
2AF	63	68	71	77	81	87
2CF	107	115	121	131	137	148

Type and Class	Terr. 07		Terr. 09,10,11	
	$500,000	$1,000,000	$500,000	$1,000,000
Private Pass.				
Class 1A	$ 34	$ 37	$ 37	$ 40
1B	40	43	42	45
2A	65	70	70	75
2C	104	112	112	121
3	50	54	54	58
Farms				
Class 1AF	26	28	28	30
2AF	57	61	61	65
2CF	96	104	103	111

page 22 } Exhibit B—Sheet 4

Notes—

1. The premiums determined in accordance with this Supplementary Rating Procedure are subject to modification under the Safe Driver Insurance Plan, except the premium for protection against uninsured motorists coverage which is not subject to modification under such Plan or any other manual rule.

2. Companies shall apply the above rating basis without submission to the Bureau.

†Factors of 1.32 and 1.42 respectively, were utilized in the determination of the $500,000 and $1,000,000 supplementary limits, excluding protection against uninsured motorists coverage for the Special-Package Automobile Policy. These factors were utilized in the same manner as were the factors for other limits.

page 23 } Exhibit C—Sheet 1

NATIONAL BUREAU OF CASUALTY UNDERWRITERS
MEMORANDUM—Automobile Casualty Manual

Matter *underlined* is new; matter in brackets [ ] is deleted.

VIRGINIA EXCEPTION SHEETS

Page 32
27. *Compact Private Passenger Automobiles*
This Rule does not apply.

MEMORANDUM—SPECIAL AUTOMOBILE POLICY MANUAL

Page 9
8A. Compact Automobile Credit
This is a discontinued Rule.
VIRGINIA COMPACT AUTOMOBILE SECTION
The list of compact cars is withdrawn in Virginia.

EXPLANATION: During the past several years, the type of compact car produced by the American manufacturers has changed substantially. Compact cars have become larger and more powerful, which is reflected in their rising loss ratio. (See Sheet 2 for the latest available experience.) When the discount was introduced, on a judgment basis, it was hoped that smaller cars would develop better experience. As a matter of fact, the pure premium for compact cars for the most recent years exceeds that for non-compact cars, as does the loss and loss adjustment ratio, thus demonstrating that compact cars have not earned their discount.

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Exhibit C—Sheet 2

National Bureau of
Casualty Underwriters

COUNTRYWIDE PRIVATE PASSENGER LIABILITY INSURANCE EXPERIENCE (a)
COMPACT CAR VS. STANDARD SIZE CAR

B.I. AND P.D. COMBINED

All Companies Reporting to M.I.R.B. & N.B.C.U.

(1)	Year (2)	Earned Exposure (3)	Earned Premium (4)	Liability Incurred Losses Basic Limits (b) (5)	Liability Incurred Losses Excess (b) (6)	Medical Payments Incurred Losses(b) (7)	Total Limits Loss Ratio (8)	Pure Premium(c) (9)
BODILY INJURY AND PROPERTY DAMAGE COMBINED								
COMPACT CARS	1961	650,054	$41,121,659	$ 26,136,950	$2,079,754	$3,346,177	.768	$40.21
	1962	1,105,893	68,283,770	44,180,094	3,924,653	5,870,465	.790	39.95
	1963	1,405,119	88,840,452	63,213,886	4,167,008	8,437,989	.853	44.99
	TOTAL	3,161,066	198,245,881	133,530,930	10,171,415	17,654,631	.814	42.24
STANDARD SIZE CARS	1961	8,857,525	567,978,293	362,980,438	28,217,751	33,034,347	.747	40.98
	1962	8,695,537	550,005,180	365,139,797	27,708,110	34,040,496	.776	41.99
	1963	8,555,646	550,481,518	352,125,366	21,118,929	34,799,125	.741	41.16
	TOTAL	26,108,708	1,668,464,991	1,080,245,601	77,044,790	101,873,958	.755	41.37

(a) Excluding Alaska, California, Idaho, Hawaii, Louisiana, Michigan, Missouri, Montana, Massachusetts, New Hampshire, New York, North Carolina, Puerto Rico and Texas.
(b) Including all loss adjustment expenses.
(c) Column (5) ÷ Column (3)

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* * * * *

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

AT RICHMOND, MARCH 29, 1967

CASE NO. 18386

For a revision of automobile bodily injury and property damage liability insurance rates.

ON A FORMER DAY came National Bureau of Casualty Underwriters and pursuant to the provisions of Chapter 6 of Title 38.1 of the Code of Virginia filed on behalf of its members and subscribers and requested approval of certain amendments to the manual of classifications, rules and rates, rating plans and modifications thereof for writing automobile bodily injury and property damage liability insurance in this State.

AND IT APPEARING to the Commission that a hearing should be held thereon and that notice of such hearing should be given as herein required,

IT IS ORDERED:

(1) That this proceeding be instituted to determine: (a) Whether the rates proposed to be charged in the filing made by the applicant for autombile bodily injury and property damage liability insurance are excessive, inadequate or unfairly discriminatory; and, (b) Any other matter which may be the proper subject of investigation; assigned Case No. 18386, docketed and set for hearing at 10:00 A.M. on May 31, 1967 in the Courtroom of the State Corporation Commission, Blanton Building, Richmond, Virginia, at which time and place the applicant and all parties in interest desiring to be heard may appear and present such facts and file such data relevant to the matters involved as may be desired;

(2) That the applicant submit to the Commission all available facts, information, data and statistics as to automobile bodily injury and property damage liability insurance concerning: (a) Past and prospective loss experience

page 26 } within and outside this State; (b) Catastrophe hazard, if any; (c) A reasonable margin for underwriting profit and contingencies; (d) Dividends, savings or unabsorbed premium deposits allowed or returned by insurers

to their policyholders or members or subscribers; (e) Past and prospective expenses, both countrywide and those specially applicable to this State; and, (f) All relevant factors within and outside this State;

(3) That applicant publish notice of the time and place of hearing, setting forth the substance of the filing made herein and the place or places where the exact program as proposed may be seen by any party in interest, in a newspaper or newspapers of general circulation published in each of the following cities in this State: Richmond, Norfolk, Roanoke, Lynchburg, Newport News, Danville, Winchester, Fredericksburg, Martinsville and Alexandria at least once a week for two successive weeks, beginning not later than the 17th day of April, 1967, and furnish proof of publication thereof at the hearing, which notice shall be substantially as follows:

"NOTICE TO THE PUBLIC

"Notice is hereby given to the public that National Bureau of Casualty Underwriters, on behalf of its members and subscribers has filed with and requested the approval of the State Corporation Commission of certain amendments to the manual of classifications, rules and rates, rating plans, and modifications thereof for writing automobile bodily injury and property damage liability insurance on private passenger cars heretofore approved by the Commission.

"RATE REVISIONS

"The proposed revision of rates vary according to coverage, type of risk insured, and territory.

"For private passenger cars insured under the Basic and Family Automobile Policies, increases of 5.6% for bodily injury and 18.5% for property damage liability insurance are proposed, these average an increase of 9.9% statewide for coverage affording limits of $15,000 per person/$30,000 per accident for bodily injury and $5,000 per accident for property damage. Changes are proposed in the premiums for Hired Automobiles, Non-Ownership Class 1, Funeral Automobiles, and School Buses, which, by relativity, are based upon the premiums for Class 3 private passenger automobile rates.

page 27 } "For the Special Package Automobile Policy an increase of 7.2% is proposed.

"The proposed liability rates effect percentage changes in basic limits premiums as follows:

Territory	*Private Passenger Class 1A*	
	B.I.	*P.D.*
Arlington and Fairfax Counties	+10.0%	+18.2%
Norfolk	—10.6%	+10.0%
Richmond	+ 6.8%	+18.2%
Lynchburg, Newport News, Roanoke	— 2.9%	+16.7%
Remainder of State	+10.3%	+18.8%

"The proposals involved in the filing of the National Bureau of Casualty Underwriters may be seen at the Bureau of Insurance, 8th Floor, Blanton Building, Richmond, Virginia.

"The State Corporation Commission has instituted an investigation upon the proposed amendments to the manual of classifications, rules and rates, rating plans, and modifications thereof filed by the applicant, and has set a public hearing thereon in Case No. 18386 which will be held in its Courtroom in the Blanton Building, Richmond, Virginia, at 10:00 A.M., May 31, 1967 at which time and place all persons in interest may appear and present such relevant data as is material to such investigation and hearing and be heard.

"NATIONAL BUREAU OF
CASUALTY UNDERWRITERS"

AN ATTESTED COPY hereof shall be sent to James M. Cahill, General Manager, National Bureau of Casualty Underwriters, 125 Maiden Lane, New York, N. Y., 10038; M. Wallace Moncure, Jr., Counsel for the applicant; and, to the Bureau of Insurance.

A True Copy

Teste:

WILLIAM C. YOUNG
Clerk of State Corporation Commission.

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* * * * *

PRESENT:
COMMISSIONERS
H. LESTER HOOKER (Chairman)
JESSE W. DILLON
RALPH T. CATTERALL

(Commissioner Dillon presiding)

APPEARANCES:
M. Wallace Moncure, Jr.,
Counsel for National Bureau of
Casualty Underwriters, Applicant

Beecher E. Stallard,
Counsel for Virginia State AFL-CIO, Intervener

page 29 } APPEARANCES (CONTINUED):

George W. Shadoan,
Counsel for AFL-CIO, Intervener
Honorable C. Harrison Mann, Jr.,
Member, General Assembly,
Attorney for Self, Individual Intervener
Honorable Henry E. Howell, Jr.,
Member, General Assembly, Individual Intervener
Honorable Stanley E. Sacks,
Member, General Assembly, Individual Intervener
Honorable Thomas W. Moss, Jr.,
Member, General Assembly, Individual Intervener
Honorable George E. Allen, Jr.,
Member, General Assembly, Individual Intervener
Honorable J. Vaughan Gary,
Counsel for National Association of
Independent Insurers, Observer
Charles E. Hammond,
Appearing for Arlington County Board
Honorable Clive L. Duval, 2d,
Member, General
Individual Intervener
Norman S. Elliott,
Counsel for the Commission

page 30 } Commissioner Dillon: Do you want to make an opening statement, Mr. Moncure?

Mr. Moncure: Just a brief one, if Your Honors please.

This is an application for a revision by the National Bureau of Casualty Underwriters, and I believe for the first time it is based upon their own member companies and subscribing companies.

The total premium amounts to over twenty-six million dollars, total premiums, in this reporting and it is based upon the current year 1965. The filing follows the usual procedure in that we take the total number of cars and divide them into the total paid losses to determine whether we are in line on these rates or not.

With regard to the bodily injury, there is no trend factor to increase that figure that we come up with, but with the property damage under the usual basis of calculations, we come up with a one point one six, with an overall
page 31 } picture of a total of nine point nine for the two combined, being five point six for bodily injury and eighteen point five for property damage.

Now, the other unusual situation here is rather than put our witnesses on the stand, they have written up their direct testimony and it has been furnished to counsel for the Commission and to the Commission and to all of the parties here it has been available to them. There is this I would like to say about that. At the time that this testimony was written up by Mr. Philipp Stern, the order of this Commission in Case No. 17680, I believe it is, of May 15th had not been rendered, and portions of this testimony deal with matters that we believe have been put to rest by that order, that is, the income on unearned premiums and on incurred losses. However, I will have him get on and point out what I think is self-evident, that you gentlemen can see it.

Commissioner Dillon: We will only consider
page 32 } that part of the evidence which is applicable.

Mr. Moncure: And, therefore, the procedure here will be, if it meets with the approval of the Commission, I will put Mr. Stern on subject to cross examination by these other gentlemen and go on.

And I believe that's about the gist of it, Gentlemen, and I hope that that will save us time in this matter, and we ask the Commission that it confine this hearing to the matters involved in this application and not for us to go afield into matters not germane to it.

Now I file proofs of the advertising required by the law with return receipts from each paper that the order required.

Commissioner Dillon: That will be received as Exhibit A.

Mr. Moncure: Thank you, Sir.

Commissioner Dillon: Mr. Elliott, do you have an opening statement?

page 33 } *MMr.* Elliott: If the Commission please, the purpose of this hearing, as Mr. Moncure has pointed out, is to revise the rates on behalf of the National Bureau for its members and subscribers.

There are involved two phases of this revision:

One, to revise the rates with respect to what we know as the "Family Policy", namely, the basic rates for fifteen, thirty and five coverage. The information required to make this calculation and in accordance with the—which meets the standards laid down by the Commission in its opinion of May 15th have been submitted and has been carefully checked.

We find no errors in that information. There is a proposal in the filing to eliminate the compact discount of ten per cent, and that proposal is based on the exhibit in the filing which shows the nationwide experience for the National

page 34 } Bureau companies for the years 1962, 1963 and 1964, I believe. That exhibit would tend to show that the compact discount of ten per cent is not justified. However, our Virginia experience is considerably better than the nationwide experience and it seems to clearly justify the continuance of that discount. I might point out that if that discount is abolished, these insureds get not only the rate increase proposed in the filing, the basic limits, but there would be placed on them an additional ten per cent which in some territories might amount to as much as thirty per cent; so in view of what the experience will show it seems to me that it does not justify the withdrawing of that discount for property damage and public liability.

There is a proposal in the filing to revise the formula calculating the Special Package Policy. Now, the Special Package Policy, as the Commission knows, is a one limit policy insofar as property damage and public liability is

page 35 } concerned, and insofar as the number of accidents. In other words, you have a single limit of thirty-five thousand dollars. That's the basic policy, and then it goes from there to other limits as the insured may choose, but that is the basic policy.

That policy has been in effect in Virginia since June 1, 1961. It was a new policy and necessarily any rate for this type of coverage which was radically different from the ordinary policy with basic limits had to be based on judgment. Now, that judgment was exercised in correlating as far as possible by mathematical formula the rates for ten, twenty and five to the basic limit of thirty-five thousand dol-

lars. Now, this policy includes, as I say, not only property damage and public liability but medical payments and a one thousand dollar death accident, accidental death benefits.

We have now had experience through accident
page 36 } year 1965 that is now available, and it seems to me
the time has now arrived when that policy no longer should be tied as they propose to the Family Policy, but should stand on its own feet. That policy has grown to such an extent that just looking at the figures for the Mutual Bureau and the National Bureau there is over six million dollars in premiums in that policy for the last accident year; so it, therefore, would seem to me that we must devise and we must have experience sufficient to put that policy on its own feet and not tie it in any way to the Family Policy because I don't think there is any longer any relevance. The relevance was in the establishment of a base rate to start off with.

As the Commission will recall, this is a similar situation to the Home Owners Policy, in which that policy had numerous coverages and in order to start out we took certain judgment advantages of the rates for the different coverages
involved under that policy. Those rates were tried
page 37 } for a period until we got sufficient time to for-
mulate rates for that policy, and that policy now stands on its own feet.

And I recommend that that be done, and I think it ought to be done, and that this method of tying it to the Family Policy should not be followed.

Commissioner Dillon: Well, do we have enough statistics sufficient now to pass on that or do we have to get additional statistics?

Mr. Elliott: I think we will have to have additional statistics on that proposal, and really I feel we are simply not in a position to adopt that proposal at this time and to really intelligently fix rates on that basis.

Commissioner Dillon: Senator Howell, do you have an opening statement?

Senator Howell: Yes, Sir. If the Commission please, we intend to submit evidence that will establish that the decrease
in rates suggested for the Norfolk area with re-
page 38 } spect to bodily injury rates should be greater than
the ten per cent decrease, approximately ten per cent decrease, proposed in the filings. At some prior time Norfolk was required to pay a much larger premium than certain other metropolitan areas in the State, and it is very apparent that we have a very good safety record down there, and we feel that the overall premium should be reduced and be

comparable with other similar urban areas, but if there are not enough figures to support that, we certainly feel that a good look should be given at the ten per cent decrease for we feel it should be greater.

We will submit evidence that there should be no increase in the property damage phase of the overall liability rate.

Now, in support of those statements our evidence which will be put on through Mr. Grayson Maddrea will show nothing new about this because Mr. Roberts in the thirty-nine thousand dollar report that he rendered to the
page 39 } Commission has showed the fallaciousness in the past practices of escalating the five per cent administrative cost in direct relation to whatever increase that they have received through the years. In other words, we automatically permit them to increase their operating expenses in direct proportion to the amount of premium increases granted; and that was about the only thing that we agreed with Mr. Roberts on, but he did establish that this was a fallacious practice that had been followed by the Commission for the past quarter of a century, apparently.

And so we ask that at this first hearing on rates following the report of Mr. Roberts that we at least follow that practice and that the companies be required to show their actual expenses in Virginia—Mr. Shadoan will allude to that in just a minute—in Virginia and nationwide. Our evidence is going to be that they don't have any filings, they have no
page 40 } statistics to show what their actual operating expenses are, and that any business which is a losing business to come before a rate-making bureau, it is prerequisite that they show that they have made an honest attempt to reduce their officers' salaries, to reduce their advertising output, to reduce every item, to stop building buildings, and take the carpets off the floor, and go in for austere management policies before they come here and ask for the fourth consecutive rate increase in about five years. We feel that's a very salient point and one that we will ask counsel for the Commission and the Insurance Bureau to support us on, in line with the Fondiller report.

Now, the other point that we are going into because at the last contested rate hearing the Commission ruled that although you were rejecting earnings on loss reserves that you would give the policyholder credit for the earnings on his unearned premiums. Now, in the investigation that
page 41 } broke off rather abruptly on page 30, it was suggested that this was an imaginary fund. We intend to put substance into the fund and show this Commis-

sion just how much it is, and we will ask that the Commission adhere to its previous ruling and give the policyholder credit for that.

We are still contending that earnings on loss reserves is a profit factor, but we realize that that is probably a losing battle in this particular Forum, and we respect the strength of the Commission's ruling at this stage of the proceedings.

The third point in asking you to reject any increase for that portion of the liability premium that is composed of property damage, we are going to offer some evidence that has not come before the Commission and the fine-toothed comb was unable to pick up when the filings were reviewed, and that is Mr. Maddrea will submit evidence that the excise tax on automobile parts which is no longer an ex-
page 42 } pense in repair, that portion of the repair cost that is involved in a property damage claim, that when you take that into consideration, which has not been taken into consideration in the filings by this Bureau, that that will justify at least holding their present rate. If you were to take that into consideration, they are bound to save money because their whole statistics that have been presented are based upon the years when they had to pay an excise tax, and now we know as a matter of fact they aren't going to have to pay an excise tax, and that should be taken into consideration by this Commission.

And there are many other factors that will be introduced by counsel for other Intervenors, but we submit that those rather simple factors will justify our request that this increase should be rejected and that the bodily injury rates insofar as Norfolk citizens are concerned be reduced more than ten per cent, but it is refreshing to be coming here for the first time when the Bureau is asking for a decrease in the rates of one segment of the State of Virginia.
page 43 } Thank you.

Commissioner Dillon: Mr. Sacks?

Mr. Sacks: May it please the Commission, as Your Honors probably know, I am a member of the General Assembly, representing with others from Norfolk some three hundred and twenty thousand people in the City of Norfolk, and I arise to speak and I intervene in these proceedings in their interest, and I believe that they coincide with the interest of a number in excess of a million motorists in the State of Virginia.

I say at the outset that to me it is a new experience. I have been here with the Commission in these rate hearings and investigation now over the past two years, and this is the first time that I think there has been as much representation

in physical numbers on the side of the motorists as there has been on the side of the insurance industry. I don't criticize that, but it has just been a factor that I like to mention at the outset of this brand new rate increase hear-
page 44 } ing because, as Senator Howell has said, we are here again for the—where the industry is seeking the fourth raise in five years, and the industry made the statement here, I would recall, Your Honors, that they feel they would have to be back here every year to ask for a rate increase.

And that's the tenor, if Your Honors please, of the opening statement that I want to make because I believe that as this hearing unfolds that real consideration ought to be given to what's happening to the Virginia motorists. These increases, I don't know whether all of us working in these rate-making procedures really appreciate and have knowledge of what the effect is on the outside of this building, those very people that Your Honors are so diligently trying to protect at the same time that you protect the industry and the general opinion of the public is that rates are becoming excessive and unfairly discriminatory and if they are correct, of course, that is in violation of the express statute that has
page 45 } been enacted by the General Assembly of Virginia that dictates what consideration shall be given.

And so, Your Honors, what I am suggesting is that at the beginning of this hearing that we not stop with consideration of what these statistical tables which are prepared by and submitted by the industry carry without regard to other factors which are given in the statute, Section 38.1-252, just as much dignity and influence. I refer specifically to the past and prospective expenses of the insurance industry because I am alarmed, I'm—I question very much where does the brunt and the cost and the expense of the tremendous advertising that the insurance industry puts on, and all of us are familiar with the fact and the evidence will show that the industry just prior to these hearings, just prior to the time when this honorable body will be called upon to make a judicial decision, the industry has flooded the
page 46 } newspapers of the State of Virginia with half-page advertisements, and you don't get those for nothing. In none of the rate hearings that I have ever appeared has there been any evidence of who bears the cost, and the substantial cost, and in none of the rate hearings has there been any evidence produced by the industry as to who is paying the bill for the lobbyists which is, I assume, a substantial one; so I ask this Honorable Commission to de-

termine and inquire in this hearing before a fourth consecutive rate raise is put on the Virginia motorists who is paying these costs, and to second what Senator Howell said, the administration expenses ought to be gone into, ought not to be taken for granted.

We are here to represent the interest of the people, but we are at a decided disadvantage as to these prepared figures, and I think that every effort ought to be made to justify and clarify and fully put before this Commission so page 47 } that Virginia motorists will know if a raise has to come that it is justified what those expenses are and who is bearing the brunt of them.

Now, let me just say one more thing at the outset of the hearing, that I think ought to be considered by all of us. In having worked in this now for the past two years and having a little bit more knowledge about the background of what is happening here than I think any of us as Interveners had when we first came here, it is my understanding that in 1944 in the Southeastern Underwriters Case the Supreme Court of the United States ruled and adjudicated that the business of insurance was subject to regulation by the Federal Government.

It is my understanding that a year later the McCarran—Fergusson Act was enacted by the Congress of the United States which allowed us in the General Assembly of Virginia and allowed this Honorable Commission to regulate insurance and to take under your wing, so to speak, its regu- page 48 } lations; but my further understanding is that it is a conditional delegation by the Federal Government to the States for the proper, effective and fair regulation of insurance.

Now, I state to this Commission, with all due respect, on the street and out of this room there is a tremendous interest on the part of motorists as to how many more times the rate increases are going to come and is the insurance industry going to continue to get apparently everything that they ask for. I say to Your Honors that it cannot continue to rise and rise, no matter what the legal justifications may be, and I don't submit and don't admit for a moment that there are legal justifications in point, but an eye has to be kept and cast on the public interest on what is happening to the motorists because argument can well be made in the future that none of us wants, and that is that the State is not effectively regulating insurance, that the condition under which it was delegated to the State by the Federal Government page 49 } has been breached or isn't being complied with, and that Federal regulation and intervention can

come. Well, I don't think anybody really wants it. It's not necessary to have it; but what I'm trying to say is really sound the caveat that regardless of the statistical, numerical, scientific and analytical basis as advanced by these experts in the industry, this Commission I ask, keep an eye on the ball as far as the interest of the public because it is getting out of hand as far as the average motorist is concerned.

Now, we believe that our evidence will show that the industry is not entitled to another raise on the industry's own figures, if the proper methods are used, as will be advanced, but more than that, in conclusion, I ask the Commission to look to these expenses because past and prospective expenses, both in the State and countrywide, are just as much a consideration under the mandate of the General Assembly as anything else.

Thank you.

page 50 } Commissioner Dillon: Mr. Mann, do you want to make a statement?

Mr. Mann: May it please the Commission, my stance here today is exactly the same as it has been in my previous appearances before this Commission in these insurance rate filings, and that is simply I am here for the purpose of seeing that the proponents of the rate increases prove their case.

Now, let me take this occasion because it is appropriate to this hearing to express gratification to the Commission for the clarity of their opinion in the Aetna Casualty Case. While, of course, I do not necessarily agree with all of the conclusions that were arrived at in that decision, and while there appeared to be a continuation of more concern for the regulated that it was for the insured, nevertheless, I think the opinion clarified the air. I think it gave us for the first time something that we can really touch and see as far as rate-making in Virginia is concerned. I feel that it

page 51 } gave the Commission itself a better understanding of rate-making than it has ever had before. Certainly it gave me a better understanding of it. For that I express my appreciation to the Commission for its decision in that case.

Commissioner Dillon: Mr. Moss?

Mr. Moss: May it please the Commission, I will be brief. Mr. Sacks has to a great extent explained his position here today. I also am a member of the General Assembly from the City of Norfolk and am appearing here today in behalf of the constituents back home.

There are one or two observations I would like to make. One is specifically with reference to the statement made by

Mr. Moncure in his opening statement, wherein he stated that in his evidence today there was mention or made mention of evidence that had since been made obsolete, so to speak, by the May 15th, 1967, opinion by the Commission, specifically with reference to investment income on unearned

page 52 } premiums.

Now, I think today, however, we will offer some evidence to perhaps bolster the position taken before and in addition thereto to present some new evidence as well, and the reason for doing this is because at the last time it was an investigation, and not a judicial, so to speak, hearing, and not subject to any review by any Appellate Court, which, of course, we have today, and for this reason I would beg your indulgence for the evidence we will put on with reference to some of the investment income on unearned premium.

Another thing which really is corroborative of what Mr. Sacks had to say is the position taken by the Commission with reference to whether this increase should actually be granted; and I read with interest that—I think it was a 1952 opinion—that the insurance companies had stated that they had been losing money for over forty years, and yet they are still in business, of course, in spite of this loss. Their stock

page 53 } is worth more than it was forty years ago or even twenty years ago, and their reserves and surplus have somewhat tripled since that time, and it would seem to me that this is truly a very strange situation; and if you will pardon me, to use an expression, it *sorts* of reminds me of the Broadway play not long ago, "How To Succeed In Business Without Really Trying".

If these gentlemen put their minds to it, I am sure that they could find a way to continue to make the profit which they are making, without having a rate increase, and for that reason I would respectfully request that it be denied.

Commissioner Dillon: Mr. Stallard, do you wish to make a statement?

Mr. Stallard: Mr. Shadoan, who will represent the Virginia State AFL-CIO, will make an opening statement.

Commissioner Dillon: Mr. Allen?

Mr. Allen: I want to make a statement, yes,

page 54 } sir. I was going to introduce Mr. Stallard. He said he didn't know whether he was on the record here or not, but I am sure he is.

Commissioner Dillon: He's on the record, yes, sir. We are glad to have him again.

Mr. Stallard: Thank you, Judge.

Mr. Allen: It has been so long.

Chairman Hooker: It has been a long time, but we are glad to see him back.

Mr. Stallard: Thank you, Judge.

Mr. Allen: I wanted to introduce Mr. Stallard and Mr. Shadoan who is here with Mr. Stallard representing the AFL-CIO. I hope you gentlemen will receive them.

Commissioner Dillon: All right. You may proceed.

Mr. Allen: I want to make a statement, and I think Mr. DuVal here would like to make a statement.

Commissioner Dillon: I'm going to come to him.

page 55 } Mr. Allen: Yes, Sir, that's all right. Suppose you take them in the order that you have.

Commissioner Dillon: Well, if you want, while you are up, go ahead.

Mr. Allen: Well, I'll wait for these.

Commissioner Dillon: All right. Who is going to speak?

Senator Howell: Mr. DuVal is next.

Commissioner Dillon: All right. Go ahead.

Mr. Allen: Mr. DuVal is next. Mr. Shadoan is on his right.

Commissioner Dillon: Mr. DuVal, you go ahead and make your statement.

Mr. DuVal: May it please the Commission, my name is Clive DuVal. I am a Delegate representing Fairfax County and the Cities of Fairfax and Falls Church, about three hundred and seventy-five thousand constituents.

I want to first express my appreciation for the

page 56 } courtesy of the Commission in permitting me to intervene on rather short notice.

I learned of this matter and became interested because of the series of complaints I received from constituents who are motorists about the steadily increasing rates they were paying for liability insurance. I looked into the matter, and your Staff was very helpful. They tell me that within the last three years there have been these changes in the rates:

Effective July 1, 1964, there were rate increases for bodily injury of fifteen point one per cent, Statewide; and property damage, fourteen point nine per cent.

Effective January 5, 1966, there were rate changes. Bodily injury rates went down two point eight per cent, but property damage rates went up five point three per cent.

And the present request, of course, Statewide

page 57 } coverages for bodily injury an increase of five point six per cent, and for property damage of eighteen point five per cent.

So Statewide the cumulative increases over a period of less than three years, if the present requests are granted,

would amount to fifteen point nine per cent up for bodily injury rates, and a really very large figure of thirty-eight point seven per cent on property damage rates.

In my own area, the .01 area, this request today, before you today is for an increase of eight point six per cent bodily injury rates, and sixteen point five per cent on property damage.

So I think my people are within their rights in saying that they have been paying high insurance rates and asking you to look into it.

I would like to respectfully request that the requested rate increases be denied for the following reasons; and
page 58 } let me say that I'll be brief because most of my points have already been covered:

But, first, to the extent that I have information and the extent that filings and testimony of the Applicants were made available to me, they relate entirely to showing that the coverages for the statutory levels are unprofitable. There is no filing that was made available to me showing what the situation is on the possibility of writing the excess coverage.

Now, these, it seems to me are two aspects of the very same underwriting business. I don't really see why the Commission in good justice and faith with the policyholders should grant an increase on the statutory rate if on the excess rate a substantial, as we think, profit may be made. It seems to us that there ought to be changes in the filings so as to allocate the losses in some fair and proportionate way as between the premiums paid for the statutory level
page 59 } and the premiums paid for excess coverage.

Now, if we are right in believing that the excess coverage produces a profitable premium, I think that this in itself might well obviate the basis which the companies presented here today for rate increases.

Commissioner Dillon: Let me ask you one question, Mr. DuVal, if I may.

Mr. DuVal: Yes, Sir.

Commissioner Dillon: Along that line, if we find that the premiums on the excess coverage are too high, don't you think we ought to or do you think we ought to reduce those premiums on the excess coverage?

Mr. DuVal: I think that would be one possibility.

Commissioner Dillon: Rather than decrease all of the rates.

Mr. DuVal: That would be one possibility, but since it is all part of one underwriting business, it seems to me that it might be more logical to proportion or apportion
page 60 } or prorate the losses against the total premiums,

so that a certain proportion and a greater proportion would be allocated to excess coverage premiums, and a lesser proportion of losses allocated to the basic level. I think you could do it either way. It would seem at least that since it is all part of one premium in effect that I am paying, I would have to have this coverage, the expense of it.

Commissioner Catterall: Wouldn't that discriminate against you if we made you pay for the other classes? In other words, the whole business of insurance is to classify by the risks.

Mr. DuVal: No, I—

Commissioner Catterall: That's why we have separate rates for the excess premiums. They are in a different class just the way the unmarried men under twenty-five are in a different class. So I think we would have to examine separately the excess premiums as a class and if they

page 61 } are yielding more than the proper return, then they should be reduced.

Mr. DuVal: Well, I see—

Commissioner Catterall: They are in an entirely separate class, and our custom has been to take those up in separate hearings from time to time, so the excess premiums are a percentage of the basic premiums; and all we have here is the data on the basic premiums.

Mr. DuVal: I know that, Sir, but I say you could do it that way. I wouldn't feel discriminated against. I would rather see gross adopted that I have suggested.

The other points have already been raised I think. I think the companies because of the rate-making procedure in which a flat increase would cost a million dollars if granted, I think that an increase in at least certain elements of expense that are involved here which, as this Com-

page 62 } mission pointed out in its opinion in Cast No. 17680, has not been proven or claimed. This may be a small amount, it may be larger. It still seems to me that under those circumstances it should be applied to the benefit of the policyholders and not to the benefit of the companies which have not asked for increases in certain elements of their expense.

Finally, I would also like to ask for a reconsideration of the situation as affecting investment income derived from unearned premium reserves. It seems to me that that money is being held for the benefit of the policyholders. Perhaps the amount is not significant. Perhaps it is very significant. It seems to me that it could be reasonably estimated that whatever it is, since we are talking in accident year 1965,

according to Mr. Stern's presentation of twenty-seven millions in premiums for the statutory coverage itself, plus other premiums for excess, that we are probably talking
page 63 } of a very substantial sum. There is no agreement for interest to be paid, but these moneys are held for the benefit of the policyholders, and it certainly seems to me that it should be taken into consideration as an aspect and an element in preventing the rates from rising further.

Lastly, I call your attention to the fact that, as Mr. Stern concedes in his presentation, that these rates are about two per cent higher than the experience of all insurance companies, the requested rate increase is two per cent higher than the experience of all companies here operating in Virginia would justify.

Based on these various points, I would like to ask that these rate increases be denied.

And I thank you again for the courtesies extended me.

NOTE: At request of Mr. DuVal, his prepared statement ment is copied into the record as follows:

page 64 } "Let me first thank the Honorable Commissioners for their courtesy in permitting me to intervene in this matter.

I requested permission to intervene in this proceeding because of the number of complaints I received from constituents in the Fairfax-Falls Church area of Northern Virginia regarding the steady increase in automobile liability insurance rates for private passenger cars over the past several years.

On looking into this aspect of the matter, I find that there have indeed been substantial increases in the basic fifteen/thirty/five liability insurance rates for private cars, as a result of the rate increases effective July 1, 1964, and the rate changes effective January 5, 1966. In fact, if the rate increases sought by the National Bureau in the present matter are approved, cumulative increases in the basic fifteen/thirty/five rates from and including July 1, 1964, according to information supplied me by your Staff, would
page 65 } amount to a fifteen point nine per cent increase for bodily injury rates and a staggering thirty-eight point seven per cent increase for property damage rates National Bureau companies.

My motorists constitutents cannot be blamed for objecting to rate increases of this magnitude in a period of less than three years.

The witness for the National Bureau says (Page 7 of Stern statement) that 'the experience for the past many

years has shown that although there was a five per cent provision for underwriting profit in the rates, no profit actually resulted from the rates for the National Bureau companies.'

I view this statement with some skepticism. If true, it is difficult to understand why the National Bureau companies would have elected to continue an unprofitable underwriting business in Virginia over a period of many years.

page 66 } Granting that the companies operate in many States and perhaps write other types of insurance, the overall profitability (or unprofitability) of these companies seems to me, nevertheless, to be a matter of interest. I note, for example, that two of the larger National Bureau companies—the Glens Falls Insurance Company and the U. S. Fidelity and Guaranty Company—show large profits over the last five years. According to Standard and Poor's statistics, between 1962 and 1966 per share investment earnings of Glens Falls increased over fifty per cent, and of the Fidelity and Guaranty almost forty per cent. Figures for other companies were not available to me.

Turning now more specifically to the purpose of this proceeding, I respectfully request the Commission to deny the National Bureau's request for rate increases at this time. My reasons are as follows:

page 67 } (1) The filing and the written testimony before this Commission seek to justify an increase in fifteen/thirty/five rates, on the basis that underwriting this basic coverage is unprofitable. But no reference, to my knowledge, is made as to whether the companies underwriting of excess coverage is or is not profitable. In other words, the writing of liability coverage in excess of the statutory limits is part of the total underwriting business of these companies in Virginia, and this aspect of their business may well produce substantial profits for them. If so, it may well be that no increase in their basic fifteen/thirty/five rates is justified.

And certainly no increase should be granted until an investigation of the overall underwriting picture of these companies is available to this Commission and to the public. If, for example, losses were prorated on some reasonable basis between statutory coverage and excess limits coverage, the purported basis for the requested rate increases

page 68 } might well vanish entirely.

(2) I note the Commission's refusal, in its opinion in Case No. 17680 at pages 21-23, to credit policyholders with investment income derived from unearned premium reserves. Nevertheless, I respectfully submit that the amount

of such income is sizeable, could be determined with reasonable certainty, and rightfully should in some appropriate way be an offset to losses paid by the companies.

The National Bureau witness has testified that in the 1965 accident year (page 4 of Stern statement), the fifteen/thirty/five rates produced premiums to the companies involved of twenty-six million, seven hundred thousand dollars. Substantial other premiums would also have been received from writing excess coverage. Even if invested for only part of the year, it seems likely that investment income on
page 69 } these funds would be earned at an annual rate of at least two per cent—or well over half a million dollars per year over recent years. Since funds in unearned premium reserves are returnable to policyholders at their option, interest on these funds should be in effect be applied for their account, in return for the use of their money, to eliminate or reduce rate increases.

(3) As this Commission has pointed out (page 13 of opinion in Case No. 17680), if rates are increased because of increased claims expense, the effect is to increase the amounts received by the companies not only for payment of losses (sixty-four point six per cent of the premium dollars) but also for expenses, profits and contingencies (thirty-five point four per cent)—even though as to at least some items of expense no showing has been made that an increased expense allowance is necessary. Past increases in rates have, there-
page 70 } fore, had the result of providing these companies with increased allowances for expenses which they have not claimed or proved.

(4) The witness for the National Bureau companies concedes (page 2 of Stern statement) that the proposed increases for these companies are approximately two per cent higher than the experience of all companies operating in Virginia could justify.

For all of the above reasons, denial of these rate increases is respectfully requested."

Commissioner Dillon: Mr. Allen.

Mr. Allen: Mr. Chairman, and the Commission: The insurance companies say that they have been
page 71 } losing money for most of the forty odd years since 1920 when they were permitted to commence business in this field; and they are still in business and getting bigger, and at the same time they have created large surpluses.

The situation requires a careful analysis and valuation. We would hope by making a full record at this hearing the issues may be resolved for the foreseeable future enough for all times.

Now, we would like particularly to put an end to the statements that are made in the newspaper advertisements by members of the Press and of the Bar and others, that our verdicts and settlements are responsible for the continued rate increases, since it will be apparent from Mr. Maddrea's testimony here today or tomorrow that the companies have been making a profit on coverages on excess limits, that is, on coverages written in excess of
page 72 } fifteen and thirty thousand dollars.

As Mr. Stern has said before, and I realize now why he said it, that verdicts and settlements have nothing to do with the rate-making, and the fact is on the figures furnished Mr. Maddrea the companies on excess coverages made in the year 1963 a profit of sixteen point three per cent; in 1964 a profit of thirty-two and a half per cent; and in 1965, seventeen and a half per cent.

Thank you.

I think I did introduce Mr. Shadoan.

Commissioner Dillon: Yes. I am going to give him an opportunity right now. Mr. Shadoan.

Mr. Allen: Mr. Shadoan is representing the AFL-CIO here, and I would appreciate you all listening to him.

Commissioner Dillon: We are glad to have you present.

Mr. Shadoan: Thank you. If the Commission please, my name is George Shadoan. I am a member of the
page 73 } Bars of the States of Kentucky and Maryland and of the District of Columbia.

Together with Mr. Stallard sitting over here, we represent the Virginia American Federation of Labor and *and* Congress of Industrial Organizations.

As you know, the AFL-CIO has not been a party to any of the previous rounds of any controversy.

Since our members do make up, however, a significant share of the automobile insurance buying public, we think it is appropriate for us to be here and we appreciate the granting of our request for intervention. I want to make something clear, however. We believe, as members of the public and as representation of those who buy insurance, that we occupy a position of impartiality. We say that because we recognize that the interest of the public and the interest of the industry are not in any significant degree adverse. We
page 74 } recognize that the overwhelming public interest is in the continuing solvency of this industry, so that the hundreds of thousands of the motoring public will not be left without protection in the event of insolvency; but we appear here in opposition to this application because we

believe that there are serious deficiencies in it, which require it to be rejected.

Some of the deficiencies we believe are apparently minor, but are nevertheless rather serious. We will not take the time to discuss them now, but we expect them to appear through the testimony.

We would invite the Commission, however, in this statement to consider what we believe to be the three issues which are central to this proceeding.

With respect to the application, the first issue is whether it complies with the specific requirements of the Virginia Rating Statute when it contains no information
page 75 } with respect to the production expense experience within the State of Virginia, and does not have similar data for some of the other factors that are specifically outlined in the statute.

In answer to that issue, we contend that over the years an actuarial approach for rate-making has developed that is completely independent, or largely independent, of the specific statutory requirements that exist here. The approach which is used, the pure premium approach, is actuarially valid, but it does not comply with the requirements of the statute; and for example, and we would contend from a standpoint of equity, aside from the legal requirements which this Commission must apply to this application, it is equitable.

Testimony has been received in recent months from I believe Mr. Stern—I have the citation—that the Commissioner of Insurance for Virginia has not examined the
page 76 } production expense experience of any Virginia company for ten years. The actuarial approach assumes that the production expense and the general expense provisions in Virginia are the same as they are countrywide, an assumption which we believe is neither valid nor legal, and we believe that this deficiency in the application must be remedied before it can be either granted or rejected with any confidence that it complies with the statutory requirements.

The second issue is whether the application complies with the requirements of law articulated by the Supreme Court of Appeals of Virginia in the Aetna Case, and as ratified by this Commission in its order of November 1965 that due consideration be given to investment income for unearned premium reserves. Insofar as I can determine, this Commission has not spelled out how that consideration shall be given. In the November opinion the Commission
page 77 } noted and accepted the Bureau testimony that it only amounted to one-half of one per cent of the premium after Federal income taxes.

If we assume that if you ignore the "after Federal income taxes", as we submit you should, that the investment income from unearned premium reserves amounts to approximately one per cent of the premium, we cannot say that that is insignificant. This is a representation of statistics designed to create an image of insignificance, but if we remember that the total profit and contingency provision is five per cent, it represents twenty per cent or one-fifth of the entire profit expectation from underwriting, so it is not insignificant; and this filing contains no data whatever concerning the income from investments of the unearned premium reserves.

We believe that the Commission should require this application and any future applications to either be
page 78 } accompanied by such data or have the data computed right into the rates, but certainly it is no consideration to have an application in a filing which has no reference to it whatever.

That leads into the third issue which we contend and we believe is the—is really the central issue of this application and of many of the other applications that have been before this Commission. And approaching this point, I want to say that in the opinion of May 15, 1967, there is one statement which we are in entire agreement with. The procedure looks complicated because it is complicated—that's right. It is inherently complicated.

We do not contend that it is complicated in an effect to smoke screen the realistic. We don't make that contention. We do make this contention though. We contend that this application is lacking in the sort of candor and trustworthiness that you should require before you grant any ap-
page 79 } plication.

For example, and what causes me to bring this issue up in opening statement is the statement in the direct testimony or the testimony in chief that has already been filed by the Bureau before this Commission. On pages 7 and 8 the statement appears:

"We always did and still do maintain our position that any other source of revenue that may be available to the insurance companies as a result of their investment activity need not be considered mathematically in the calculation of rates since it has already received due consideration in the establishment of a 5% provision for underwriting profit."

We regard the representation to this Commission that investment income on unearned premium reserves had already

been given due consideration in the establishment of a five per cent provision for underwriting profit to be such a material misrepresentation of facts as to require
page 80 } the rejection of the instant application. The importance of that representation can only be seen or recognized by looking at the context in which it was made. As late or as early as October 12, 1965, in Case No. 17357 this Commission received into the record a letter from Mr. J. M. Cahill, the General Manager for the National Bureau of Casualty Underwriters, and certain accompanying memorandums, and that letter which appears at pages 493 and 494 of the Official Reporter's notes begins:

"Just before the adjournment of the hearing on June 24, 1965, the Commission asked that information be submitted on the income on reserves.

"The National Bureau reaffirms its position that investment income should not be considered in rate-making since the insurance function should stand on its own" two "feet from the profit standpoint."
page 81 } "Without receding from this position, but to furnish the information requested by the Commission, we have prepared the attached Memorandum 1 on estimated investment earnings on unearned premium reserves, * * * ."

The Memorandum concludes at page 497:

"The conclusion to be drawn from these facts is that it is neither necessary nor desirable to take into account in developing automobile liability insurance rates the very small amount of investment earnings that might be attributed to funds held in the form of unearned premium reserves."

This, while its general context is inconsistent with the position taken today, could possibly be subject to explanation, but Mr. Cahill did not stop with that letter. He went further in his testimony before the Commission, and at
page 82 } various places repeats it should not be considered without qualifying consideration to mean mathematically or due consideration.

But at page 655 he went further and volunteered, so there would be no misunderstanding:

"And, if I might comment just for a moment longer the position of the National Bureau on this issue. As I said before, the National Bureau reaffirms its position that invest-

ment income should not be considered in ratemaking since the insurance function should stand on its own feet from the profit standpoint; and I want to make this important point. It is our further position that if investment income is to be considered at all, it is to be considered in relation to the size of the margin that is reasonable to allow for underwriting profit and contingencies."

Commissioner Catterall: You saw how we
page 83 } handled that in the May 15th opinion.

Mr. Shadoan: The May 15th opinion, as far as I could determine, Your Honor, frankly, the one place unearned premiums was mentioned I thought was a typographical error because it was in context of the discussion of losses there I assumed.

Commissioner Catterall: No, no. We had already decided in a previous case that we would consider the unearned premiums,—

Mr. Shadoan: This is the way I interpreted it.

Commissioner Catterall: —first and then showed how different it was in the case of the loss of reserves.

Commissioner Catterall: And the point we made was the difference of opinion between you and Mr. Cahill is if it's a half of one per cent after taxes or one per cent before taxes.

page 84 } Mr. Shadoan: Well, I want to make it clear—

Commissioner Catterall: I take it you don't want us to consider capital gains because if we did that we would have to consider capital losses.

Mr. Shadoan: Well, in answer to that, it is not in the context in which I would anticipate approaching it, but we would disagree completely, Your Honors, and I'll tell you why.

There is hardly any business that is more heavily affected with the public interest than the insurance business, at least with respect to automobiles. If the market plunges, this State is not going to stand idly by and watch an indusry become insolvent and see hundreds of thousands of motorists be without protection. The public interest is so heavy that some action would have to be taken, and I believe that that argument, that assumption, that we would not
page 85 } consider capital losses is incorrect. I think we have to. It's part of the insurance business.

Commissioner Catterall: No, no. I am speaking about the contention has been made by some expert somewhere that we ought to consider the fact that the stock market goes up three per cent—

Mr. Shadoan: Yes, Sir.

Commissioner Catterall: —every year, and, therefore, we should subtract that from the premium.

Mr. Shadoan: And I'll ask you take it.

Commissioner Catterall: You don't follow that argument?

Mr. Shadoan: I am saying that we believe, perhaps not every year, but we believe the investment income generally is a relevant factor, and we believe that if their investments are bad and they are losing money on investments, we will as the public, in some form will have to step in, page 86 } either through increased rates or in some way to maintain the vital solvency of this industry. In other words, I am answering that question exactly the opposite.

Commissioner Catterall: You want the public to bear the capital losses?

Mr. Shadoan: We would have to. If they reached a stage that their insolvency is imminent for the industry, the public through its government, whether it is this Commission or some other agency, would have to do something.

Commissioner Catterall: You mean a FDIC for insurance companies?

Mr. Shadoan: The form that would take I think would have to be settled in the context of the political and social environment that the issue was raised.

Commissioner Catterall: That's not one of the items in the statute you just quoted.

Mr. Shadoan: No, it is not, and let me say that page 87 } I have not raised that because I think that's a critical issue. It's just one in which I am—one which Judge Catterall raised, and my view on it is a little different from yours. It doesn't scare me that perhaps the public would have to be responsible if there was a serious plunge in the market. I would answer that question, "yes, the public will have to bear that responsibility."

But returning to this, let me say the reason I'm raising this is not from the technical standpoint of what considerations should be given. I am raising this from the standpoint of what I think is central to this and it's an example of the problem that you have. We are talking about a complicated procedure that is difficult to understand and we are talking about the agency that supplies the information does so in a fashion which is not candid, and that's why I am page 88 } going through this because I believe it is unequivocably clear that what has happened is the Commission—the Bureau for twenty years has taken the position that investment income from any source in any

fashion should not be given consideration in any way, whether as a component, mathematically, or in any fashion.

And now they come here because you have decided to the contrary and because the Woodward and Fondiller report suggests it that due consideration has been given in establishing the five per cent factor, and appear here and take exactly the opposite position, and I say this demonstrates the sort of trustworthiness that cannot be countenanced by this Commission.

A month, a month after your opinion in November of 1965, on December 17th of 1965 the Secretary of the National Bureau, Mr. Daniel McNamara, testified before the Insurance Commissioner in Maryland, and in part we find this in the Official Reporter's notes:

page 89 } "Q. In respect to any other State has it ever been a component element in the data underlying rate filings, if you know?"

And they said parenthetically. Here we are talking about component. Now, you have decided your case, so we find it; but what does the answer say?

"A. I can testify that in Maryland as well as every other State as well since the Bureau has been in operation there has been no consideration or reflection of investment income in the determination of automobile insurance rates."

And that appeared in Transcript, 119.

Shortly thereafter he represented to the Commissioner that the NAIC as a body had approved the 1921 Fire Formula for automobile insurance; that is to say—I am sure the Commissioners are familiar with the 1921 Fire Formula
page 90 } that says, "No part of the banking profits shall be considered." He told the Commissioner that had been adopted by the NAIC as a body for automobile insurance, and that was at pages 272 through 275. And, of course, that report in 1921 was exclusively related to fire.

What has happened is that in 1952 the Subcommittee on —I'll get the exact title of that Subcommittee probably, I don't see it here—but the Subcommittee on Cost and Profit Factors of casualty insurance lines rendered a report, and that Committee was unanimous, unanimous in its view that investment income should be considered, that the profit factor allowed casualty lines should not be a factor of the business done, but that the profit factor should be related to the stock-

holders' equity of this capital, that they should receive a percentage of income related to what they have in the business, not the volume of premiums, and concluded that after you consider the investment income and compute that

page 91 } in mathematically, they should be allowed three point five per cent profit, not the five per cent that was requested.

Now, it was in response to that that the National Bureau took up the campaign. That Subcommittee report has never as far as I know, has never been approved nor rejected by the NAIC; it's laying dormant.

But what happened in 1966, just last year? Last year the Rates and Rating Subcommittee of the Committee on Casualty Insurance—Casualty and Surety Insurance I believe is the precise name—was concerned with this national controversy that's arising, and sent out a questionnaire to every insurance department requesting that they respond within two weeks if possible, and almost a hundred per cent did, and we expect to introduce that and show that in answer to those questionnaires, and specifically to Question 12, over seventy-seven per cent, over three-fourths of responding jurisdictions,

page 92 } answered affirmatively Question 12, "Would a NAIC study of sources of profit to insurers be helpful in determining a reasonable underwriting profit provision?"

Now, this, we submit, must be taken and considered in context with the 1952 report because the Memorandum that was submitted in 1952 by the National Bureau in reply to that NAIC Committee had a major subdivision, Subdivision C, which appears on page 20 of the report, which says unequivocally that "the consideration of investment income in arriving at a fair profit margin is unsound, unjust and unreasonable".

Following the Rates and Rating Subcommittee report of 1966, and a report to this questionnaire which I just referred you to, the National Bureau brought up to date its 1952 Memorandum with an additional memorandum which went through the whole prospects of the year, and saying "Don't consider investment income."

In the meantime the Kentucky Commissioner in

page 93 } January, 1967, indicated his concern with investment income and how it should be approached.

Commissioner Catterall: Don't you consider this has all been settled by the May 15th opinion? I mean, these people that are still fussing about it, Mr. Cahill does not approve of it one bit, but they are bound by that decision.

Mr. Shadoan: My whole point here, if the Commission please—

Commissioner Catterall: What you see is a dead horse.

Mr. Shadoan: —is one that if it weren't here—I'm not being a dead horse because—I don't know whether it is because the Commission is embarrassed by the point that I am making or whether I am not making it clear. What I am saying is that the representation made in the direct testimony on file in this application is a direct misrepresentation of fact.

page 94 } Commissioner Catterall: Well, that's the dead horse I'm talking about. Perhaps a dead pig would be better.

Mr. Shadoan: There is a rule with which I am familiar, for which I believe the Latin is *falsus in uno, falsus in omnibus*. What I am saying is that if this is the kind of candor that you can expect in a portion of the report, how can you have confidence in the other data?

Mr. Moncure: Judge, I think we are getting a little far afield. It is not pertinent here and accusations are made that Mr. Cahill can't answer.

Commissioner Dillon: I assume that he is not going to cover this in his argument at the end of it. That is the reason I did not stop him.

Mr. Shadoan: Will, I simply wanted to go through and to outline. As the Commission knows, when evidence comes in, it comes in as parts of a jigsaw puzzle, and unless the picture is drawn in the opening statement, it doesn't have

page 95 } a great deal of clarity, and that's what we are trying to show.

I think that you understand what we are trying to demonstrate and I won't pursue it further, although I will simply say this, that the position in February, in February of this year, the Bureau testified at length and showed its computations of so much, so many dollars for investment income, added it all together and came up with ten per cent. I said, "Well, look, we consider this investment income as ten per cent; it's five per cent on investment income, and it's five per cent for underwriting, and that gives us ten per cent which we say is reasonable."

It was at that stage that when the memorandum was produced and cross examination ensued that the National Bureau withdrew its application. It did so not on the grounds that its credibility had been questioned, but on the grounds

page 96 } that they wanted to submit data with respect to expense experience within the State of Arkansas.

Here's what we would ask at the conclusion of this hearing we would ask the Commission to do:

We would ask the Commission to deny the present application—One.

Two—We would ask the Commission to require the future applications to be accompanied by filings which include specific computations of investment income from unearned premium reserves.

Let me say in the context of that I think that this Department, Commissioner Parker's Department, should set forth the way it should be computed because the Memoranda which this Commission has accepted we would regard as misleading.

Commissioner Catterall: Well, now, you saw how we treated that in the May 15th opinion. We said flatly we weren't going to do that. We are going to consider
page 97 } that they've got money—

Mr. Shadoan: Yes.

Commissioner Catterall: —in advance and that's something to be considered.

Mr. Shadoan: We—

Commissioner Catterall: We consider that either by saying that they ought to make four and a half per cent for profit and contingencies or if they show that they need more money, we would still consider it.

Mr. Shadoan: I am saying that what we are requesting is inconsistent. We have to make it in this context because this is a proceeding which, if my clients feel that it wants, it could have that portion of the decision reviewed. They could not have the portion of your May 15th decision reviewed because it is an investigatory opinion.

Commissioner Catterall: Well, that opinion, of course, will be filed with any application for an appeal, and the
page 98 } Court of Appeals can reverse anything in that decision that it does not permit in it.

Mr. Shadoan: In any event—

Commissioner Catterall: You won't be *be* caught up there with—

Mr. Shadoan: We understand the position of the Commission is inconsistent with this request. We have chosen to make the request in the context of this specific application.

We request that future filings, and let me indicate that I understand that this is inconsistent with the opinion, again, and before we request that future filings include profit provisions which are related to stockholders' equity rather than to premium volume.

Finally, we ask the Commission, pursuant to the provisions of the Virginia Code, to apply an appropriate sanction to the National Bureau for the misleading tactics it has
page 99 } employed in the present application.

In addition, we say that we would urge the recognition of investment income from the loss reserves and from capital and surplus in accord with the recommendations of the 1952 NAIC Subcommittee, and for the reason which was stated in that report.

Yes, I left out a major item. The third recommendation was, and we believe that this is a specific and direct violation of the existing statute, that future applications include specific data regarding production experience and general administration expense experience within this State.

Thank you.

Commissioner Dillon: Are you ready with your evidence?

Mr. Moncure: Yes, Sir.

page 100 } Chairman Hooker: The Commission has a telegram from Mrs. Inez Baker, of Portsmouth, Virginia, a member of the General Assembly, in opposition to this proposed rate increase.

Mr. Moncure: Mr. Stern, come around, please, Sir.

Commissioner Dillon: Now, it is understood that that part of Mr. Stern's testimony in conflict with this opinion will not be considered.

Mr. Moncure: That will be pages 7 and 8 that some of these gentlemen mentioned in their opening statements. They are the pages that are out really, and one little bit on page 3.

Senator Howell: Just a moment.

Commissioner Dillon: Well, let him swear the witness in, please.

page 101 } PHILIPP K. STERN, a witness introduced on behalf of Applicant, being first duly sworn, testified as follows:

Commissioner Dillon: All right. Now, go ahead.

Senator Howell: If His Honor please, on May 8th counsel for the Commission, on behalf of the Commission I assume, said this testimony was received on this date, and being forwarded. We don't feel that it should be taken out of context. I think the whole statement should go in this, not the statement absent certain portions of pages 7 and 8. Do I understand you that you were—I didn't quite understand what the Commission was saying.

Commissioner Dillon: The whole statement will go in, and be copied into the record.

Senator Howell: And what did you say about it?

Philipp K. Stern

page 102 } Commissioner Dillon: We are not going to consider that part of the testimony of Mr. Stern that is inconsistent with our—

Senator Howell: May 15th.

Commissioner Dillon: —May 15th opinion.

Senator Howell: Well, his is consistent with your opinion, isn't it?

Commissioner Catterall: We are not going to consider anything that isn't.

Commissioner Dillon: I don't know; I haven't read it.

Senator Howell: You haven't read it, but I don't think there is anything. I think he anticipated what you all were going to write. I don't know how he had that prophetic instinct, but I see no, I see—

Commissioner Dillon: Well, if he can, he's pretty good.

page 103 } Senator Howell: Our proposition is, if Your Honor please, that there is nothing inconsistent with Mr. Stern's letter and your opinion, that they go like hand in glove, and, therefore, we don't want to exclude anything.

Commissioner Dillon: Well, let's wait and see what it is.

Senator Howell: If you haven't read the opinion, I am sure you don't want to exclude—I mean, if you haven't read his letter, you wouldn't want to exclude it.

Commissioner Dillon: I haven't read his evidence.

Senator Howell: So certainly you wouldn't want to exclude something you haven't read.

Commissioner Dillon: No. He said—

Senator Howell: Until it's all read.

Commissioner Dillon: He said there were certain portions of his testimony that were in conflict with this, and I said, "If it is, we will not consider them."

page 104 } Mr. Moncure: May I get the record straight by putting this in the record? In Mr. Stern's written testimony the last paragraph starting on page 2 and ending on page 3—

Commissioner Dillon: Do you have any more copies of that?

Mr. Moncure: Yes, Sir.

Commissioner Dillon: If we could have three—may we have four?

Chairman Hooker: I don't care for any.

NOTE: Copies handed to the Bench.

Commissioner Dillon: We have plenty of them.

Mr. Moncure: Starting with the last paragraph on page 2 and ending with that paragraph on page 3, that deals with matters which we believe are covered and taken care of in the Commission's order of May 15th in Case No. 17680.

Now, on page 7 starting with the last line on
page 105 } that page and running from that point through
page 8 in its entirety, and ending with the paragraph at the top of page 9, this deals with investment income on loss reserves and on investments which we consider to be moot questions in this hearing. The reason it appears in this testimony we were maintaining our position that they were not proper to be taken into account, but we did not have at the time this was prepared the ruling of this Commission on these two subjects which appeared in its order of May 15th.

And that's why in my opening statement I asked that the ground rules be established that those matters were no longer germaine, and if they are going to be invoked in here, we will find ourselves another seven days; hearing like we had—

Commissioner Dillon: No, we are not going to consider that.

Mr. Moncure: —on a complete and thorough investigation.

Commissioner Dillon: Senator Howell may
page 106 } make a motion if he wants to that we reconsider
that point, and we will overrule his motion, and he can take it on up to the Supreme Court. We are not going to listen to any evidence or cross examination on that point.

Senator Howell: If Your Honor please, on behalf of myself as Intervener, I wanted to go into evidence as a contradiction of the finding of the Commission that the fund is imaginary.

On Page 22, whoever wrote this opinion for the Commission, it just says "Opinion of the Commission", I don't know who the author was unless all three of you participated in it, it described the earnings on unearned premiums as an imaginary fund. We say it is contradicted by the statement on page 8 that they have always considered the fund. That's the only contradiction that I can see.

Commissioner Dillon: All right. You may make
page 107 } a motion that we reconsider it.

Senator Howell: I mean, it would have to go into evidence, you see.

Philipp K. Stern

Commissioner Dillon: No, it doesn't have to go into evidence.

Senator Howell: We have to tender the evidence under the Supreme Court rule. We have to—

Commissioner Dillon: We would be here for three weeks if we let him get into this.

Senator Howell: After all, this Commission is here for eternity, so far as you all know, so three weeks—I mean—

Commissioner Dillon: It's useless, so—

Senator Howell: My point is that the Commission is here to sit and hear these cases.

Commissioner Dillon: If you can accomplish anything by argument for three years, it would be all right
page 108 } with the Commission, but you can't accomplish anything.

Senator Howell: If Your Honor please, I know that you have more experience in the insurance field than any other members of the Commission, but I have had a little bit of experience in law, and the Supreme Court requires us to tender the evidence in order to get a ruling on a rejection of evidence, as I tender it.

Commissioner Dillon: You can tender the evidence in the form of an exhibit, and we will reject the evidence and it will go on up to the Supreme Court.

Senator Howell: All right, Sir. Well, that's your ruling. We are tendering the entire testimony of Mr. Stern. Your Honor has ruled that it is not admissible, the material occurring on pages 7 and 8. We note our exception to Your Honors' ruling.

Commissioner Dillon: We will mark it rejected. It will be with the record.

page 109 } Mr. Moncure: If Your Honor please, I don't think that this Commission's rule is that it would be rejected. I think the Commission ruled that it is a moot question that it's not going to consider.

Commissioner Dillon: No, we are not going into it.

Mr. Sacks: I think, if Your Honor please, you are allowing, are you not, the testimony that the Bureau was required to submit before hand to go into the record? You are not allowing this witness, are you, to withdraw that part from his testimony?

Commissioner Dillon: We are not going to allow cross examination on a moot question.

Mr. Sacks: But what he has testified to—

Commissioner Dillon: Will be copied into the record, his whole testimony.

Mr. Sacks: In toto, so he gets the benefit of
page 110 } what he said, but we don't get the benefit of cross examining him.

Commissioner Dillon: No, he doesn't get any benefit. We are not going to even consider it.

Mr. Sacks: I understand.

Commissioner Dillon: We are not going to consider it.

Mr. Sacks: All right, Sir.

Commissioner Catterall: The ruling is very simple. We had that year long investigation to consider all of these points that you all have raised, and that decision is not going to be changed now, and anything in conflict with that May 15th decision is ruled as immaterial.

Mr. Sacks: But—

Commissioner Catterall: Immaterial.

Mr. Sacks: Commissioner Catterall, may I say this? The investigation was conducted under rules and regulations pertaining to an investigation. My understanding
page 111 } would be that the Supreme Court of Appeals cannot review, and you are the Court of last resort in that instance. Now, the Bureau companies—

Commissioner Catterall: They can review any decision that we make, and they can review any decision we made in that May 15th order. It can be sent up with your appeal in this case and you could ask them to reverse any line, word or sentence in it.

Mr. Sacks: But that's an investigation. Now, now, Your Honor—

Commissioner Catterall: But you have repeated the ruling in this case.

Mr. Sacks: I understand, Your Honor, but certainly the Commission isn't telling the million Virginia motorists that before the evidence comes in we have made up our mind, and you can—

Commissioner Catterall: We have made up our mind about everything in the May 15th decision. That's the purpose of it.

Mr. Sacks: All right, Sir. Exactly, but don't
page 112 } we have the right and the benefit and the privilege when the Bureau comes in to ask for another raise to approach it on the evidence that they put in? What's the use of asking them to give you evidence and statistics and tables if you don't let us cross examine them?

Commissioner Catterall: You can approach this evidence by using the May 15th decision as the law of the case.

Philipp K. Stern

Mr. Sacks: All right, Sir. Well, then, apparently, Sir—

Commissioner Catterall: We don't have to agree on the evidence, but the evidence must be material, and if the topic that is offered to prove something that has been ruled on already in the May 15th decision, then it's irrelevant.

Mr. Sacks: Well, where we differ, Your Honor, is the Commission apparently believes that we can appeal from the investigatory opinion which we feel we cannot.

page 113 } Commissioner Dillon: You can appeal from any ruling we make here today.

Mr. Sacks: All right, Sir. Well, then—

Commissioner Dillon: And that will be included in it.

Mr. Sacks: All right, Sir.

Mr. Mann: Do I understand that what you agree is that every aspect of the May 15th decision is applicable to this case?

A. Yes, Sir, yes, Sir.

Mr. Mann: Then, Your Honors, I wish the record to show that I take exception to that.

Commissioner Dillon: Well, you don't have to except. You have the right.

Senator Howell: If Your Honor please, as a friend of the Court I feel that is *is* incumbent upon me to give you all an opportunity to amend page 30 where you state that the General Assembly raised death limits to fifty thousand dollars in 19 .....—

page 114 } Commissioner Dillon: Well, that's—we don't have the Court's—

Senator Howell: I'm not through yet. It was raised to fifty thousand dollars, and I feel that I owe it to the Commission to let you know what the General Assembly did.

Commissioner Dillon: We understand that. It has been aired in the papers and in the press. We understand that perfectly well, and I don't believe that any of us know whether it is fifty or forty. It's fifty in one paragraph, and forty in the other.

Senator Howell: Well, the Courts and the Legislature know the purpose was to go to forty. The Senate amended the House Bill.

Commissioner Dillon: Well, I don't know. I don't know just how the Court wants it.

Senator Howell: Well, once in a while we would like to get the benefit of forty, not the fifty.

page 115 } Commissioner Catterall: We admit you can't predict now that no plaintiff's lawyer is ever

going to say that the court can't properly go behind the Governor's signature.

Senator Howell: You can't predict they are going to allow fifty either.

Commissioner Catterall: Well, I say we can't predict.

Commissioner Dillon: We can't predict one way or the other.

Mr. Shadoan: With the Commission's permission, I would like to address myself to this procedural point and make a recommendation.

Any time a regulatory body makes such an issue and it's not completely resolved here by the courts, and the issue comes up again, you have this problem. For example, in Maryland the industry understandably is very unhappy with the Commissioner's ruling there, and at the rate hearings

page 116 } which take place they continue to bring in experts from all over the country to contest that ruling, feeling, and they have been allowed to do so on the grounds that they have a right to make their case in this hearing, not in another.

This Commission is anxious to conclude this matter, and I share that anxiety and desire. I would recommend as an alternative if you are not going to receive evidence on these points which you feel have already been sufficiently explored that the entirety of the record in Case No. 17680, which is the investigatory proceeding, be incorporated by reference in this proceeding so that if an appeal is taken from this, the Supreme Court of Appeals can review it.

Commissioner Catterall: You can put in the record on appeal, if you take an appeal in this case, you can include in it anything that you wish to.

Mr. Shadoan: Well, if this Commission will

page 117 } incorporate this record by reference.

Commissioner Catterall: Well, we won't incorporate it in this record, but if you take an appeal you could ask that all or any part of it be copied into the record on appeal.

Commissioner Dillon: What harm would it do to incorporate it by reference in this record?

Commissioner Dillon: Because if you incorporate it now, then they would have to take it all up, and they wouldn't want to pay for all those pages. They can copy it into the record.

Mr. Shadoan: No, they only have to have reprinted that portion they want.

Philipp K. Stern

Commissioner Catterall: In other words, we are not going to make it a part of this record in the sense that Mrs. Wootton would have to copy it over.

Mr. Shadoan: Oh, no, oh, no, I mean by reference.

page 118 }

Commissioner Catterall: We are saying that we take judicial notice of everything in it, but that any appellant could copy in the record on appeal anything from the record in the previous case and anything from the investigatory case.

Mr. Shadoan: I would simply request that it be noted in the record as the Interveners and AFL-CIO Exhibit No. 1, and be incorporated by reference. It does not have to be recopied in the record.

Commissioner Catterall: Well, you don't want to incorporate it by reference now. I don't see how they can put it in—

Chairman Hooker: Why not?

Commissioner Dillon: They want to put it in right now.

Chairman Hooker: I don't see any objection to it.

Commissioner Catterall: Well, wouldn't they have to copy the whole thing into this record?

page 119 }

Chairman Hooker: No.

Mr. Dillon: No, just the part that they want.

Mr. Shadoan: We could designate whatever part we want.

Chairman Hooker: In case they appealed, they can just go down and get our official record.

Mr. Shadoan: It's just like an *exhibiti*, Your Honors.

Commissioner Catterall: An exhibit? Well, to send it up as an exhibit would not cost them very much.

Mr. Shadoan: That's what we are talking about, incorporating this transcript as an exhibit, Exhibit No. 1 of Interveners and AFL-CIO.

Commissioner Dillon: It will be received as Exhibit No. 1.

Mr. Shadoan: Thank you.

Mr. DuVal: I just want to be sure that any exception taken by one of the Interveners applies in behalf of all of us, and we don't have to keep making them.

page 120 }

Commissioner Dillon: Oh, surely.

Chairman Hooker: Under the Constitution you don't have to take exceptions to the Commission.

Commissioner Catterall: Yes. Also the rules relating to appeals say expressly that no exception need be taken because anybody who is aggrieved can take an appeal even if they don't attend the hearing.

Chairman Hooker: If they've got an interest.

Commissioner Catterall: They've got to have an interest. You can't take an appeal unless you are insured by one of these companies.

Mr. Sacks: May it please the Court, I think the point of the gentleman is the same point that I make, and that is he simply *want* to make it known to the Commission, as I do, that we are not happy with the rulings now.

page 121 } Mr. Moncure: I want it clearly understood that that opinion is going to be part of this record when it does go anywhere.

Chairman Hooker: That's clearly understood.

Commissioner Dillon: That will be received as Exhibit No. 2.

Senator Howell: If Your Honors please, can we stipulate before recess that we are parties in interest?

Commissioner Catterall: The only problem with that is that Young—

Mr. Moncure: I'm not going to stipulate anything in that regard.

Chairman Hooker: You've got an insurance policy, haven't you?

Commissioner Catterall: The Young incident took us entirely by surprise, and so we can't stipulate what the Court of Appeals will do.

page 122 } Senator Howell: If Your Honors please, we want to move for a continuance until such time as we have a policyholder that is covered. I'm covered by Travelers, and Travelers is not I don't believe in the National Bureau. We've only got National Bureau here; isn't that right? You've taken in two clumps. You've got the Mutual companies coming in June. I just want to make sure.

Commissioner Dillon: How long will it take you to get your policy?

A. I've got mine. I don't have to get my policy. I am in Travelers. If they are representing Travelers—is Travelers a party in interest here?

Commissioner Dillon: Are they?

A. They are subscribers.

Mr. Moncure: They are a subscriber. That may not mean anything now, I don't think. You may find yourself in the position of Mr. Young in the Supreme Court.

Senator Howell: That's exactly what I know

page 123 } and I don't want to waste my time, and I want to ask the Commission so that we can have this record be meaningful.

Commissioner Dillon: Couldn't you do this, Senator Howell? We could reserve a No. 3 for a copy of an insurance policy issued by one of the companies represented by the National Bureau.

Senator Howell: It doesn't matter, just so I can make sure we go to the Supreme Court. I don't want to sit here and find out that I'm like Mr. Young.

Commissioner Dillon: We will reserve Exhibit No. 3 for—

Senator Howell: For a party in interest.

Commissioner Dillon: For a party in interest.

Senator Howell: For a party in interest whom we may be representing. I am sure among our sixty-five—

Commissioner Dillon: 11:25 A.M. The Commission will recess for ten minutes.

page 124 } 11:35 A.M. The Commission resumes its session.

Mr. Sacks: If Your Honors please, during the intermission Mr. Moncure talked with us, and my understanding is that the National Bureau stipulates that all of the Interveners, except as you have just related to me, except the AFL-CIO are policyholders of the National Bureau companies and as such have that standing in this proceeding.

Commissioner Dillon: It is all right with us, but will that assure you of going to the Supreme Court?

Mr. Sacks: It's a stipulation agreement, and it's a fact in this record here, as I understand it.

Mr. Moncure: I don't know whether the Supreme Court will be bound by my stipulation there.

Commissioner Dillon: And I don't know whether they will be bound by our agreeing to this stipulation. I page 125 } just don't want you to lose your point.

Mr. Sacks: All right, Sir. As long as everybody understands that, it is stated here as a fact that all of the Interveners here—

Commissioner Dillon: It is a fact.

Senator Howell: With the same force and effect as if we produced the policies.

Commissioner Dillon: All right.

Mr. Moncure: Your Honors, I would just relate this to these boys in full justice to them. When we were up there on

one appeal from the Commission by a young man, one individual, the Chief Justice said, "Mr. Moncure, is he properly before the Court?" And my answer to the Chief Justice was, "That's for you to decide; I don't care. He doesn't have any case if he is here." And they saw fit to say he wasn't properly there.

page 126 } Mr. Sacks: Well, my understanding from you, Mr. Moncure, is that if the Supreme Court of Appeals asked you again—

Mr. Moncure: I will say, "I stipulated he is here", but I will not do it for AFL-CIO because I don't know who they are.

Mr. Sacks: All right, Sir.. Well, they will speak for themselves.

Mr. Shadoan: I would inquire as to whether the National Bureau through its counsel would stipulate that Julian Carper, President of the Virginia State AFL-CIO, if called to testify would testify that he had conducted an investigation and found a significant number of the members of the Virginia State AFL-CIO are policyholders of the National Bureau companies?

Mr. Moncure: I have no objection to that statement.

Mr. Shadoan: I say, would you stipulate to this?

Mr. Moncure: No, no, I would not.

Mr. Shadoan: All right, we will present evidence.

page 127 } Mr. Moncure: Stipulate anything on a Labor Union as such without their producing evidence.

Mr. Shadoan: We will produce this, Sir.

Commissioner Dillon: All right, Sir. Go ahead, Mr. Moncure.

Mr. Moncure: I am not turning him over to the Philistines, Your Honor: He is here for cross examination.

Commissioner Dillon: Well, that's what I am saying. You want to identify him and his company.

DIRECT EXAMINATION

By Mr. Moncure

Q. Mr. Stern, will you state your name please, Sir, and your occupation?

A. Philipp K. Stern; Actuary and Manager, Actuarial Division, National Bureau of Casualty Underwriters.

Q. Now, Sir, what education—

Philipp K. Stern

Commissioner Dillon: I think we can—will you
page 128 } all stipulate that he is qualified?
Senator Howell: Yes, Sir.

Mr. Moncure: Judge, sometimes it's important to the Supreme Court for us to know his years of experience.

Q. How many years have you been involved in rate-making processes as an actuary, Mr. Stern?

A. As an actuary, approximately twelve years.

Q. How long before that did you have any such experience with reference to investments?

A. In successive stages as just a plain trainee and assistant actuary.

Q. Please give your degrees of colleges or anywhere else, and also associations of actuaries of which you may be a member for the record, Sir.

A. I am an Associate of the Casualty Actuarial Society which is the professional organization of actuaries. Is that sufficient or do you want me to go beyond that?

page 129 } Mr. Moncure: I think that will be sufficient.
Go ahead. I just wanted something in the record.

NOTE: Direct Testimony as filed with the Commission is as follows:

The filing before the Commission in this hearing has been made by the National Bureau of Casualty Underwriters on behalf of its members and subscribers for automobile liability insurance in Virginia. It proposes to revise the Private Passenger bodily injury and property damage liability insurance rates in the Automobile Casualty Manual and the single limit premium charges in the Special Package Automobile Policy Manual for the liability (including medical expense) coverages. The rates for certain miscellaneous classifications are revised in conjunction with the change in Private Passenger rates.

In developing this proposed revision, ratemaking procedures were employed which are patterned after those used in past Private Passenger rate revisions in Virginia, but there are differences that will be pointed out. The expense experience supporting this filing reflects the same
page 130 } basis as filings in the past, namely that of the
members of the National Bureau. However, in basing the filing on the loss experience of the companies

reporting to the National Bureau of Casualty Underwriters, we have departed from the past practice in this State of calculating rates on the basis of the loss experience of all companies writing automobile liability insurance in Virginia.

The question of loss experience upon which rates should be established was extensively explored in the investigation concerning ratemaking procedures conducted by the Commission during 1966. In the course of those hearings, the National Bureau advocated a system under which rating organizations would file rates on behalf of their members and subscribers, and companies not affiliated with a rating organization would make their own filings. Each filing would be judged on its own merits and on the supporting information on which the rate filer relied. As far as the National Bureau is concerned, we stated at the 1966 hearings that the rate filing would be based on the experience of only the companies that report their statistics to the National Bureau, which is what is done in almost all other States. That experience reflects best the level of rates our companies require for the type of business they write and the service they provide to their policyholders. The combination of National Bureau experience with that of others in Virginia usually has the effect of producing too low a rate level for the National Bureau companies. For example, the experience of all companies for accident year 1965 would indicate an increase of approximately eight per cent, compared with the rate level needs of the National Bureau for an increase of nine point nine per cent. While the difference between the rate level indications of all companies and those of the National Bureau alone is smaller this year than it has been in the past, the principle is important.

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Freeing the companies writing automobile liabilty insurance from the existing rigid unformity in Virgina could have wholesome effects in other areas where progress has been inhibited in the past. At this time we have in mind specifically proposing the introduction of a refined private passenger classification plan that is used by the National Bureau companies in thirty-four other States and the District of Columbia and has been received favorably by the producers and the general public. We have filed this plan in Virginia recently and will request favorable action by the Commission when the plan is considered in a separate hearing.

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Some of the non-Bureau companies have adopted the same

plan in other States and they would probably propose to do so in Virginia after the plan has been approved for the National Bureau companies. Other non-Bureau companies are satisfied with their own class plans which they are using in other States and they may wish to introduce their own plans in this State. And others still may want to continue the status quo for themselves here in Virginia. We believe that each rate filer should be allowed to use the class
page 133 } plan it believes to be appropriate for its business, provided the plan can be reasonably well supported. Opening the door to diverse classification systems will encourage experimentation, strengthen competition and serve the public interest. On the other hand, if rate uniformity were to be continued, the classification system would remain a compromise that satisfies no company.

The fact that this revision will result in manual rates for the National Bureau companies being higher than the rates of other companies in some territories and for some classes should not at all be disturbing or stand in the way of approval. Merchandising in the American economy, with the sole exception of monopolistic utilities, is built on the concept of a wide range of differentiation as to price and quality of the offered goods and services, which is the essence of competition within the free enterprise system.

Automobile liability insurance is no exception.
page 134 } The fact that manual rates might be higher than those used by other companies will not place National Bureau companies at an insurmountable competitive disadvantage. One reason is the recognition by the segment of the public that obtains insurance through the agency system that the services rendered are commensurate to the price. Moreover, members and subscribers of the National Bureau use the Safe Driver Insurance Plan in Virginia, which produces lower rates than manual for the accident-free. Many non-Bureau companies do not use any such merit rating plan; for some of them the lower level of rates they charge or will be charging after the abolition of rate uniformity is in lieu of the rate reduction for the safe driver. For the driver with an accident record, the National Bureau's Safe Driver Insurance Plan superimposed upon rates that are adequate for National Bureau companies will provide an additional avenue for obtaining coverage in the voluntary market. All these considerations are not peculiar to Virginia;
page 135 } in virtually all States the National Bureau companies charge rates that reflect only the experi-

ence reported to the National Bureau. Further, the rate regulatory statute permits any member or subscriber to the National Bureau to apply to the Commission for use of a deviation, downward or upward, from the approved rates.

We shall now turn to the specific exhibits in the rate filing in order to explain the derivation of the proposed rates.

On Exhibit A, Sheet 1, of the filing we developed the Statewide indicated rate level change based upon accident year 1965 experience. You will note that the National Bureau data includes the experience of four hundred and nineteen thousand cars, in round numbers, insured during 1965. These cars produced a premium at present fifteen/thirty/five rates of close to twenty-six million, seven hundred thousand dollars, well above the volume required to meet the standards of our formula according to which the rate level is based upon the experience for one year. In this revision, we are

page 136 } able to utilize experience up to limits of fifteen thousand dollars per person/thirty thousand dollars per accident and five thousand dollars for property damage, the minimum required by the financial responsibility law. Correspondingly, the underlying pure premiums reflect the premium charges for the same limits.

As in prior revisions, we have reviewed the average paid claim cost data in order to determine to what extent a trend in loss costs exists. For bodily injury, no clear indication is presented by the average paid claim cost of a trend either upward or downward, and we are, therefore, using a factor of unity for this coverage. We note, however, as we have pointed out to the Bureau of Insurance in the supplementary information submitted in support of this filing, that average paid claim costs on a total limits basis have risen substantially in Virginia during the latest year. In reviewing bodily injury average paid claim costs all amounts above five thousand dollars on every claim payment are eliminated. This

page 137 } practice was established many years ago when financial responsibility limits in many States were still at a low five/ten bodily injury limit. The purpose of this exclusion was to avoid large fluctuations due to exceptionally large claims. In view of present conditions as respects claim costs in general as well as existing financial responsibility limits, the five thousand dollar limitation is much too conservative and has a depressing effect upon the data that are used to determine trend. Since the required minimum limits in Virginia are fifteen/thirty, and the statutory limit for

death is fifty thousand dollars, the use of total limits average paid claim costs for the review of trend would be more realistic than our present method. We have begun to accumulate average paid claim cost data with a limitation to ten thousand dollars on every individual claim, but we do not yet have this information for a sufficiently long period of time to use for trend purposes. In order to avoid
page 138 } any possibility of introducing a chance fluctuation through the use of total limits data and because average paid claim cost data limited to ten thousand dollars are not yet available, we are continuing in this review the use of the conservative five thousand dollar limitation. On the basis of these data, as stated before, we conclude that no adjustment should be made on the bodily injury losses.

For property damage insurance, Exhibit A, Sheet 3, shows average paid claim costs for the years ended June 30, 1963 through March 31, 1966, by quarterly ending twelve month periods. Column (4) in that exhibit shows the steady rise of average paid claim costs, and the increasing rate in this rise. These data and many other economic indicators lead to the conclusion that further increases in property damage liability claims costs are to be expected. That means that property damage claims arising from policies that will be written at the new rates will be higher than the average claim costs reflected in the available accident year ex-
page 139 } perience. The extent of the increase must be measured in relation to the time element. When the filing was prepared, it was contemplated that an effective date of May 1, 1967 would be achieved and that the revised rates would be in effect for one year at which time they would be replaced by rates reflecting later experience. Policies written during that year would be in effect beyond that one year period, and the last policy written would not expire until April 30, 1969. During this entire span, accidents would occur under these policies and each resulting loss would reflect the then prevailing loss level.

The midpoint of that period, namely May 1, 1968 is representative of the loss level that will prevail between May 1, 1967 and April 30, 1969. From July 1, 1965, the midpoint of the latest accident year, to May 1, 1968 average paid claim costs are expected to rise at a rate of nine dollars and seventy-six cents per year. In the twenty-three months
page 140 } that have elapsed from July 1, 1965 to date, the trend line indicates that claim costs have already risen by eighteen dollars and seventy-one cents. The addi-

tional calculated increase of eight dollars and ninety-one cents for the remaining eleven months does not even carry the adjustment to the midpoint of coverage we aimed at since the anticipated May 1 effective date for revised rates did not materialize.

Returning to Exhibit A, Sheet 1, this increase is applied to the property damage pure premium in line 6 to produce the rate level pure premium in line 8. In this connection it is noted that the factor to include the unallocated loss adjustment with the reported incurred losses including allocated loss adjustment is one point one three five in this filing compared with one point one six in the last revision. This change resulted from a review of the experience and has the effect of reducing the rate level indications for property damage liability by two point six percentage points.

page 141 } The underlying pure premium for bodily injury and property damage respectively in line 9 is the loss portion of the present respective average rate. The present Statewide average rates are shown on Sheet 2 of the Exhibit as forty-two dollars and thirty-eight cents for bodily injury and twenty-one dollars and thirty-three cents for property damage. The underlying pure premiums were determined by applying the expected loss and loss adjustment ratio of point six four six to the present average rates. Supporting information for the determination of the expected loss and loss adjustment ratio is found in the material submitted to the Bureau of Insurance in response to its letter of March 10, 1967. It consists of the review of countrywide expense experience of the member companies of the National Bureau of Casualty Underwriters for the latest three years available, calendar years 1963 through 1965. This review indicated that the same expense provisions should

page 142 } be continued as were used in the last Virginia rate filing with the exception of the unallocated loss adjustment referred to before.

The expense provisions in the rates are set forth on Sheet 11 of Exhibit A. In addition to the expense items supported by the review of the Insurance Expense Exhibit they include the usual budgetary provisions for production cost allowance and for taxes, and a margin of five per cent for underwriting profit and contingencies.

We urge again, as we have done in prior hearings, that this provision be continued in the rates. The experience for the past many years has shown that although there was a five

per cent provision for underwriting profit in the rates, no profit actually resulted from the rates for the National Bureau companies. The National Bureau compilation of private passenger experience for accident years 1963-1965, which we submitted to the Bureau of Insurance, clearly shows that the actual loss and loss adjustment ratio in
page 143 } Virginia for private passenger cars including assigned risks has averaged eighty-one per cent, which is approximately eleven percentage points higher than the provision in the rates for loss and loss adjustment and for underwriting profit. For the past three years, and probably for all years since World War II, the five per cent profit provision was merely a contingency cushion, and not adequate at that. But even if five per cent were earned as underwriting profit, this would be before Federal Income Tax which is currently at a rate of forty-eight per cent. Therefore, after Federal Income Tax, there would only be left two point six per cent of earned premiums as an underwriting profit.

We always did and still do maintain our position that any other source of revenue that may be available to the insurance companies as a result of their investment activity need not be considered mathematically in the calculation of rates since it has already received due consideration in the
page 144 } establishment of a five per cent provision for underwriting profit. Nevertheless, information has been supplied in 1965 and 1966, and again recently at the request of the Counsel to the Commission, on the rate of return from the investment of the unearned premium reserve. The various calculations show that this rate of return is about one-half of one per cent of earned premium after Federal Income Tax.

The question also has been raised whether investment return on loss reserves should be considered in the ratemaking formula. We again state that this should not be done. Loss reserves are not held for conditional return to the policyholder as are unearned premium reserves. The payment of losses arises out of the risk that the company assumes and the company stands behind this obligation with all of its assets; the loss reserves merely provide a quantitative estimate of the potential liability. As premiums from current underwriting operations become earned they flow into the funds that contribute to the company's assets. A
page 145 } portion of these additions to the surplus account corresponding to the loss provision in the rate

will be required to pay losses. If losses exceed the loss provision, other company assets have to be used to fulfill the company's obligation. The company then suffers a loss through the drain on its assets, and its ability to obtain an investment return on its own funds is impaired. The ratemaking procedure does not allow recouping past losses due to inadequacy of the loss portion of the premium dollar. It would be irrational to take into account any investment income on that portion of the company's assets that are used eventually for the payment of losses without recognizing at the same time that during the same period the company lost investment income on its own capital funds that had to be used for the payment of losses and had to deplete its own funds to subsidize the underwriting operation.

After this explanation of the expense structure that determines the underlying pure premium, we return
page 146 } to the Statewide rate level exhibit.

A comparison of the underlying pure premiums with the rate level pure premiums produces the Statewide rate level changes in line 10 of Exhibit A, Sheet 1, namely, increases of five point six per cent for bodily injury, eighteen point five per cent for property damage and nine point nine per cent for both coverages combined. These percentages would have been somewhat higher if we had reflected the effect of the Safe Driver Insurance Plan. The changes made in the Plan in the revision that became effective in January, 1966 did not completely balance the Plan. The latest distribution produces an off-balance of point six per cent which was not reflected in our calculation of the average rate.

The next step in the ratemaking procedure is the distribution of the Statewide rate level changes among the existing territories as shown in Exhibit A, Sheet 4, for bodily injury and in Sheet 5 for property damage. As in prior
page 147 } revisions, this distribution is made by a formula that treats all territories alike so that each territory participates in the Statewide rate level change in proportion to its contribution to the overall loss experience. Column (6) demonstrates the relative position of each territory. For example, for bodily injury, it is shown that Arlington and Fairfax Counties need an increase four point one per cent higher than the Statewide average while Richmond is only two point two per cent higher and Norfolk is fifteen point two per cent lower than the Statewide average. Consequently, as shown in Column (7), the increase is some-

what higher in Arlington and Fairfax Counties than it is for Richmond, while the rate level in Norfolk is reduced. As was pointed out here in the past, the rate level in any territory depends entirely upon the claim record of the insureds in that territory. Regardless of where an accident occurs, the resulting loss is assigned to the territory in which the car that is responsible for the accident is garaged, page 148 } and no territory is charged for accidents caused within its boundaries by cars garaged somewhere else.

The revised rates are calculated in Column (9) by first applying the per cent change to the present average rate and then converting the new average rate into the Class 1A rate by dividing by the average classification differential. For bodily injury, the new rate is converted at the same time to a ten/twenty basis since the manual is still published in that fashion.

In this connection, we have informed the Bureau of Insurance that we would not oppose an interim arrangement in the manual rate pages to recognize that a larger percentage of insureds purchase bodily injury coverage at fifteen/thirty limits. The National Bureau will, if requested, include a supplementary rate schedule of fifteen/thirty bodily injury rates in the manual. The ten/twenty bodily injury rates are needed in order to calculate the premium charges page 149 } for higher limits since the increased limits tables uses ten/twenty as a base. The new classification plan which we referred to earlier shows base rates for several of the most popular limits combinations which would include in Virginia the fifteen/thirty limit when the class plan is introduced.

Rates for the other private passenger classifications are shown on Exhibit A, Sheet 7. They were determined by applying the present classification differentials, shown on Exhibit A, Sheet 6, to the revised Class 1A rates.

Sheet 7 of Exhibit A also shows rates for Employers Non-Ownership Class 1, funeral cars and school buses. Rates for these classifications are determined in relationship to the Class 3 private passenger rates as shown on Exhibit A, Sheet 9. These relationships are reviewed periodically on the basis of country-wide experience. Such review is included in this filing on Sheet 10 of Exhibit A. On the basis of the reviewed data, the percentage relationship for Employers page 150 } Non-Ownership Class 1A rates is reduced from seven per cent of the Class 3 rate to five per cent

of that rate for bodily injury and property damage. For funeral cars, the relationship is reduced for bodily injury from one hundred and ten per cent to one hundred per cent and for property damage from one hundred per cent to eighty per cent of the Class 3 rate. No changes are made for school buses.

Exhibit B of the filing sets forth the revision of the Special Package Automobile Policy premiums. It is proposed at this time to continue the same relationship of the price for the Special Package Automobile Policy coverage to the price for comparable coverages under the Family Automobile Policy as exists today. This approach is supported by the comparison of the loss ratios at present rates shown in the exhibit. We have made this comparison on the basis of bodily injury and property damage premiums and losses and did not include the medical coverage because the latter coverage was changed in Virginia subsequent to the latest available experience period through the elimination of a

page 151 } provision that affected the loss potential. For bodily injury and property damage combined, the Special Package Automobile Policy produces almost the same loss ratio at present rates and for comparable limits as does the Family Automobile Policy. From this, it can be concluded that the present relationship in the premiums is supported by the experience. Rates calculated on this basis are shown in Sheets 1 and 2 of Exhibit 8. The revised premiums for this policy will produce an increase in overall premium level of seven point two per cent Statewide.

We have not proposed in this filing any change in the medical payments rates in the Automobile Casualty Manual and no change has been proposed in the present rate for the uninsured motorists coverage shown in the Automobile Casualty Manual and also shown, separately since the January, 1966 reprint, in the Special Package Automobile Policy Manual.

For the medical payments coverage we sub-

page 152 } mitted supplementary information to the Bureau of Insurance which showed that only a small change of minus one point seven per cent is indicated by the current experience. Such small per cent change on relatively low rates would not alter the dollar rates in the table.

The review of the uninsured motorists coverage rates requires reference to the loss experience as well as to the revenues available from the uninsured motorists fund from

which payments are made to the insurers annually in proportion to each company's uninsured motorists premium volume. Since the calculations regarding the uninsured motorists fund have to be on an all-company basis, the comparable loss experience of all companies has to be used.

The filing includes a proposal to eliminate the manual rule providing for a ten per cent discount for compact cars. This proposal is based on countrywide experience for the years 1961 through 1963 which was the latest available information when the decision was reached to make this rule change in all other States. This experience verified the increas-
page 153 } ing awareness of underwriters that compact cars did not present the lower hazard that was expected when the compact car discount was introduced on a judgment basis. One reason for the disappointing performance is the creation of accident situations by compact cars, even if they themselves do not get involved in the accident. Further, the design of American compact cars in recent years has changed to make them more similar to full size cars.

The discontinuation of the compact car discount will have the effect of increasing the collectible premium by an estimated one point two per cent. Therefore, the rate changes required to produce the proposed increase in premium level are reduced by this amount. This calculation is carried out in the development of the rate level changes by territory in Sheets 4 and 5 of Exhibit A of the filing. Thus, in order to produce a five point six per cent increase in the bodily injury Statewide premium level, a plus four point three per cent rate level change is shown in Column (7) on
page 154 } Sheet 4; similarly a rate level change of plus seventeen point one per cent for property damage is included in Sheet 5 to produce a premium level change of plus eighteen point five per cent.

In response to a request from the Bureau of Insurance, we have submitted the Virginia private passenger classification experience which included: (a) data by the existing private passenger rate classes, (b) experience for single car versus multi-car risks, and (c) experience on young drivers, comparing those with and those without the driver training credit. In view of the filing we have already made of the new classification plan in this State, we suggest that the review of classification experience under the present class plan is academic. To a great extent the new class plan follows modifications indicated by the experience developed countrywide which was available at the time the new class plan was designed.

Philipp K. Stern

In that respect, the new classification plan will bring about changes indicated also by the Virginia experience.

We submit that this filing meets the statutory
page 155 } requirements and that the proposed rates will not be excessive or inadequate for the members and subscribers of the National Bureau and that they will not be unfairly discriminatory. The latter characteristic, of necessity, has to be clarified in light of our pending proposal for early consideration of a revised private passenger classification plan. That proposal has not yet been heard by the Commission and all evidence has not been placed before it. Consequently, we describe the present classification plan as a plan that produces rates that are free from unfair discrimination by the status of present knowledge. When all the evidence has been presented, we will ask the Commission's approval to replace the present class plan by a class plan that will distribute the cost of insurance more effectively among the various types of risks in relation to their loss producing hazard.

The establishment of adequate rates for our member and subscriber companies combined with a responsive classification system will go a long way toward re-building
page 156 } a free and stronger market for automobile liability insurance in the State of Virginia, marked by vigorous competition and high standards of performance by the companies in relation to their policyholders.

We respectfully request early and favorable action by the Commission.

Commissioner Dillon: All right, Mr. Elliott. Do you want to cross examine?

CROSS EXAMINATION

By Mr. Elliott

Q. Mr. Stern, one of your proposals in this case is to eliminate the ten per cent compact discount; is that corrrect?

A. That is correct.

Commissioner Dillon: Just one minute before you continue. I don't think that he testified that he prepared this evidence to the best of his knowledge and belief. The Supreme Court may want to know that.

Mr. Moncure: All right.

Philipp K. Stern

Q. Mr. Stern, this filing with the Commission was prepared I believe under your supervision, Sir, and has
page 157 } been checked by you in every respect?
A. That is correct, sir.

Q. And the figures that appear therein are correct from your records that subscribing companies furnished you; is that correct, Sir?

A. That is correct, Sir.

Q. And they are furnished as directed by this Commission and its Insurance Department?

A. Yes, Sir.

Commissioner Dillon: All right. Now, Mr. Elliott.

Mr. Elliott

Q. And I believe you base that request on your Exhibit C, Sheet 2, with the filing; is that correct?

A. That is correct, yes.

And that exhibit shows bodily injury and property damage experience for compact cars nationwide for all companies reporting to the Mutual Bureau and the National Bureau for policies, for accident years 1961, 1962, and 1963, and the same percentagewise; is that correct?

A. Approximately the same, yes, Sir. Oh, I'm
page 158 } sorry—yes, that is correct.
Q. Now, while that exhibit seems to support that conclusion, the experience in Virginia doesn't follow that pattern, does it?

A. Yes, that is correct, but I want to point out that our classification plans are designed for countrywide application, and you do get fluctuations by State or by territory which may not always be in line with the countrywide results.

Now, we believe that eventually the compact cars in Virginia will show the same kind of information as our much broader information shows countrywide. I want to at the same time explain to you that these additional revenues that will result from the elimination of the ten per cent discount have been reflected in our calculation of rates, and the proposed rates are correspondingly lower; so that everybody will benefit from the elimination of this discount other than the compact cars by lower rates than would have resulted without that elimination.

page 159 } In the development of rates on Exhibit A, Sheets 4 and 5, we reflect the additional revenue in Column (7), and then to follow that I have to refer you to

Sheet 6 which is a note sheet, and there with reference to Column (7) it states that Column (6) was adjusted by Statewide rate level changes, decreased to reflect the increase in premium level of one point two per cent which will result from the elimination of the compact car discount.

Q. Well, what you are saying is that on Sheet 1 of Exhibit A that you show a proposed Statewide rate level change of five point six per cent for bodily injury and eighteen and a half per cent for property damage or a combined increase of nine point nine per cent. Now, in the application of the rates you have given effect to a proposed ten per cent increase in the compact cars?

A. That is correct. And, therefore, in Column (7) on Sheets 4 and 5 of Exhibit A; you will notice that the rate of a factor

page 160 } for bodily injury is one point zero four three rather than one point zero five six which it would have been if we had kept to the figures on Sheet 1.

Q. Now, the latest available experience, as I have it in Virginia, for National Bureau and Mutual Insurance Rating Bureau companies is for 1964 and 1965 for compact cars and standard-size cars. Have you seen that exhibit?

A. I did not—I probably have it, I did not study it. This is a Mutual Bureau exhibit.

Q. Yes.

A. We submitted to you—

Q. Well, that's on the same basis as—

A. Yes.

Q. —as your Exhibit C, Sheet 2, to which you have just referred, is it not?

A. Yes, it is on the same basis, but this exhibit shows Virginia experience of the Mutual Bureau and National Bureau combined. That is the basis on which the Mutual Bureau will use the experience in making rates. We submitted to you in—

page 161 } Q. Well, before we go beyond that—I'll get to your exhibits in a minute or two—but your Exhibit C, Sheet 2, "Countrywide Experience for Mutual Insurance Rating Bureau Companies and National Bureau Companies for Accident Years 1961, 1962 and 1963, and for Standard-Size Cars for the same years"?

A. That is correct.

Q. And the exhibit I have just handed you is for all companies reporting to the Mutual Insurance Rating Bureau and the National Bureau for accident years 1964 and 1965, for

compact cars and standard-size cars, and that is the Virginia experience?

A. That is correct.

Q. Now, that exhibit, if you will look at it, shows the loss ratio, total limits loss ratio, for compact cars for the two years of point seven one one, and for standard-size cars of point seven four four; that is correct, is it not?

A. That is correct.

Mr. Elliott: I ask that this be received as Exhibit No. .....?

page 162 } Commissioner Dillon: Senator Howell, did you decide not to produce Exhibit No. 3?

Senator Howell: We have reserved it.

Commissioner Dillon: We reserved it, and I didn't know whether your stipulation took care of it or not.

Senator Howell: We want to keep it.

Commissioner Dillon: Well, that will be Exhibit No. 4 then.

Mr. Elliott:

Q. Now, at our request, you also furnished an exhibit showing the 1964 and 1965 experience for bodily injury and property damage for compact cars and standard-size cars, together with the bodily injury and property damage combined for compact cars and standard-size cars, for accident years 1964 and 1965; is that correct, Sir?

A. That's correct.

Q. Is that the exhibit I show you?

A. Yes, Sir.

page 163 } Mr. Elliott: I ask that that be received as Exhibit No. 5.

Commissioner Dillon: It will be received as Exhibit No. 5.

Mr. Elliott

Q. Now, that exhibit for compact cars, for bodily injury shows a loss ratio for total limits of point six four one for the two years?

A. Bodily injury, that is correct, yes.

Q. And for property damage point eight zero four for the two years?

A. Yes, Sir.

Q. Now, for standard cars it shows bodily injury loss ratio for the two years of point seven one one; is that correct?

A. That is correct.

Q. And for property damage point eight zero nine?

A. That is correct.

Q. And turning to the combined for the two years, for the compact cars the bodily injury and property
page 164 } damage combined shows point six eight six; is that correct, Sir?

A. That is correct.

Q. And for bodily injury and property damage combined for standard-size cars point seven three eight?

A. That is correct, Sir.

Q. What is the earned exposure of compact cars reporting to the Mutual Insurance Rating Bureau and the National Bureau for the two years, 1964 and 1965, as shown on Exhibit No. 4? That would be a hundred and sixty-nine thousand, four hundred and eighteen?

A. Yes. We would have to bear in mind that this means approximately eighty-five thousand per year; the latest year is eighty-eight thousand. That's the number of cars which are involved, about eighty-eight thousand or eighty-five thousand per year.

Q. And you have a total for the two years of standard-size cars of approximately eight hundred and seventy thousand, five hundred?

A. Yes, except again we have to realize there's
page 165 } a doubling up. It's the same cars, the same drivers, about four hundred thousand standard cars against—

Q. Per year?

A. Eighty-five thousand per year, yes.

Q. Per year against eighty-five thousand?

A. Right.

Q. And for the National Bureau alone you have approximately—oh, I would say seventy-two thousand per year?

A. Yes, for compacts.

Q. For compact cars, and approximately three hundred and forty-three thousand for standard-size cars?

A. That is correct.

Q. Now, turning to the Special Package Policy, you are proposing to change the method of calculating the rate on that policy and are tying it into the rates for the Family Policy; is that right?

A. That is correct. The change is only in the
page 166 } mechanics of calculating rates. The procedure

of tying the rates for the Special Package Automobile Policy into those rates for the Automobile Casualty Manual is a standard procedure which is not new in this revision, as we have in the past tied the two policies together by a formula which changed from time to time.

Q. Well, let's look at the Special Package Policy. The Special Package Policy became effective for use in Virginia on June 1, 1961; is that correct?

A. I assume that's correct.

Q. And it has been in effect or it has been used by companies electing to use it since that time?

A. Yes.

Q. Now, the Special Package Policy is a one-premium policy, based on a single coverage or a single limits coverage for bodily injury and property damage plus medical payments, plus an accidental death benefit, and there

page 167 } is added to that the uninsured motorists; is that right?

A. That is added separately in Virginia.

Q. Yes, I mean that—that, of course—

A. We do not include the U. M. rate component in the formula.

Q. Well, it's a single rate. Other than the four dollars per year or two dollars per half year; is that correct?

A. That is correct.

Q. Now, this policy is a slightly different policy from this Standard Policy, is it not?

A. There are some differences, yes, Sir.

Q. Well, there are many differences there?

A. Yes, Sir, there are.

Q. Your basic Family Policy is a fifteen/thirty and five insofar as liability is concerned?

page 168 } A. That's correct.

Q. And your basic Family Policy starts at thirty-five/thirty-five/ thirty-five?

A. Not exactly. It is a thirty-five thousand single limits, which is somewhat different from thirty-five/thirty-five/ thirty-five.

Q. Well—

A. I know what you mean. It is a single limits—

Q. A single limit of thirty-five thousand dollars?

A. Yes.

Q. In other words, if one insured or if an accident occurred, the company's liability is thirty-five thousand dollars?

A. That is right.

Q. Whereas, if under the Standard Policy it would depend on whether more than one claimant was hurt, in which event the limit would be thirty thousand dollars; if only one were hurt, then it would be fifteen thousand dollars?

page 169 } A. That is correct.

Q. And if property damage was sustained, the limit would be five thousand dollars?

A. Correct, Sir.

Q. Now, this policy was a new policy in Virginia and it was necessary to use a judgment rate with respect to it, was it not?

A. That is correct, yes, Sir.

Q. And that judgment rate was based upon the application of certain known facts to certain things that you could expect under the Special Package, such as it was necessary to apply judgment factors in order to raise the basic limits of the basic policy to this one limit; is that not right, Sir?

A. Yes, that is basically correct, Mr. Elliott. However, we relied on judgment only to a very small extent in this area. There was more judgment involved in other areas. In order to raise the coverage from fifteen/thirty and five to a single thirty-five thousand, we went through a

page 170 } number of calculations based on the existing entries in these tables, and then we had to make a judgment decision of which combination is most likely to be effective and which combination—we had to go to certain assumptions as to the accepted effective coverage, but we relied mainly on our existing entries in these tables.

Q. That original judgment I believe you applied to the bodily injury portion of the original ten/twenty written; is that not right?

A. Yes, that is correct.

Q. And you also applied modified factors with respect to the five thousand dollar limit in the ten and twenty rate?

A. That is correct. That was true at that time at least.

Q. You applied half of the medical payments—correct?

A. That is correct.

Q. Now, the rates for the Special Package

page 171 } Policy have not always been tied to the rates for the Family Policy; isn't that true?

A. Let me say "Yes", but I have to modify that. They have been tied to the Family Policy rates, but in a different fashion because of different conditions that prevailed at the different times of the revisions of rates.

Q. Now, in 1963 there was a revision of rates for the

Standard Policy, but that revision was not tied into or applied, at the Bureau's request, to the Special Package Policy?

A. That is correct.

Q. Thereafter, in July 1964 there was a revision, but that revision was applied except that the 1963 revision was eliminated; is that correct?

A. You may put it that way, yes, Sir.

Q. Well, that was the effect of it?

A. That was the effect of it, yes, Sir.

Q. And now it was again revised in January 1966?

A. Yes.

page 172 } Q. And at that time the full revision of the Family Policy was applied to the Special Package Policy plus I think the medical payments were increased to seventy-five per cent; is that correct?

A. Yes.

Q. And these were done by formulas which—for the spreading of this original ten/twenty and five rate?

A. Partly for that purpose and partly to reflect the overall packaging discount which is reflected in the rates.

Q. And that was a discount of fifteen per cent?

A. In round numbers, yes. It is not exactly fifteen in every territory.

Q. Now, at the time of the January 1966 revision you had fairly limited experience in the Package Policy, did you not?

A. Yes, that is correct.

Q. At that time we were working on 1963 accident year experience?

page 173 } A. Right.

Q. We now have under this policy experience for part of accident year 1961 and for all of accident years 1962, 1963, 1964 and 1965?

A. That is correct.

Q. And the exposure under that policy is right considerable, is it not?

A. Well, for the National Bureau not as substantial as it would be for the other companies and for us it is approximately ten to twelve per cent of the total that is written under the Special Package Automobile Policy.

Commissioner Catterall: Total automobiles or total premiums?

A. I am looking at premiums, total—

Commissioner Catterall: Total premiums?

A. Total premiums, yes.

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Commissioner Catterall: Total of all premiums?

A. Yes. Well, I'm reading from Exhibit B of our filing which shows three million dollars in round figures of Special Package Automobile Policy premiums at present

page 174 } rates, and about twenty-six and a half million dollars for the Family Automobile Policy.

Mr. Elliott

Q. Is that an exhibit which shows your total exposure?

A. No, it does not show the exposure, Mr. Elliott. It shows the premium. I have the—

Q. Hasn't that premium been pulled out and adjusted?

A. Yes, Sir. It is a calculated premium at present rates for bodily injury and property damage only.

Q. And at fifteen/thirty and five rates?

A. Yes, that is correct.

Q. Now, not at the single limit of thirty-five thousand?

A. That is correct. That exhibit is made up and prepared in that form in order to give you a direct comparison between the losses on the Family Automobile Policy compared with the Special Package Automobile Policy.

page 175 } Q. Well, they can't be compared, can they, Mr. Stern?

A. Well, you can compare it up to a certain point, and then you have always some differences you have to evaluate. Well, I thought I had some exhibits here—I don't.

Q. Some of your companies write the Special Package Policy, some of the Mutual Insurace Rating Bureau companies write the Special Package Policy, and I take it some of the Independents write the Special Package Policy?

A. I don't know whether any Independents do. You probably have the record—we don't. It could be that some of them may write it.

Q. I have—well, that's all right. Well, even for the National Bureau and the Mutual Bureau companies there is at present, I mean there was actually in the year 1965 premiums in excess of six and one-half million dollars, was there not?

A. I don't have any figure right now to support that, but I assume you are right.

page 176 } Q. Wouldn't that figure—

A. Yes, it is right. Mr. Elliott, I would like to explain that there are more companies on the Mutual Bureau side that write the Special Package Automobile Policy more extensively than on the side of the National. This is merely

a matter of company preference. It so happens to be that way.

Q. Well, the point I want to make, Mr. Stern, is this policy represents a substantial portion of the automobile business in Virginia?

A. If you look at it that way, yes.

Q. And there is a substantial amount of experience now under that policy?

A. Yes.

Q. Since we have had all this prior experience with this policy and have more or less formed a judgment rating, why is it we can't now make a rate for this policy applicable to the policy itself?

A. Mr. Elliott, you are touching on one of the basic questions which are being considered now for rate-
page 177 } making. The Package Policy for automobiles, for private passenger cars, is not the only package policy which is now being written. You know that in the popular field of insurance many more package policies are written presenting combinations of coverages.

This packaging of coverages is a relatively new development. It has gone back now for many years, but it still is new, it is growing. Physicians in the field, actuaries, are giving a great deal of thought to the method of making rates for combinations of coverages versus the making of rates for the different parts. And I can tell you that there is hardly a meeting of the Casualty Actuarial Society that we don't have a paper and a seminar which deals with the making of rates for various package policies, and the automobile package policy is always a part of it.

There are some people working on that. We have one man who is very well founded in statistics and in theo-
page 178 } retical approaches, working on this problem. We have not yet found all the answers. There are problems of on one hand, as you say, letting the experience stand on its own feet, letting the rates stand on their own feet, on their own experience, and on the other hand to then nonsensical results if you compare two different types of combinations, B. I., P. D., and Medical separately on one side, and B. I., P. D. and Medical combined in the package on the other and this same thing applies for the other property coverages. The problem of obtaining sensible results is if you have on one side separate coverages and on the other you have combinations of coverages insuring essentially the same kind of hazards.

Now, we have not yet found all the answers, and that is one reason for continuing our past practice of letting the Family Automobile Policy rate sort of determine the combination in these Special Package Automobile Policies.

I want to point to the experience we submitted
page 179 } in Exhibit B of our filing. We show the experience for the latest year, 1965 accident year, for the Special Package on the one and the Family on the other. We made the premiums and the losses as comparable as we could make them, that is, we are showing coverages and losses for fifteen/thirty and five on both sides; and this comparison shows that the two types of policies for the National Bureau companies produce loss ratios that are very close. For the Family Automobile Policy, loss ratio of sixty-seven per cent; and for the Special Package Automobile Policy, sixty-nine per cent.

On the basis of this experience we believe that the practice of tying in and reflecting a packaging discount is sound.

Now, I expect that our studies, the studies of many people involved in the problem, will eventually lead to a rate-making procedure which will allow each of the package policies to reflect their own experience and at the same time
page 180 } still produce reasonable answers.

Q. Well, Mr. Stern, I think you have testified that Exhibit B, where you have under "Special Package" you are dividing the coverage up under fifteen/thirty and five. There is no such Package Policy, and that is simply an artificial allocation, is it not?

A. Well, not entirely. The losses are reported to us in such form that we can determine for the Special Package Automobile Policy the losses up to the limits of fifteen/thirty and five as well as the single limit loss indication of thirty-five thousand.

Q. Well, the premium is not broken down like that.

A. We can calculate the premium from exposures, and the separate fifteen/thirty and five rate plus the packaging discount.

Q. Well, what do you do with the thirty-five thousand dollar single loss?

A. You are talking about an individual case?
page 181 } Q. In those cases there must be cases where one individual, many cases that there is a loss in excess of fifteen thousand dollars?

A. Yes. We treat it for the purpose of this analysis as if the

policy had been written on a fifteen/thirty and five basis, and determine the excess on that basis.

Q. The figures I have available show that for the two accident years 1964 and 1965 there is an exposure between the Mutual Bureau and the National Bureau companies of two hundred and two thousand, three hundred and sixty cars or an average of one hundred and one thousand cars a year, with a total premium, not based on present rates but on rates which were effective in 1964, and present rates of 1965, of over twelve million dollars.

Now, I ask you, Mr. Stern, isn't that a sufficient volume, even forgetting that other companies might be writing the Special Package Policy, for this Commission to
page 182 } fix a rate on the Special Package Policy, irrespective of what may happen to the Family Policy?

A. If you did that, you may get sensible answers this time, you may run into a problem the next time you try to do it again.

For example, if you don't explore all the possibilities of distortions and fluctuations, if you don't explore that and know what to do with it if you find it, what would you do if your row of figures show that the rate for the Special Package Automobile Policy should be higher than for the Family Policy? It wouldn't make sense. We would always—

Commissioner Catterall: How much exposure would you have to have before that would be credible?

A. I don't have the answer to that, Sir, because this is one of the problems which we are now considering in our seminars and papers. We have not yet found the answer to that.
page 183 } No, this is not unusual. There are many areas of intellectual endeavor where people know there is a problem, and they have not solved it yet. Economists are constantly trying to find better ways of measuring certain happenings and they haven't found all the answers, and this is one area where we have not yet found an answer.

Commissioner Catterall: Don't you have a rule of thumb to saying whether a certain amount of experience is credible?

A. Yes, we do—

Commissioner Catterall: What is that rule of thumb?

A. —for ordinary rate-making, but here is a new policy.

Commissioner Catterall: What is the rule of thumb for ordinary rate-making?

Philipp K. Stern

A. Well, if we look at experience which we are used to, we know what we can expect. We have a rule of thumb, we have a table which tells us at what point we can accept
page 184 } the results.

Commissioner Catterall: How many million dollars in premiums do you have to have?

A. Well, we have different tables for different purposes. For example, in measuring of trend, we have a table that goes up to seven million dollars, which is not high in relation to the figures we are talking about here.

We have a table that ties in with the number of incurred claims, and no doubt if we took the figures Mr. Elliott quoted, we would probably find enough incurred claims to satisfy the ordinary measure of credibility.

But here we have special policies of a combination of coverages which has to make sense in relation to the separate coverages, and we have not yet found the answers to these problems.

Commissioner Catterall: How long before you are going to find those answers?
page 185 } A. Well, one of the reports is due to the Actuarial Committee this fall.

Commissioner Catterall: So if this matter of a special policy was put over until the fall, we would have better information then than we have now?

A. Well, this is still a study. I don't know whether it will produce the answers to all the questions. That is why we suggest that we continue the present practice of tying into the rates developed for the Family.

Automobile Policy reflecting the overall discount of fifteen per cent, and in the light of the loss ratios we have, this is not going to do any damage to the policyholders who buy either type of policy.

Mr. Elliott:

Q. I think, Mr. Stern, I made a misstatement when I asked you the question about the present exposure. I said that the figures quoted to you had not been raised to the present rates for 1964. I think the correct statement is
page 186 } that the figures that I gave you are based on present rates, so that the twelve millions plus of premiums is for accident years 1964 and 1965, that includes 1964 raised to the present rates.

Now, your approach to this revision is that, as I understand

it, you take the ten/twenty and five rate, and consider that as the same as twenty-five single limits rate, and apply to that a factor of one point zero five in order to reach the thirty-five thousand dollar basic single limits rate; is that right?

A. Well, if you talk about the mechanics, I will say "Yes, this is what we do." But there is a reasoning underlying that. If you say that we take the ten/twenty and five rate, and consider that equivalent to a rate for twenty-five thousand dollar coverage, it would appear illogical. The mechanics are as you describe them, but the reasoning is different.

page 187 } If I may explain to you, I have a few calculations here. We tested the new procedure which we are proposing here against the method we used in the 1965 revision, that is, the revision that became effective in January 1966; and we found that we would have obtained almost the same rates as we propose in this filing if we had used the old procedure. To be specific, in two territories the answer would have been identical.

Q. What territories do you have in mind?

A. One, and the combination of Nine, Ten and Eleven, all Territory Four. The combination of Nine, Ten and Eleven. In two territories, Territories Two and Seven, the rate would have been one dollar lower; and in one territory, Territory Three, the rate would have been one dollar higher.

Now, why did we modify our formula? Simply because it is a straightforward method which requires a minimum of calcalculations, and it gives us about the same answer.

page 188 } If you want to compare the present formula with the old formula, you have to go beyond the mechanics of it. Under the old formula we took the ten/twenty and five rate. We raised each component B. I. and P. D. to a twenty-five thousand dollar single limit by the application of the appropriate single limits factors. We then apply a discount to the results, and that discount measures the difference in coverage between single limits and split limits.

We then added to this B. I. and P. D. component—

Q. You are talking about twenty-five. You mean thirty-five, don't you?

A. We went to twenty-five, and then our next step was thirty-five. The next raise was to twenty-five thousand single limit, by an appropriate factor to thirty-five thousand. We then added to it a portion of the medical rates and the sum of all this was discounted by the so-called "Packaging Discount".

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In this revision we simply take the ten/twenty
page 189 } and five rate. We add to it the charge for one
thousand dollar medical payments coverage, discount the whole sum of all this by fifteen per cent to reflect the Packaging Discount, and then we raise this package to a thirty-five thousand dollar limit again by an appropriate factor. Now you have—

Commissioner Dillon: Have you finished your answer?

A. I have to add one more sentence at least to that. You have certain offsetting influences between these two formulae that, as I pointed out, the final result gives you almost the same answer.

Commissioner Dillon: Have you finished?

A. Yes, Sir.

Commissioner Dillon: For the sake of saving time—we are willing to stay here, Senator, from now on if it is necessary, but for the sake of conserving time, I wonder if the Interveners would get together at lunch so we won't
page 190 } cover each Intervener won't cover the same field.

Senator Howell: We are specializing in different items to cover.

Commissioner Dillon: Different items by different Interveners. We don't want each Intervener asking the same question.

12:30 P.M. The Commission will recess until 2:00 o'clock.

2:00 P.M. The Commission resumes its session.

Mr. Elliott

Q. Mr. Stern, in your answer with respect to the formula used up to now you stated the ten/twenty-five and five to twenty-five thousand dollars. That is not correct, is it?

A. No. I checked the record. We raised it right away to thirty-five thousand dollars.

Q. And by the use of discounting the factors?
page 191 } A. That is correct, yes.

Q. Then you added in after the last revision seventy-five per cent of the medical rates and multiplied that by—or you took a fifteen per cent discount for the year or seven and a half per cent for the semi-annual premium, and

added in the half of the uninsured motorists for the semi-annual?

A. I agree with everything you said except for the U. M. rate. The uninsured motorist rate is still shown separately from the other rates.

Q. I mean, ultimately it is added in?

A. For the insured, yes.

Q. Up to that point you get one rate for the single limits coverage?

A. That is right, combining bodily injury, property damage and medical payments.

Q. Now, under the proposed method you take the ten/twenty and five rate, and one hundred per cent
page 192 } of the medical coverage, and multiply that by a factor of one point zero five, and that gives you the rate other than the uninsured motorist?

A. That is true.

Q. So that the difference, the essential difference is that you are adding in considerable more medical pay and dropping off on the property damage and bodily injury?

A. Exactly, that is correct. And as I said before, the results are almost identical.

Q. Does that just happen to be so?

A. No, I don't think so. I think that there is a built-in offsetting factor, and our formula is simply a streamlining of the calculations and not designed to produce any different answers.

Q. Well, the medical pay service is not being changed in any way?

A. No.

Mr. Elliot: In order to show the Commission what this difficult problem is, I have had handed to me today and filed for the Mutual Insurance Rating Bureau
page 193 } the experience of the members and subscribers of the National Bureau and the Mutual Bureau a statement for accident years 1964 and 1965 showing premiums and losses under the Special Package Policy; and in this exhibit the losses have not been developed to an ultimate basis, but they do present the picture of just what the problem is, as I see it.

I would like to file this as an exhibit.

Commissioner Dillon: It will be received as Exhibit No. 6.

Philipp K. Stern

Mr. Elliott: I am having some copies made and I'll get you gentlemen some copies as soon as I can.

Senator Howell: Okay.

Mr. Elliott

Q. The use by you of the ten/twenty for the single limits rate without modification to reflect the higher limits under the Special Package Policy, seems to me to be an
page 194 } inconsistency because there is considerable more coverage under the Special Package Policy at twenty-five thousand single limits.

A. As you pointed out before that there is an offsetting calculation of effect on the medical payments. By itself it would be illogical, but the way the calculation goes through, taking somewhat less than the B. I. and P. D. and somewhat more than the Medical, it comes out to almost the same answer. It is only a *implification* of our calculations.

Also partly it is a matter explaining more easily to members of the public, agents, what the overall differential is between the streamline Special Automobile Policy and the conventional Family Automobile Policy. It is so much easier to explain to the public, the agents, by comparing the separate parts that the spread is in the price because in addition to that spread, you have the difference in coverages, that is appreciative.

Nr, Elliott: That's all for now.

page 195 } A. Mr. Elliott, if I may elaborate on one of my answers on the compact car.

Q. Oh, yes, Sir.

A. You handed me your exhibit, and you find that for the bodily injury and property damage loss ratios—

Q. That's Exhibit No. 5?

A. I believe it was Exhibit No. 5. I wanted to point out at that time that on property damage the compact car loss ratio is point eight zero four, and the standard-size car loss ratio is point eight zero nine, almost identical. On bodily injury the difference is greater.

Commissioner Catterall: That's nationwide?

Mr. Elliott: No, this is Virginia.

A. This is Virginia.

Commissioner Catterall: You've got the Virginia figures there—oh.

A. That was Mr. Elliott's exhibit, yes, Sir.

page 196 } I want to point out that these loss ratios already reflect the discount that may be determined; so although the nation's is not completely justified, it certainly shows that compact cars are not as much better as the ten per cent discount would indicate, so we are somewhere in between as far as Virginia experience is concerned, and countrywide definitely shows that compact cars are no better than the standard-size cars.

Commissioner Catterall: Do you think they are five per cent better in Virginia?

A. It's about five per cent I would say, yes.

Mr. Elliott

Q. Isn't the discount already built into the premium for the compact cars?

A. Yes, and if we take it off—

Q. It's discounted, it is a discounted premium already?

A. Yes.

page 197 } Q. And it is still better than the standard cars premium?

A. Yes, that's right. On the P. D. *i* would say there is no difference. On the B. I. there is a difference there. There is another point to be made in looking at standard and compact cars. Since this experience was accumulated, compact cars have gotten even bigger and they are more like standard cars today than they were in 1963, 1964 and 1965.

Q. Well, you have certain specifications in your rules—

A. Yes.

Q. —as to what is the compact and what is not a compact car?

A. Yes.

Q. Well, some of them have gone beyond those rules, and that automatically disqualifies them for the ten per cent discount; isn't that right?

A. That is correct, yes.

Mr. Elliott: That's all I have now.

page 198 } Commissioner Dillon: Let's go right across.

Mr. Moss: I am going to defer until later. I prefer following them.

Commissioner Dillon: All right. Mr. Shadoan.

Philipp K. Stern

CROSS EXAMINATION

By Mr. Shadoan

Q. Mr. Stern, how long have you been involved in the business of insurance?

A. Twenty-one years.

Q. Now, this was asked you on direct examination. I'm not sure that this precise question was asked. Who composed the text of your direct testimony?

A. I did.

Q. And what function or responsibility did you have for the preparation of the filing that is before the Commission?

A. I am the Manager of the Actuarial Division of the National Bureau.

Q. Now, am I correct that the application which
page 199 } is before the filing—I'm sorry—before the Commission rests upon that filing plus the two additional exhibits which have been presented?

A. Which two additional exhibits are you referring to?

Q. No. 4 and No. 5, I believe. I have three exhibits here. What I'm asking is aside from the filing itself, which I don't believe has been marked as an exhibit in this hearing, is there any other data which has been submitted in support of the application?

A. Yes. We received two inquiries from Mr. Hazlewood, Rate Analyst of the Bureau of Insurance, in which he raised many questions and asked for additional information. We submitted this information in four letters which are a matter of record in the Department's files, one dated—

Q. You have answered the question sufficient for the moment. I don't want to cut you off. I just want to save time.

page 200 } Mr. Shadoan: If the Commission please, I am going to move that any information which is germane to your consideration of this application be marked as exhibits and received in evidence, so that we may properly examine it.

Chairman Hooker: We have considered it.

Mr. Shadoan: So that you may properly examine it.

Commissioner Catterall: It was Exhibit No. 1, wasn't it?

Chairman Hooker: What was Exhibit No. 1?

Commissioner Dillon: Exhibit No. 1 was the record in the investigation, this was Exhibit No. 1. This has not been received as an exhibit.

Philipp K. Stern

Mr. Shadoan: The filing has not even been received; that was an oversight.

Commissioner Catterall: That ought to be Ex-
page 201 } hibit No. 1.

Commissioner Dillon: It is a part of the record, but—

Mr. Shadoan: No, no, the filing for this application. I am not talking about this.

Commissioner Dillon: I know. You are talking about the present application now.

Mr. Shadoan: That's right, Sir.

Commissioner Dillon: It is in the record. That's a part of the record.

Mr. Elliott: It's a part of the record.

Commissioner Dillon: That's the pleadings.

Mr. Moncure: That's the pleadings. It's what you are considering.

Mr. Shadoan: Well, now, are we considering all of the informal correspondence between the Insurance Department
and various Interveners, and everything that is
page 202 } in the Insurance Department's file is part of the
pleadings?

Commissioner Catterall: Oh, no. If they are explanatory letters, that was that fine-tooth comb we talk about.

Mr. Shadoan: Yes, I have heard of that.

Commissioner Catterall: And they combed up these letters, and they can be put in as exhibits.

Commissioner Dillon: You can put them in if you want to.

Mr. Shadoan: Well, I was just suggesting as a matter of procedure that it would be much clearer for everyone if the data or the evidence, in what ever form it is supposed to support the decision of this Body that would be reached, would be received in evidence, either by testimony or not.

Commissioner Catterall: He wants to exhibit these letters that were sent in.

Commissioner Dillon: There's no harm in putting the fil-
ings in as an exhibit.

page 203 } Mr. Shadoan: It should be in as an exhibit.

Commissioner Catterall: It would be the correspondent plaintiff on appeal, for his pleadings. It should be put in as an exhibit too.

Commissioner Dillon: As an exhibit, sure.

Mr. Moncure: If you want to call it an exhibit, all right, and just give it a number, but I think this pleading is a motion for judgment.

Commissioner Dillon: That's right, but let's make it Exhibit No. 7. There is no harm in it.

Mr. Moncure: No. 7? That's all right.

Mr. Shadoan: No. 7 will be the filing, and then—

Mr. Elliott: There is nothing that we have that has not been at least tendered and been made available
page 204 } to the Interveners on May 10. I wrote every known Intervener that Mr. Stern in his prepared testimony refers in several places to certain supplemental data he has furnished the Bureau of Insurance from time to time pursuant to its requests in connection with its investigation of the National Bureau filings.

This data is on file with the Bureau of Insurance and may be inspected by you or any party in interest at any time during office hours before this hearing. It is voluminous, and copies have not and will not be made.

Mr. Shadoan: Let me make my purpose and reasoning clear. I certainly did not mean to indicate that anybody has been guilty of any improper action.

What I am saying is this: If this case is reviewed—it doesn't matter how the decision goes—that review will be on the record of the proceedings before this Body
page 205 } and for the purposes of an orderly proceeding and a proper record, I was simply trying to isolate what it was that this application consists of, and this Commission's, I assume, decision will rest on the matters of record in this hearing.

And I'm trying to establish what the matters of record are, and that's all.

Commissioner Dillon: Well, it is a matter of record in two ways now. It's a part of the pleading, and it's an exhibit, so I think we've got it nailed down.

Mr. Shadoan

Q. Now, what I am asking you, Mr. Stern, at this point is just to get this point wrapped up, and then I'll leave it. The filing, which is Exhibit No. 7, and Exhibits Nos. 4 and 5, which are additional tables showing experience relating to compact cars and standard-size cars, plus your direct testimony consist of the evidence upon which you ask this Commission to grant the application; is that correct?
page 206 } A. That is correct, Sir.

Q. Now, am I correct that the filing when we really strip away much of the supplemental data, and we talk

about the overall rate increase, that is found on Exhibit No. 7, Sheet 1—that shows the Statewide change, does it not?

A. Yes.

Q. Now, the calculation of that change is shown specifically —this is Sheet 1 as it is written; is that not correct?

A. That is correct, yes.

Q. Now, insofar as we are concerned with what the overall rate change should be as proposed in this application, without regard to the refinements of classification, we don't need to ge beyond that sheet, do we?

A. Yes.

Commissioner Catterall: "Yes" what?

A. Sheet 1 won't give you the Statewide rate level.

Mr. Shadoan

Q. What I said was correct.

page 207 } Commissioner Catterall: You said "No", and then you said "Yes".

A. But you do not have to go beyond Sheet 1.

Mr. Shadoan: He means it must be for the present.

Commissioner Catterall: That these will do.

Mr. Shadoan: Yes, Sir.

Commissioner Dillon: Well, you mislead me on that. I didn't think he agreed with you.

Mr. Shadoan

Q. Now, Mr. Stern, having been involved in insurance for some twenty-one years, you are familiar with the so-called "All Industry Bill" that was formulated in the wake of the Southeastern Underwriters Case, and the McCarran Act; is that right?

A. Yes.

Q. And am I correct that the provisions of the Virginia Code, and specifically the rating provisions em-
page 208 } bodied in Article 38.1, Section 252, entitled "Provisions Governing the Making of Rates" is essentially the same provision that was embodied in the Model Bill?

A. I think that is correct.

Q. Now, this statutory section, Mr. Stern, begins:

"Rates for the kinds of insurance to which this chapter applies shall be made in accordance with the following provisions:"

And there are two provisions which I would invite your attention to:

Sub-paragraph (1) says:

"Rates shall not be excessive, inadequate or unfairly discriminatory;"

And sub-paragraph (3) says:

"Due consideration shall be given to past and prospective loss experience within and outside this State, to
page 209 } conflagration or *catastrotrophe* hazards, to a reasonable margin for underwriting profit and contingencies, to dividends, savings or unabsorbed premium deposits allowed or returned by insurers to their policyholders or members or subscribers, to past and prospective expenses both countrywide and those specially applicable to this State, and to all relevant factors within and outside this State;"

And the rest of it is inapplicable.

Now, are these the statutory outlines which the National Bureau follows in the making of rates in Virginia?

A. Yes, Sir.

Q. All right. Now, I would like for you to invite my attention in the filings to the data in the filings or the supplemental exhibits which show the consideration that has been given to conflagration or catastrophe hazards.

page 210 } A. I am not aware of the conflagration hazards for automobile liability insurance, but the catastrophe hazard is recognized in the manner in which we separate as we exclude losses which are of a catastrophe nature. We are making rates on the basic limits experience, that is, basic limits for Virginia, fifteen/thirty and five experience, which are the limits which are required of motorists in order to comply with the financial responsibility law.

And any losses in excess of that are in the area of catastrophe and are not reflected in these calculations.

Q. And are not reflected in the Manual?

A. That is correct.

Q. Well, now, am I correct that this filing does not involve any physical damage provisions? It is solely B. I. and P. D.; is that correct?

A. That is correct, yes, Sir.

Q. So that if you had a hurricane, and that sort
page 211 } of thing, it still wouldn't be relevant to this policy,
would it? It wouldn't result in any liability under the coverages of this policy, these policies?

A. That is correct.

Q. All right. Now, can you invite my attention to the portion of the—or section of the filing or supplemental exhibits which shows the data respecting the expense provisions and experience within the State?

A. Yes. The second sheet of Exhibit No. 7, which is filing Exhibit A, Sheet 2, the last paragraph is entitled "Expense Provisions in Manual Rates".

Q. I'm sorry, Sir. Could you tell us where that is again, please, Sir?

A. It's Exhibit A, the filing, Exhibit A, Sheet 2, of the Filing Memorandum itself. The last paragraph is headed "Expense Provisions in Manual Rates":

"The expense provisions underlying the revised
page 212 } rates are the same as those underlying the present rates, except that the property damage factor to include unallocated claim adjustment expense in the experience has been reduced from 1.6 to 1.135."

Q. Now, your calculation of the entries on Sheet 1, which I believe is the next page, shows specifically the number of cars, and it shows in dollar terms the loss experience and loss adjustment experience which has been sustained in Virginia; is that not correct?

A. Yes.

Q. Can you invite my attention to any portion of the filing or of the exhibits which shows the expense experience in Virginia in the same terms?

A. The paragraph I just read to you referred to the fact that there is no change made in the expense loadings underlying the revised rates. The expense loadings reflected in the
underlying pure premium, which is line (9) of
page 213 } Sheet 1 of Exhibit A, the exhibit you just looked
at. That is how the expense experience enters into the calculations.

Q. Did you understand my question?

A. It is part of the expense experience—yes.

Q. You did understand my question?

A. I'm sorry, I finished it before I could get my information.

Philipp K. Stern

Q. Did you understand my question?

A. Yes, I did. You asked me how we reflect the expense experience.

Q. No, that was not the question, Sir. Listen to the question.

The question is: Where in the filing do you reflect dollar figures or data respecting the expense experience in Virginia similar to the loss and loss adjustment experience which you have collected in Sheet 1 of Exhibit A?

A. Exhibit A, Sheet 11, gives you the breakdown of the expense items.

page 214 } Q. Just a moment, Sir. Maybe I will be more specific. You see on Section 4 there? It says twelve million, ninety-six thousand, two hundred and one dollars for B. I.?

A. Yes.

Q. What is the figure for expenses?

A. There is no need to express expenses in dollar amounts.

Q. That's not my question, Sir. I am not asking your opinion whether it is necessary or not. I am asking you whether you have the data.

A. There is no such dollar amount shown in this filing.

Q. And you don't have that data, do you? You don't know what the expense experience is inside the State of Virginia, do you?

A. Yes, we do know.

Q. Do you collect that data?

A. Not for Virginia by itself. We collect—

Q. You collect it countrywide, don't you?

page 215 } A. Yes, we do.

Q. You do not collect it for specially, the expense which is specially applicable to this State, do you?

A. The provision you refer to specially applicable to this State—

Q. I am not asking you to refer to—

Mr. Moncure: Let this gentleman finish his answer.

Mr. Shadoan: Well, just a moment, Sir. I think I am entitled to a responsive answer. That question was did he collect this experience expressly applicable to the State, not his interpretation of this statute. I am not asking his legal opinion.

Mr. Moncure: He is trying to tell you. He gave you the percentagewise, and can convert it to a dollar in a minute.

Mr. Shadoan: I would just like for him to try to be responsive to the questions.

page 216 } Commissioner Dillon: Let's hear his answer.

A. If there were an expense item that is specially applicable to Virginia, we would have it, but there is no such expense item except some difference in the tax structure in Virginia, premium tax structure. That is the only item that is specially applicable to Virginia. All other items are susceptible of a countrywide review of expense experience as is contemplated by the whole industry group.

Mr. Shadoan

Q. Now, you have no data, do you, Sir, to demonstrate that the production expense in Virginia—let's be more specific—the commissions paid to Virginia agents is the same commission plan to New York agents. You don't have that data, do you?

A. I don't have it because it would be irrelevant.

Q. It is not collected because you regard it as irrelevant—correct?

A. It is—we regard it as irrelevant, and it has

page 217 } been so regarded in past filings.

Q. And it has not been collected—right?

A. No, it has not been collected.

Q. Am I correct that you have previously testified that the Virginia Commissioner of Insurance has not made any investigation on his own for ten years to see what the expense experience is in Virginia?

A. I don't remember testifying to that.

Mr. Moncure: That was your opening statement. This witness has not answered.

Mr. Shadoan: I understand that. I was giving him a chance to admit it.

Senator Howell: It may be twenty years is right.

Commissioner Catterall: When did we reduce the acquisition cost from twenty-five per cent to twenty per cent; what was that year?

Commissioner Dillon: 1964, wasn't it?

page 218 } Commissioner Catterall: It was not ten years ago, was it?

Mr. Moncure: It was 1958, I think Sir.

Commissioner Dillon: Somewhere along there.

Chairman Hooker: It has been pretty close to ten years.

Commissioner Catterall: And we have not reduced it since. That's the question.

Philipp K. Stern

Senator Howell: Mr. Parker is here. Probably he could remember.

Mr. Shadoan: Let me continue the examination, please.

Mr. Shadoan

Q. Mr. Stern, you recall testifying on either this 12th or 13th of September, 1966, in the investigation before this Commission, don't you?

A. Yes, I do.

page 219 } Q. Referring to page 716 of the Official Reporter's notes, I ask you whether or not the following question was propounded to you, and you made the following answer:

"Q. Do you know when the last time is that he sent a Virginia examiner out to audit in detail the expenses, the general administrative expenses, of an insurance company, one of the three hundred that sell insurance in this State?

"A. I don't know when he did, but he hasn't done it in ten years."

Was that question propounded, and that answer made by you?

A. I am sorry. The answer was garbled.

Q. The answer was—

A. I repeated that. I remember exactly what I said.

Q. What did you say?

page 220 } A. I said if he hadn't done it for ten years, there are other insurance departments that constantly have examined us out, checking on company records. There are other departments that constantly check on company records.

Q. Yes. You did say that? I want the record to be sure that this is not out of context. You did say that?

A. I did not say that he did not examine for ten years.

Q. You said that the Virginia Commissioner hadn't, but other companies had; is that right?

A. I said that if he didn't, then other Insurance Commissioners did.

Q. Well, in other words, when it says "I don't know when he did, but he hasn't done it in ten years", you did not make that answer?

A. No, I did not.

Philipp K. Stern

Q. What you made was that "if he hadn't, then somebody else has"; is that right?

A. That is correct. And I think I made a point of that, if you follow that.

Q. I have already said that the record reflects
page 221 } that you did make that point; but you don't contend that the Department of Insurance of New York or any other State examines these company records with respect to those expenses which are specially applicable to Virginia, do you?

A. I think the Examiners examine everything in the company's books, and they make sure that everything is properly allocated and recorded in the reports.

Commissioner Catterall: Well, now, you don't mean that if they examine the Aetna Insurance Company in New York and found out how much they were paying their office help, they would try to allocate that in forty different States?

A. Oh, no, they wouldn't do that, but if the Examiner should find that an item that is especially applicable to Virginia is assigned to Idaho, even though the Examiner is from New York, he certainly would pick the company up and do something about it.

page 222 } Mr. Shadoan

Q. What I am saying is, they don't examine these records with a view toward determining the expense experience within a State for whom they do not work, do they?

A. No, I cannot agree with you because the Examiners examine with a view to overall correctness of the company records.

Q. Yes, I think that's clear. Now, for the purpose of making rates in Virginia and to the extent that expenses specially applicable to this State are relevant, you have no data which you can submit to this Commission showing what those expenses have been in Virginia, do you?

A. Mr. Shadoan, allow me to point out that your question consists of a statement, and then the question; and I can't say "Yes" to it because I would accept your statement.

Q. Well, let me suggest this to you, and I want this to be fair. When you can, what I would like for you to do is to give one of three responses: You don't understand
page 223 } the question, if you don't; or, if you do, try to

answer it affirmatively or negatively, and then make such qualifications as are necessary to give an understandable and honest answer. That's what I want you to do.

A. I was about to do that.

Q. All right. Well, go ahead and answer the question then.

A. If there are expenses that are especially applicable to Virginia, they would be collected. We don't have any information on such *such* expenses because there are no expenses.

Q. Do you have any way of knowing by statistical collection that the commissions paid Virginia agents are the same as commissions paid New York agents?

A. I do not know that because this is not relevant to our rate-making procedure. The allowance, the production cost allowance, in our expense structure is what we

page 224 } call a budgetary item.

Q. Established.

A. It's a fixed amount, and we do not control, and nobody attempts to control, what each individual company pays to its producers.

However, in the expense experience, the countrywide expense experience, which we submitted to the Bureau of Insurance—I believe it is there—there is an item which shows the actual acquisition costs countrywide and which shows that actually it is higher than the provision in the rates.

Q. Now, if the acquisition costs in New York are ten per cent above the national average, and the acquisition costs in Virginia are ten per cent below the national average, that means Virginia motorists are paying for a part of the protection being afforded New York residents and motorists. Is that not correct?

A. It doesn't work that way. The Production—

Q. Well, now—I'm sorry, go ahead.

page 225 } A. Companies have their production, their expenses. It is entirely between them and their agents. This is a competitive business, and they couldn't possibly get away with any disparity as you contemplate.

Q. Well, now, you have concluded that, but you have no statistical data to support that conclusion, do you?

A. No, I do not, except that the companies know what their actual expenses are, and if the actual production costs, the production costs were lower than the average provided in the rates, we will find out about that.

Q. I would like to pursue this just a little bit further. If the

acquisition costs or the general administration costs in Virginia were ten per cent lower than the national average, this would give you an additional ten per cent which you could absorb by way of loss adjustments, loss and loss adjustments, before you started eating into the five per cent profit and contingency provision; isn't that right?

page 226 } A. Well, if it were actually lower, yes, that would be true.

Q. And insofar as the collection of data is concerned, we have absolutely no way of knowing what the general administration expenses and the acquisition expenses specially applicable to Virginia have been; isn't that right?

A. Well, these are not expenses specially applicable to Virginia for this reason.

First, I want to point out in that last statement—

Q. Just a moment, Sir.

A. —to me—

Q. You are going to qualify, but if you can, I won't stop you from qualifying, but if you can give us—

Commissioner Dillon: Answer his questions, if you can, Mr. Stern.

A. Yes, but I would like to point out that you are making me answer—

Commissioner Dillon: You can qualify—

Mr. Shadoan: And then qualify.

page 227 } Commissioner Dillon: —but answer his question.

Chairman Hooker: And then explain it.

Commissioner Dillon: Answer his question, and explain it.

Mr. Shadoan: And then explain it, yes.

Commissioner Dillon: And if you can't answer it "Yes" or "No", say so.

A. I think I answered your question, didn't I?

Mr. Shadoan

Q. No, I'm sorry. I don't think you are intending not to, but you are giving explanations before you get to the answers. Can you repeat the question? I'm sorry.

NOTE: Question read as follows:

Q. And insofar as the collection of data is concerned, we have absolutely no way of knowing what the general adminis-

tration expenses and the acquisition expenses specially applicable to Virginia have been; isn't that right?

page 228 } Reporter: And you answered:

"A. Well, these are not expenses specially applicable to Virginia for this reason."

A. All right. I'll start again answering your question.
The answer is we do know what the expenses have been from our countrywide expense experience.

Mr. Shadoan: Mrs. Wootton, read the question to him again, will you?

NOTE: Question read as follows:

Q. And insofar as the collection of data is concerned, we have absolutely no way of knowing what the general administration expenses and the acquisition expenses specially applicable to Virginia have been; isn't that right?
A. I see—for Virginia. No, we do not have specific Virginia data.
However, if I may—
Q. Go right ahead and explain. I don't want to cut you off. Go right ahead.
page 229 } A. You mentioned two expenses items in one sentence.
Q. Yes.
A. General administration, and acquisition costs. These two are treated differently in our expense structure. One is supported both by countrywide statistics, and this is the general administration expenses. The other is a budgetary item, that is, the production costs allowance.
Q. Now, have you finished, Sir?
A. Yes, Sir.

Commissioner Dillon: Go ahead.

Mr. Shadoan
Q. Mr. Stern, you distinguish between the formula for rate-making purposes and the formula for computing underwriting profit and loss, don't you?
A. Yes.

Q. And these are two different areas; is that not correct?

A. Yes.

page 230 } Q. And your area of expertise is in the field of statistics which are used for rate-making purposes; is that not correct?

A. That is correct.

Q. And in your work as an actuary in reviewing the statistics and methods of rate-making, that is essentially unrelated from the matter of computing profit and loss; is that not correct?

A. Well, I can't say it is unrelated. We look at the insurance expense exhibit which shows an underwriting gain and underwriting loss.

Q. At page 706 of the investigation, which I have referred to previously, I ask you whether or not the following question was not propounded to you, and you did not make the following answer:

"Q. In other words, Mr. Stern, actually in your view the statistics and methods for rate-making are es-
page 231 } sentially unrelated in your mind as an actuary from profit and loss?

"A. It is not only in my mind, it's a fact."

Q. Was that question put to you, and did you make that answer?

A. Yes. I think it was in a different context. You asked me here whether I am at all acquainted with the calculations which go into such statements as the insurance expense exhibit.

Q. Well, in order to put it in context, I will follow it up with the second question immediately following on the same page?

"Q. Well, when you say 'it's a fact', that has heretofore been generally the procedure throughout the United States that the statistical information on earned/incurred is totally related to ratemaking, and not to accounting methods for computing profit and loss on underwriting? Is that clear to you, Mr. Stern?

page 232 } "A. The answer is yes, correctly so.

"Q. In other words, in your mind, the two are totally unrelated?

"A. Yes, that is correct."

Philipp K. Stern

Q. Now, does that capture the context of your testimony at this time?

A. Yes.

Q. When you make your rates—what I'm really trying to establish, Mr. Stern, is as far as your rates are concerned, we go back to about one page in the filing, don't we? We look at the loss and allocated loss, the adjustment experience, Exhibit A, Sheet 1, and the earned number of cars, and we divide the losses into the cars, and that's it, isn't it? We would make a couple of refinements, but this is what the rate is based upon, isn't it?

A. But this is not all.

Q. Yes. We are going to get into that. It is related to the expected loss which is what — sixty-fifty point five?

page 233 } A. Sixty-four point six.

Q. Sixty-four point six? Now we take that sixty-four point six, we take the number of cars, we take the loss and loss adjustment expense, and these are the three components which go in the making of the overall rate changes —right?

A. That's correct, yes.

Q. Okay. And in doing that we couldn't care less what the actual profit and loss on underwriting has been—right?

A. That's correct.

Q. And we assume that these budgetary items, which is a way of saying estimates, remain the same, the rest of the premium dollar; isn't that right? We assume taxes remain the same, we assume production expense remains the same, and all these other factors shall remain the same?

A. The same as what?

Q. As the budgetary breakdown, the estimated

page 234 } breakdown of the dollars concerned. Let me withdraw the question. Maybe you don't understand it.

If these factors, such as expenses, had been reduced at the same time that your loss expense was going up, the calculation of the rate ignores that because it only includes three components; is that not right?

A. Yes. If other elements have changed and would not be reflected, we would say they were ignored.

Q. Now, would you agree to the statement contained in the Woodward and Fondiller report, page 35, which says in essence—this is not an exact quote—that the statutory profit and loss does not enter into rate-making?

A. Yes.

Commissioner Catterall: How would you define a budget item? Does that mean an estimate or an allowance when you say that the twenty per cent for acquisition costs is a budgetary payment, and you base that on the nationwide
page 235 } acquisition costs, and then we allow them twenty per cent. That means if they spend more, it comes out of their own pocket, and if they spend less, that's savings?

A. That is correct.

Commissioner Catterall: So it's really an allowance more than it is an estimate, is it not?

A. That's correct.

Commissioner Catterall: An allowance based on the normal procedure of all things?

A. That is correct. And we call it "Total Production Costs Allowance". That's what it is called.

Commissioner Catterall: And what was the actual for the last available information, nationwide? Was it more or less than twenty per cent?

A. It was somewhat more than twenty per cent.

Mr. Shadoan: I would like to say, and I don't
page 236 } know whether this applies to the other Interveners, Commissioner Catterall, but in the interest of time I would be willing to stipulate that the country-wide figures for expenses exceed twenty per cent.

Commissioner Catterall: Well, I would like to get the exact figure on that and also on the overhead expenses.

Mr. Shadoan: All right.

Commissioner Catterall: The allowance and the nationwide result.

Mr. Shadoan: I would like to know too. I just saw the exhibits.

Commissioner Catterall: Well, let's have those two figures in the record.

A. I have those here. The total acquisition costs, country-wide, for National Bureau members was as follows:

1963, twenty one point eighty-six.

Mr. Shadoan: I'm sorry, I didn't get that.

page 237 } A. Twenty-one point eighty-six.

1964, twenty-one point forty-four per cent. 1965, twenty point sixty-four per cent. And the three year mean, twenty-one point thirty-one per cent.

Philipp K. Stern

Mr. Shadoan

Q. Is that the countrywise experience for all stock companies or for your member and subscriber companies?

A. That is for the National Bureau member companies.

Q. And that's the countrywide experience; is that correct?

A. That is correct.

Q. Have you got—Commissioner Catterall was interested also in knowing the same information for general administration. Have you got that?

A. Yes.

1963, five point six three per cent.

Commissioner Catterall: What's the allowance?

page 238 } A. The provision in the rates is five point five per cent.

Commissioner Catterall: Your allowance is five point five.

Mr. Shadoan

Q. And 1963 was what?

Commissioner Dillon: Five point six three.

A. I am sorry. I correct this, five point eight eight. 1964, five point seven seven. 1965, five point seven five. Average, five point eight zero.

Mr. Shadoan

Q. These are countrywide figures—correct?

A. That is correct.

Q. Now, you have members that deviate from the rates established by your Bureau, don't you?

A. I don't know whether any members deviate to a substantial point; I doubt it. Subscribers do more.

page 239 } Q. Well, now, I don't want to know—

Commissioner Catterall: Well, let me put in there—it just came into my mind—those countrywide statistics don't include things like State Farm, and Sears-Roebuck where they don't pay out anything?

A. No, they do not.

Commissioner Catterall: You don't have an end to that picture at all?

A. These are only members of the National Bureau.

Commissioner Catterall: Because they would change those rates tremendously if they did enter into them.

A. Yes.

Commissioner Catterall: I just wanted to clear that up.

Mr. Shadoan

Q. Well, now, we are either going to have to establish this or I'm going to have some data from the Insurance Department filings.

page 240 } Would you concede that it's a fact that you have member and subscriber companies that deviate because they have the experience that is less than those allowances—I mean, downward deviations?

A. Could you just repeat the first two words?

Q. Do you have member or subscriber companies that file downward deviations because their expense experience is less than the allowance which we have been talking about?

A. I know there are subscriber companies that do, and there could possibly be members who also do.

Q. And we don't know—that's because these companies, for one reason or another, are able to reduce their expense experience for these allowances, and they come in for a downward deviation—right?

A. Oh, yes, sure.

page 241 } Commissioner Catterall: Now, do those downward deviating companies go into your statistics? I mean, you said that the allowance was twenty per cent, and the actual was twenty-one per cent; and that twenty-one per cent, does that include in the computation of the twenty-one per cent the lower expenses of the deviating companies?

A. It would, yes.

Commissioner Catterall: So the non-deviating companies would have more than twenty-one per cent?

A. Yes, Sir.

Mr. Shadoan

Q. Now, you don't know, do you, whether the State of Virginia has more downward deviating companies than the State of New York or California, do you?

A. No. I don't think that is something you can measure in terms of premium volume or—

Q. And you don't know whether or not, generally, the experience in Virginia is less than these allowances, do you?

page 242 } A. No. I would like to explain that.

Q. Go right ahead—if I may.

A. The provisions of the All-Industry Bill and the laws patterned after that bill recognize that certain expense items cannot be allocated by States. Take one situation, home office expenses, branch offices, the different type of organization of companies. Some companies are de-centralized. Some operate a branch office which handles several States or parts of several States.

You could not possibly allocate those expenses to any particular State, and that is the basic reason for relying on countrywide data.

Q. Well, the All-Industry Bill, and the particular section of it which is Section 252 of Article 38.1, Section 3, there are two phrases I would like to discuss with you for a moment.

The first phrase, and this is in the clause that page 243 } says "due consideration shall be given to". This phrase is to past and prospective loss experience within and outside the State.

The other one, which I am sure you are familiar with and which we have been talking about, says "to past and prospective expenses, both countrywide and those specially applicable to the State".

Focusing on the first phrase for a minute, "past and prospective loss experience within and outside the State", your filing does not have anything about the loss experience outside the State, does it?

A. It does not contain any data on loss experience outside the State. That doesn't mean that it is not recognized,—

Q. Now, do you contend that the bill—I'm sorry—you weren't finished?

A. I should modify this. As a matter of fact, we did include one exhibit on compact car experience which was countrywide.

Q. Historically, up until all this controversy, page 244 } which has been generated in the last couple of years, the Bureaus have submitted exhibits showing their countrywide experience as well as the Statewide loss experience, haven't they?

A. I don't know in what way.

Q. Well, I mean, you generally, in the past you would have this exhibit which might look something like this, which you would submit as supplemental data, showing the countrywide experience of member companies with respect to losses; isn't that right?

Philipp K. Stern

A. No. I don't remember that.

Q. All right. You submitted supplemental data showing what you contended to be your arithmetic profit and loss on underwriting, didn't you?

A. Not in rate filings.

Commissioner Catterall: Well, what do you mean when we speak about five per cent for profit and contingencies?

Senator Howell: Judge, we couldn't hear you.

page 245 } Commissioner Catterall: In view of the answer I am preplexed because we keep talking about the five per cent for profit, and if we are talking about five per cent for profit, how can you answer that we don't talk about profits?

Senator Howell: Because we are out of gear with the Virginia statute, if Your Honor please.

Commissioner Catterall: Well, I would like to have the witness clear it up.

A. Your Honor, I thought that Mr. Shadoan's question was did we submit data on profit and loss in rate filings.

Commissioner Catterall: And you said "No", and I don't understand your answer because I thought that was what we had been talking about.

A. If we submit our breakdown of expenses or breakdown of premium dollar, we have a provision of five per

page 246 } cent for underwriting profit and contingencies, but, as a matter of practice, we usually do not include an exhibit that shows any countrywide profit and loss experience; and I think Mr. Shadoan's question was addressed to that point.

Mr. Shadoan: That's right, it was.

Q. See this document here that is marked "H", and has the graph, and says "Companies Suffer Underwriting Losses on Automobile Liability Insurance in Maryland"; and it has figures. It took in a hundred and expended a hundred and thirteen; and it purports to show the actual loss experience.

A. May I see this?

Q. Yes.

A. This is the kind of exhibit that is sometimes used to supplement a position.

Q. And that's showing—

A. But it is not included in the actual calculation of a rate filing.

Q. Well, wasn't my question whether or not you didn't previously submit supplemental exhibits to show
page 247 } countrywide loss experience; wasn't that my question?

A. Did you say "supplemental"?

Q. Yes.

Q. Well, if you misunderstood, that's fine. You used to do that—right?

A. Yes, of course, we do.

Q. Well, where is it in this filing?

A. Apparently our definition of "supplementary" differs.

Q. Do you have anything like this in this filing?

A. No, we do not. My answer was directed at the concept of supplementary being something that is outside the document that is itself the rate filing.

Q. Yes.

A. And to add to the calculation of rates.

Q. I understand.

A. And the chart you are showing is very often used as explanatory material in support of the general
page 248 } reasoning underlying the rates, but it does not enter arithmetically into the calculation of rates.

Q. Well, what we have already established, haven't we, that insofar as the rates are concerned, the overall rate change is determined by three simple components as the rest of the filing is refinement of that rate increase by classification and territory; isn't that right?

A. Yes.

Q. All right. Now, this data which you previously submitted was supplemental data which was designed to show that due consideration had been given to the statutory factors; isn't that right?

A. No.

Q. So why did you submit it at all then?

A. Various types of exhibits are sometimes necessary to support the reasoning that underlies the rate-making procedure or any specific feature in the rate-making procedure.

page 249 } Q. Well, now, as late as December 1965 am I not correct that you had, in the hearing in Maryland you had maybe ten supplemental exhibits showing the profit and loss experience of the companies, both countrywide and in Maryland; is that not correct?

A. I couldn't confirm it. I did not prepare that filing.

Philipp K. Stern

Q. Well, let me ask you this. What is the factor that governs your determination of whether you prepare such supplemental exhibits or not in a given State?

A. Well, for one thing I was not working for the National Bureau in December 1965.

Q. Are you unable to answer the question because you did not have experience with the National Bureau before about three months ago—or whatever it is, six months?

A. Six months. No, my answer was that in the case of Maryland I couldn't tell you what determined it because I was not connected with the National Bureau.

page 250 } Q. I wasn't asking about that. My question was what factor governs the National Bureau's consideration as to when they are going to use these supplemental exhibits or not in a given State?

A. I would say namely the status of knowledge of those involved in the case.

Q. In other words—

A. If you deal with a knowledgeable department staff or department, you don't need some of those things. Sometimes you have to use them in order to make your point very clear.

Q. Well, am I correct that no such exhibits were used in February of 1967 in Arkansas before a Commissioner who had been in office three weeks and who had lost about half his Department?

A. I believe that the hearing was terminated before it was finished, and I don't know whether any such charge would hav been presented for his certification.

page 251 } Q. Well, I want you to assume that the direct case in chief had been presented and there had been no such suppemental information, and I would like for you to tell me whether you can explain why such an unknowledgeable inexperienced Commissioner should not be given the benefit of these supplemental exhibits.

Mr. Moncure: Judge, I think we are going far afield on a rate hearing in Virginia, to talk about how you are handling something, and what your judgment or opinion was in Arkansas.

Mr. Shadoan: Well, I would like to indicate to the Commission, so there will be no understanding, why I'm doing this.

Mr. Moncure: I don't see what bearing it has on a policy here.

Mr. Shadoan: Well, I would like to illuminate counsel as to the bearing. This statute—

Commissioner Dillon: Really, I would like to know why.

page 252 } Mr. Shadoan: Sir?

Commissioner Dillon: I would like to know why.

Mr. Shadoan: This statute has specific criteria set out in its statements.

Commissioner Dillon: There is no use to argue. We will let him go ahead and answer the question.

Commissioner Catterall: Well, the News Leader today says that Mr. Shadoan scared them so that they withdrew before they finished.

Senator Howell: That's right. That's what we are hopeful will happen before today's hearing.

Commissioner Catterall: That's why they never finished in Arkansas.

3:05 P.M. Commissioner Dillon: The Commission will recess for five minutes.

3:10 P.M. The Commission resumes its session.

page 253 } Commissioner Dillon: Did you get that answer to your question?

Mr. Shadoan: I don't even remember the question.

Commissioner Catterall: Why didn't you use it here?

A. Well, Sir, I would like to answer why we didn't use it here.

The Commission investigated it, this aspect, for a whole year, expert witnesses and many exhibits, and we are sure that the Commission knows every point of this underwriting picture. The Commission has the official results the Bureau of Insurance compiled, page 14 data, the insurance expense exhibit, and all these figures are in the records of the Commission.

And there was absolutely no sense in drawing pictures for a Commission that is well informed.

Commissioner Dillon: Now, we appreciate what you said about it. Now, why didn't you file it in Arkansas?

page 254 } A. I believe that the man who was there had it in his brief case and never put it up.

Mr. Shadoan: He did, huh? Would you indulge me for a moment? I want to see what he said when I asked him the question.

Philipp K. Stern

Commissioner Catterall: He saw Davy Crockett coming, and quieted down.

Mr. Shadoan

Q. Upon what do you base your notion that he had it in his brief case, Mr. Stern?

A. I don't know whether he did.

Q. Well, you made a statement. What is the basis for it?

A. I said I assumed that he did.

Q. You said you—

A. I assumed that—

Q. You said "I believed that he did". Upon what do you base your belief?

A. If I had gone there, I would have had something like that in my pocket to make sure that the Com-
page 255 } missioner understands if there is a new Commissioner, but other people may handle a hearing differently.

Q. How long are you going to continue to rely upon the investigation before you start submitting such data to support your applications in Virginia?

A. I can't answer this question. I don't know what we will do next year. Circumstances may require an entirely different kind of filing.

Q. Do you understand that it is your obligation to submit data in your filings to support the requested increase without regard to what the Commission may know about the operation of your companies?

A. I don't think that is an obligation. We can rely on certain records which are public records, which are known, such as the insurance expense exhibits and the annual statements.

Q. You don't think that you have to submit
page 256 } data with respect to expenses because the Commission is already aware of the expense exhibits? Is that what you are saying?

A. Yes. And I believe the Virginia law, like the All-Industry Bill, specifically provides that if the Commissioner feels that additional information is required, he shall request it.

Q. Yes. Are you aware of the fact that the Kentucky Commissioner required a special call to go out to your members to find out what the expense experience was within that State?

A. Yes.

Q. He apparently thought that the expense experience in that State was specially applicable to the State of Kentucky; is that correct?

A. Yes.

Q. No such data has been compiled for the State of Virginia; is that correct?

A. Yes, that's correct.

page 257 } Q. How long would it take you if they asked you to issue a call to collect the data?

A. Well, I would have to check the companies' statisticians to know what they have available. Usually, any request for statistics is issued before the statistics are summarized in the company's office. For example, the Kentucky data, I think the request was sent at the end of the year for the coming year.

Q. Have you finished answering the question?

A. Yes.

Q. I don't know whether I established this or not, but you will agree, will you not, that if in fact the expense experience in Virginia is less than those budgetary allocations, that your increase requested would have to be diminished by the extent of the difference?

A. I don't see how you can ever determine that. As Judge Catterall pointed out, so often the twenty per cent

page 258 } budgetary allowance for acquisition expense is something the company has to live with. If it can stay in business by spending less, well, that's one thing. If the company spends more, the company is out by that much.

And we make no attempt to regulate in any way the amount of money the company can spend except beyond the allowance in the rates for this item.

Q. The Commission's opinion recognized the validity of the study, and demonstrated that you were four-tenths of one per cent off in your assumption that expenses tracked your losses. You are aware of that, aren't you?

A. Yes.

Q. Well, that demonstrated, did it not, that the last time you got an increase here you were four-tenths of one per cent of the premium volume off in terms of expense experience, didn't it?

A. Yes, but as the opinion of the Commission

page 259 } stated, rates are not made that closely. They are rounded to the nearest dollar, and there are many estimates involved, and the four-tenths of one per cent is not significant.

Q. How much of the five per cent for profit and contingencies is for contingencies and not profit?

A. From past experience I would say all of it.

Q. No profit. That allocation, the word "profit" that is set up there doesn't mean a thing?

A. I didn't say that.

Q. Well, what does it mean? How much of it relates to profit in terms of expectation, and how much of it relates to contingencies?

That's what I'm asking you.

A. The five per cent provides a cushion for contingencies, to pay unexpected excess in losses or excess in expenses. If no such unexpected expenses and losses occur, then a company can realize a profit.

page 260 } Q. Well, now—

Commissioner Catterall: Well, you have one contingency that you are certain to have, which is not included in the rate-making formula.

A. Sir?

Commissioner Catterall: Federal income tax.

Mr. Shadoan: I am not denying contingencies exist or even suggesting that they don't exist. I am simply trying to find how much of that we expect in the ordinary course of experience to be eaten up by contingencies.

Q. And if your predictions are correct, how much of it will be realized as profit on underwriting? Can you answer that question?

A. I thought I did. I said it depends on the run-off of the experience. If losses are higher than expected, or expenses are higher than expected, then whatever the excess is will eat into the five per cent, become a contingency

page 261 } cushion, and whatever is left will be left as an underwriting profit.

Q. But it may be that we are looking at it backwards, as you are answering my question by looking back at what has already happened. I'm asking in terms of looking forward as to what we expect.

A. Oh. Optimistically, we expect that the five per cent will be available as an underwriting profit prior to Federal income taxes.

Q. So there is no specific contingency that you include in that anticipation?

A. That is right, except, of course, if the five per cent is

realized, this is not money that stays in the company's drawers; it's still subject to income tax.

Q. The four-tenths then of one per cent would be what—approximately—that would be almost ten per cent of your entire profit expectation, wouldn't it? You know what four-tenths of one per cent I am talking about?

A. Yes; yes.

page 262 } Q. Well, is my statement correct?

A. It is correct that way, yes.

Q. Now, is there any reason why you should expect the four-tenths of one per cent tracking phenomena not to occur with respect to the filing that was analyzed? I believe it was 17537 or something like that. It was the 1965 filing that was analyzed, I believe. Is there any reason why you should expect a different result with respect to the present filing?

A. Yes, there is a reason.

Q. Tell us about it.

A. The enormous increase in the inflationary pressure which has its reflection in increased wages, and most of our general administration item is wages, so all of it would probably be wages; and there is a shortage of suitable manpower and suitable positions are at a high price today—clerical workers, programists, and such people. I don't think companies are going to save any money. I think their expenses are going to go up.

page 263 } Q. Upon what economic study or other considerations do you base your statement that the inflation rate for 1967 is greater than that which existed in 1966?

A. The latest information from the Bureau of Labor Statistics in Virginia began April—I believe the April Index showed a record rise, I think the highest since 1953 or something like that. I think it's pretty well known that wages are going up as the inflationary pressure continues.

Q. Well—

A. As a matter of fact, the statement was made that even food prices, which have been stable for some time, will go up because the wholesale price index has gone up dramatically.

Q. Well, now, with respect to your testimony, if I—am I misunderstanding you? As I understand it, you are saying that you don't expect the results to be the same because the rate of increase in inflation in 1967 is greater than the rate of increase at the time the analysis was made.

page 264 } Is that your testimony or am I misconstruing it?
A. No, I think that's about what I said.

Q. And I ask you, Sir, not whether or not there is inflation in 1967, but upon what you base the statement that the rate of increase in wages is greater today and, if I understood your statement correctly, it's statistics from the Bureau of Labor; is that right?

A. Right.

Q. Let me read you something, and see if this causes you to change your mind about your belief as to why those exhibits were not presented in Arkansas.

Page 235 of the transcript, the question begins:

"Before leaving it, however, I would like to ask you this. Are the exhibits that you have used for this filing the exhibits you customarily use when you apply for a rate
page 265 } filing or is there some segment of data that you customarily use that are not present in this filing, and specifically, rather than just letting you wander in the dark, I am referring to exhibits which customarily stated losses of the companies in terms of real dollars and in terms of total dollars underwriting loss. Up until this controversy appeared in the last couple of years, wasn't it customary to have these kinds of exhibits?

"A. In the filings, no.

"Q. No, no, supplemental to the filings.

"A. In some cases and in some States we have prepared in past years some exhibits pertaining to that area, yes.

"Q. And then with the criticism of the underwriting profit method of computation and accounting methods,
page 266 } you folks decided it might be better simply to limit your attention to rate-making and to contend that accounting has nothing to do with it; is that right?

"Mr. Wright: We object to that, to the form of the question. He can ask the witness what was done and when it was done.

"The Commissioner sustains. Rephrase your question, Mr. Shadoan.

"Q. Mr. Jewel, I am asking you whether or not those exhibits are omitted from this hearing and others because they demonstrate that accounting principles are applicable to the business of rate-making?

"A. No, Sir.

"Q. Why are they omitted?

"A. Because they are not relevant to the making of rates. They have nothing to do with the rate-making

page 267 } procedure of the National Bureau.

"Q. When did you determine that they were no longer relevant and should not be used as supporting data?

"A. We have known all along they are not relevant to rate-making.

"The Commissioner: Mr. Jewel, Why were they submitted at one time and then their use discontinued?

"The Witness: In some States at the request of the Insurance Department themselves, we prepare for them an exhibit trying to set up what would be and what was the underwriting loss.

"The Commissioner: Are you telling me that they were not customarily submitted, rather they were submitted at the request of the Insurance Department?

"The Witness: Yes, Sir, in most cases it was

page 268 } at the request of the Insurance Department or in some cases at public hearings when the Department wanted us to bring out or to show what this was. We would do it then, but in the normal procedure in making a rate filing we did not prepare and furnish any exhibit of that type.

"The Commissioner: Do you have that information available here?

"The Witness: We made that up, the information available to Mr. Shadoan at his request. I think it was one of the exhibits.

"The Commissioner: Is that correct?

"Mr. Shadoan: That's not what I am referring to, Mr. Commissioner."

Then we go into the whole thing, but we don't need to. Do you still contend that he had them in his brief case down there?

A. I didn't contend it. I said I assumed, I would have prepared it if I had gone there.

page 269 } Q. Well, now, he said that they were not customarily presented unless the Insurance Department or somebody requested them.

A. Well—

Q. Is that different from your testimony?

A. No, it is not.

Q. And you agree that they have nothing to do with rate-making—right?

A. That is correct.

Q. Underwriting profit and loss is completely irrelevant to rate-making—right?

A. Underwriting profit and loss is a matter of the past.

Q. Okay.

A. Rate-making is concerned with the future.

Commissioner Catterall: But don't you want some underwriting profit and loss in the future?

A. Yes, Sir. That's why we include a provision for that in the rates.

page 270 } Commissioner Catterall: I can't understand your "No" answers. You come in here demanding profit, and then say it is irrelevant.

A. The—

Commissioner Catterall: Why don't you say "Yes" to everything?

Commissioner Dillon: He means the past profit and loss is not considered.

Commissioner Catterall: Well, that's very confusing to these people who are listening to us.

A. The future—

Commissioner Dillon: The future profit.

Chairman Hooker: That's the way I understand, they don't want any future.

Commissioner Dillon: He wants it in the future, but he doesn't want to tell you what the past is.

Mr. Shadoan

page 271 } Q. Well, now, even in this complicated actuarial science, it really comes down to predicting the future compared to experience, doesn't it?

A. Yes.

Q. Mr. Stern, I am going to pass to you what is marked for the purpose of your inspection as Exhibit Z which bears the caption " "Maryland Automobile Liability Insurance Private Passenger Cars, Underwriting Loss for Accident Years Ended June 30, 1963 and 1964", and ask you whether you have any similar document for this Commission to examine.

A. I have a summary of the Page 14 data for Virginia, not exactly in the same form, but this is the summary of Page 14 data.

Philipp K. Stern

Q. I am going to show you what is marked as Exhibit H which is a graph, reading in bold-face "Companies Suffer Underwriting Losses on Automobile Liability Insurance in Maryland" stating the excess of claims and operating expenses over premiums for 1963 was two million, page 272 } eight hundred and fifty thousand, five hundred and seventy dollars; and the excess of claims and operating expenses over premiums for 1964 was four million, four hundred and seventy thousand, and nine dollars.

And I ask you to examine that and tell me whether you have any similar document for this Commission to examine?

A. No, I do not. The Commission in its decision on the 1965 rate case recognized that the past rate-making procedures had constantly undershot the mark and that the rate-making procedure should be more responsive.

Commissioner Catterall: Let us look at that last picture. We don't get those things appraised.

I am glad they don't present things like that here.

Mr. Shadoan

Q. Mr. Stern, I would like to invite your attention for a moment to the loss development factor which I believe was utilized in this filing. Was there a loss develop-page 273 } ment factor utilized in this filing?

A. Yes.

Q. Where does that appear in the filing?

A. Exhibit A, Sheet 2, states what the loss development factors were.

Q. Well, don't you have a computation of it somewhere?

A. Yes, we do. We submitted that to the Bureau of Insurance as supplementary information in our letter of April 21, 1967.

Q. If you would let me look at that for a moment, I will promise to give it back to you.

Now, is this the same method of computing loss development that you have been using for the last several years or is it different?

A. It is the same except for one thing. This is the first time that we are able to use for bodily injury the fifteen/thirty experience. In the past we had to use page 274 } ten/twenty experience, mainly because loss development on a fifteen/thirty basis was not available for these additional coverage points.

Philipp K. Stern

Q. Now, the actuarial method, however, the actuarial approach, remains the same; is that correct?

A. It is, yes.

Q. Now, is this the same actuarial approach you were using in New York in 1956 and 1958?

A. In 1956.

Q. Well, let me back off a moment to make sure I understand. What I really want to know is whether the actuarial approach that you use to compute the loss development factor in this rate filing differs from the loss development approach that you were using in New York during the period that I mentioned?

A. Well, in 1956 we still used policy data for rate-making.

Commissioner Catterall: I can't hear you.

A. In 1956 we used policy year data for rate-
page 275 } making, policy year experience.

Commissioner Catterall: Policy year experience. Policy year instead of accident year?

A. Yes; which required entirely different practice.

Mr. Shadoan

Q. Well, now—

A. Now—

Q. I'm sorry.

A. In 1958 we used accident year the first time.

Q. Well, now, what I'm getting at is this. Are you familiar with the New York Department of Insurance Study—I believe it was 1956—and which was referred to by the New York Court of Appeals in the case of National Bureau of Casualty Underwriters against Superintendent of Insurance, and reported in Volume 174 of New York Supplement (2nd) 836 in 1958? It's a book, the annual book which they publish, I
believe, which said that your loss development
page 276 } factor was off by three per cent at that time.
Are you familiar with that study?

A. That—it's not a special study. It's shown every year in that little booklet.

Q. Did they make that finding as to your approach in reaching the loss development at that time?

A. The finding was made, but the decision of the Superintendent was overturned by the Superior Court and remanded back for new proceedings, and in the course of the court proceedings the Superintendent approved a rate increase in New York, and the entire court case became moot.

Q. Isn't it a fact that everything you said was correct except that portion about the court reversing the Commissioner and remanding it. The Court didn't reverse the Commissioner's finding that the increase was not warranted. It found that it was mooted because it took so long to get to the Court of Appeals; isn't that right?

A. No, I am sorry. The Court first ruled that
page 277 } the Commissioner was not specific in his disapproval, that an increase in rates was indicated, and remanded it back to the Commission.

Q. Did the Court make any finding that the study by the Department of Insurance, indicating the loss development factor was an error by three per cent, was wrong?

A. It did not go into a detail because the whole proceedings were found defective.

Q. Well, now, do you agree that the loss development factor was three per cent off in New York at that time?

A. I do not.

Q. In other words, you contend that the Department of Insurance there was wrong; is that right?

A. Yes.

Q. But you recognize that that report which they publish every year is so good it can be used as a text book, don't you?

A. Well, yes, for different purposes, not for
page 278 } this kind of rate-making.

Q. You were very praiseworthy without qualification of that annual report when you testified in this Commission's investigation, weren't you?

A. Well, yes, but not in the context of calculating loss development factors.

Q. I understand. Even the best of us can be mistaken, and they were on that occasion; is that right?

A. No, they are not mistaken. They are exhibiting certain data to demonstrate certain kinds of run-off of the experience, which has nothing to do with this loss development factor.

Q. Let me ask you this. Am I incorrect in my understanding that the Woodward and Fondiller study concluded that there was no reason for them to believe that your loss development factor was wrong, but they could not validate it because they couldn't trace the experience out far enough?

A. That was one point made. They did not say
page 279 } they cannot validate it. What the report said was at a certain point our loss development stops and we assume that from then on there will be no further

development, and this affects approximately two and a half per cent of the losses, and I believe the report used a phrase like this "in order to obtain certainty," it would be advisable to test the runoff experience somewhat further than the sixty-three months we are using.

Commissioner Catterall: That would take eight years, would it not?

A. Something like that.

Commissioner Catterall: That would take eight years before you put on the last nickel.

Mr. Shadoan

Q. Exhibit A, Sheet 3, of your filing sets forth quarterly figures and the computation of your determination of property damage factor which is commonly called the "Trend Factor" is that correct?

page 280 } A. Yes, Sir.

Q. Where is the data supporting your conclusion with respect to the trend factor on bodily injury, Sir?

A. We did not use a factor. We used a factor of unity for bodily injury, and we submitted information on that point to the Bureau of Insurance in the same letter of April 21, 1967.

Commissioner Catterall: Haven't you got a copy of that to go in as an exhibit—an extra copy?

A. I'm afraid I don't.

Mr. Elliott: We can have a copy made.

Commissioner Catterall: Well, any heavy document like that ought to be in the record.

Commissioner Dillon: Well, it will be received as Exhibit No. 8.

Mr. Elliott: We will file that as Exhibit No. 8.

page 281 } Mr. Shadoan

Q. Can you tell me why this is limited to the bodily injury with five thousand dollar limit, Sir?

A. Yes, Sir, I would like to do that.

Q. Would you do that?

A. Formerly I explained that in rate-making, the making of rates for manual, we exclude from our data any losses which are in the area of catastrophe, that is, the losses above the required limits of fifteen/thirty and five. When we deal with the average paid claim cost data, we, of course, have a

much smaller volume of experience to look at. We are only looking at paid losses and we are looking at them on a quarterly basis.

In order to limit or exclude the influence of chance used in large cases, we eliminate from any loss payments the amounts above five thousand dollars. Now, this is a procedure which is really outdated for present conditions. It was established years ago when most States had for their limits

page 282 } five/ten for bodily injury.

Today most States require ten/twenty as a minimum. Virginia and a few other States require fifteen/thirty. Therefore, many more claims will reach into the upper levels above five thousand, and our method of eliminating any amount above five thousand actually levels the trend and is not responsive to the actual conditions.

If we look at bodily injury losses without any limitation, we would find that in Virginia as in other States, the bodily injury claim cost is rapidly increasing; and we did make a study of that situation, and this is an area where we thought a chart might be of assistance in understanding the picture.

Q. May I ask you this, Sir? I would like for you—what is that, Exhibit No. 8 that you just gave me?

A. No. 8.

Q. That doesn't have any line of best fit, it

page 283 } doesn't have any computation of the proposed factor. It just has raw data.

A. It does not because we submitted it in an explanation similar to the one I just gave you, pointing out that limiting the bodily injury payments to five thousand dollars understates the bodily injury case.

Q. Mr. Stern—

A. I have an—

Q. I'm sorry.

A. —exhibit here which shows the total limits bodily injury paid claim costs in Virginia, and it shows that, for example, from 1965 to 1966 the bodily injury total limits claim costs rose from eleven hundred and eighty-six dollars to twelve hundred and seventy-five dollars, and it is not the picture as we see it on the so-called limited basis. It does show a very clear impression.

Q. Let me—

A. However, in order to be conservative, we did use our factor of unity.

Q. Let me ask you to trade No. 8 for what I

page 284 } have marked as No. 9. I would like to see No. 8.

Senator Howell: No. 8, Mr. Stern.

A. No. 8? I'm trying to remember which one that is.

Mr. Shadoan

Q. Well, if you will examine what I have marked as No. 9, you will see an actuarial computation of the trend factor for bodily injury which was part of the Maryland filing, including both Maryland experience and countrywide experience. Is that not correct?

A. I haven't seen the exhibit you are talking about.

Q. I just handed it to you, as No. 9.

A. Oh, yes, I see, yes, yes.

Commissioner Dillon: Are you going to offer that?

Mr. Shadoan: Yes, I am going to offer that.

Commissioner Dillon: All right. That will be

page 285 } received as Exhibit No. 9.

Mr. Shadoan: With the Commission's permission, as to those exhibits such as that I would request the Commission to submit photostatic copies of those exhibits.

Commissioner Dillon: Yes.

Mr. Shadoan

Q. Have you had a chance to examine that?

A. Yes. I am acquainted with this type of exhibit.

May I explain to you why.

Q. Yes, that was the next question. Go ahead.

A. Our standard procedure for the determination of the average paid claim cost trend factor is to take the State and countrywide rate of average, with the State data entitled to less credibility by the standards which are established for that purpose.

Q. I'm sorry. I didn't get that. What was it?

page 286 } A. We are using the rate of average of the State and countrywide indications, where the State data are not entitled to full credibility.

Q. I see. But the computation down below?

A. In Virginia we have, for many years, we have found that countrywide data are not welcome in this kind of calculation. Therefore, we don't have an exhibit.

In addition to that, it would be purely academic because Virginia data are fully credible.

Q. Why don't we have a trend factor and computation on this exhibit?

A. Because our interpretation was that this exhibit does

not indicate a clear trend. Our letter of explanation—if you will turn back a few pages in this exhibit, you will find a paragraph we wrote about that, and it was similar to that I just explained to you, that it is really inappro-
page 287 } priate for us to use bodily injury paid claim costs limited to five thousand dollars, and that if we used a more appropriate total limits figure, a trend would be indicated.

Q. When did you make that decision that you weren't going to use five thousand any more, but that you were going to use total limits?

A. Well, we made that decision about two or three years ago, but it takes that long, not to go to total limits, but to go to a different basis, and it takes that long to accumulate the necessary data because we have to cover the quarterly periods here.

Q. And that's why the Maryland Exhibit No. 9 is five thousand; is that right?

A. Yes, because we did not get half ten thousand dollars there. Pretty soon we will have sufficient data limited to ten thousand.

Q. Right now you don't have the total limits data either—right?

A. Oh, yes, we have the total limits data, and I would like to introduce this exhibit to you, which shows very
page 288 } clearly what the total limits bodily injury data—

Q. Yes.

Commissioner Dillon: That will be received as Exhibit No. 10.

A. We have additional copies.

Mr. Shadoan: Is this what he is marking as Exhibit No. 10?

Senator Howell: Yes.

Mr. Shadoan

Q. This graph?

A. Yes.

Q. That's not a computation of a trend factor, is it? That's a representation of your conclusion, isn't it?

A. No. That is a representation of facts. These are average paid claim costs.

Q. Well, where, Sir, is the computation? Where is the computation?

Philipp K. Stern

A. We did not submit a computation on the basis of data which we did not think to be indicative of a true picture. I can tell you one thing, that this picture which we reject because it was inadequate, we would have indi-
page 289 } cated and created the wrong impression of a downward trend, which obviously is not the case if you look at the picture of limits which are more appropriate the way we have shown them.

Q. It would have shown a downward trend, and it wasn't used because if it showed a downward trend, it was wrong?

A. No, it was not. I did not say that.

I said that we submitted the data with all qualifications, explaining that the Virginia conditions the total limits data are more appropriate than data limited at Five Thousand dollars because of the high limit required in Virginia of fifteen-thirty, and also because of the increase in the limits for the one for death statute.

Q. You include a sheet showing a computation of the trend factor for property damage, and it shows an increase?

A. Right.

page 290 } Q. You've got no similar sheet for bodily injury because it showed a downward trend that you do not think is a proper representation of the trend; is that it?

A. Not quite.

Q. Well, what is proper?

A. Our statement was that there is no clear trend, either upward or downward. If you look at this exhibit, you will notice, for example, that the first quarter of 196.....—

Q. Which exhibit?

Mr. Elliott: The last you were referring to.

A. This exhibit, which is I believe Exhibit No. 8.

Mr. Shadoan

Q. No, that's not Exhibit No. 8. I don't think I have seen that.

A. I thought I—

Q. We have been over Exhibit No. 8 right here.

A. Well, the exhibit which you have, that's the
page 291 } next one.

You will notice that the average claim costs for the last quarter ending, for the year ended March 31, 1966, shows a steep increase over the prior periods. The average claim costs on that limited basis for the first quarter

of 1966 is almost exactly the same as the average paid claim costs for the year ended 6/30/1965, which corresponds approximately to the bodily injury data used in rate-making.

So these two points show that there has been no decrease in the average paid claim costs, even on this very limited basis. However, if we had data available on the ten thousand dollar basis, they would clearly show an upward trend in bodily injury claim costs, as is demonstrated by the chart which I introduced and which are the total limits bodily claim costs.

Q. Exhibit No. 10?

A. Exhibit No. 10.

page 292 } Q. If you don't have the data, but you know what it will show, what did you use to put this chart together with except data?

A. Let me explain again. When I explained to you what this five thousand dollar limitation means, I told you that as we accumulate the paid loss transaction reports from the companies, we eliminate from each claim any amount above five thousand dollars.

Now we have been doing the same thing for a while now on a ten thousand dollar basis. What we get is the total paid claim costs under each claim, the total paid amount.

And that is what this chart demonstrates, that's what we have; but we don't have for a sufficiently long period, we don't have for a sufficiently long period the data where we only eliminated the amounts above ten thousand dollars.

page 293 } Q. So that if I understood you to say about ten minutes ago that you didn't use the five thousand dollar figures any more because the total limits figures were better, I was mistaken? Is that what you said or not?

A. I don't think I said the ten thousand dollar figures are better. I said that we submitted the data to the Bureau of Insurance with a comment in which we pointed out that the data limited to five thousand dollars per claim understate the actual conditions, that we are preparing to obtain data on a ten thousand dollar basis; but we also submitted to the Department, the Bureau of Insurance—made a comment, I should say—on the picture as it is presented by total limits average paid claim costs.

Commissioner Catterall: You said the total limits was not proper to use because it contains catastrophes which take it away from being a pure trend. Is that what you said?

Philipp K. Stern

A. Yes; and it could introduce a cash situation.
page 294 } It could exaggerate a trend at one time, and then, again of course, completely understate it the next time. If you have one fifty or a hundred thousand dollar paid amount in one quarter, it will make the claim costs soar, and this one quarter would stand out, it would always appear to be wrong and incredible.

Commissioner Catterall: It would look as if going tobogganing the next quarter?

A. Yes; and vice versa, of course, if that happened to be the last quarter, it would, as in any quarter within the line, it would create the trend line, it would cause the trend line to go way out of line up.

Mr. Shadoan

Q. Why didn't you prepare an exhibit similar to the one that you are looking at that you submitted to Maryland, excluding the countrywide data? That's Exhibit No. 10, I think.

A. Is your question why we did not submit the exhibit excluding countrywide information?
page 295 } Q. No, no, no, no. You have already explained that they don't like countrywide data here, so I'm asking why didn't you submit one like that showing the line of best fit, showing the actuarial computation of the trend, to this Commission as you did in Maryland in 1965?

A. I thought I answered that before. I said that we stated in our letter that using the bodily injury data limited to five thousand dollars would give an erroneous answer.

Q. You said:

"We believe that our self-imposed limitation to $5,000 per bodily injury claim is not realistic in light of the 15/30 minimum required limits in Virginia."

Right?

A. Right.

Q. "With these high required limits, average paid claim costs based on all limits would produce a more
page 296 } realistic indicator."
Right?

A. Right.

Q. And you don't have the necessary data to use this new method—right?

Philipp K. Stern

A. I have the total limits data, and by mere inspection—
Q. But you don't have a computation of the trend factor from either, do you?
A. Oh, yes, I have a computation.
Q. Well, that's what I want.

Commissioner Catterall: I thought you said it was zero, unity?
A. I—
Mr. Shadoan: That was an assumption, Commissioner, not a computation.
A. The unity judgment conclusion that this will be zero.
Commissioner Catterall: Wasn't that true of the 1965 rate hearing? If you had a zero—do you call it "zero" or "unity" trend factor?

page 297 } Mr. Shadoan
Q. You had an assumption in that hearing too, didn't you?
A. That is correct.

Commissioner Catterall: That there was no trend up and down.
Mr. Shadoan: They had an assumption, Commissioner. What I'm saying is there is an actuarial formula which they use when it's up. Why don't they use it when it's down instead of assuming that there is no trend?
Commissioner Catterall: Well, they have the twelve quarters.
Mr. Shadoan: Well, now—
Commissioner Catterall: The twelve quarters show a level line or it's such a slight up and down, it didn't make any difference.
A. If I may explain to you—

Mr. Shadoan
Q. If you've got the computation, go ahead and
page 298 } dig it up.
A. The situation—

Commissioner Dillon: As long as he has to dig it up, let's recess until 9:30 in the morning. Does that suit everybody?
Senator Howell: If Your Honors please, I don't want to overwork the Commission, but we are coming backwards and

forwards from Norfolk. We took an hour and a half recess for lunch. It's just 4:00 o'clock, the shank of the afternoon. We would like to wind up this as soon as we can, consistent with a full hearing.

Commissioner Dillon: Well—

Senator Howell: If you are getting ready to—

Commissioner Dillon: What we are thinking about is Mrs. Wootton. She's getting a little tired on this.

page 299 } Senator Howell: Well, we certainly—maybe we can turn the record on, and she doesn't have to take it.

Commissioner Dillon: We will run over tomorrow later.

Senator Howell: All right, Sir. Well, before you adjourn—

Commissioner Dillon: All right, Sir.

Senator Howell: I want to make a motion, and maybe we won't have to come back tomorrow.

And that is, I think Mr. Shadoan has proved conclusively that the mandatory provisions for filing are not being complied with, and it's absolutely indisputable that they have not computed two essential and mandatory legislative prerequisites for filing.

We make the motion to dismiss the filing at this time.

page 300 } If Your Honors—I don't know whether you have had a chance to read the section or not, but it very clearly says that they have to—

Mr. Shadoan: Here it is. Here it is right here, Paragraph Three.

Senator Howell: Yes, Sir. "The rates for the kinds of insurance to which this Chapter applies"—and I want you to pay careful attention, and I know Mr. Elliott will back me up on this—"applies shall be made". It's not "may", it's not permissive, it's mandatory. The word "shall" has a definite legislative effect, and then when we get to the prerequisite number three, which is mandatory, Mr. Shadoan established was a question that they do not have the past and prospective expenses, both countrywide and those specially applicable to this State, and he also established that due consideration had not been given to past and prospective loss experience within and outside this State.

page 301 } So with the omission of two legislative mandatory factors in the filing, we would like for you all to take just five minutes to consider the motion, and then come back, and maybe we won't have to come back here tomorrow.

Philipp K. Stern

Mr. Shadoan: Before you do, Your Honors, I would like to ask one question. I think the motion is well taken. I would like to ask the witness one question before you consider it.

Mr. Shadoan

Q. Mr. Stern, I have here and I'm reading from a telegram:

"HON. JOHN NORMAN HARKEY,
INSURANCE COMMISSIONER
ARKANSAS INSURANCE DEPARTMENT
NATIONAL OLD LINE LIFE BUILDING—
ROOM 313
LITTLE ROCK, ARKANSAS

"THE NATIONAL BUREAU OF CASUALTY UNDERWRITERS HEREBY WITHDRAWS ITS AUTOMOBILE LIABILITY RATE FILING SUBMITTED TO THE ARKANSAS INSURANCE DEPARTMENT ON
page 302 } NOVEMBER 17, 1966. IN VIEW OF THE QUESTIONS AT THE HEARING CONCERNING COMMISSIONS TO PRODUCERS ON ARKANSAS AUTOMOBILE LIABILITY BUSINESS AND YOUR GENERAL INQUIRIES ON EXPENSE DATA, WE WILL COMPILE AND STUDY APPROPRIATE DATA. THESE DATA, WHEN ANALYZED, WILL BE SUBMITTED TO YOU BEFORE ANY NEW FILING IS MADE. OUR LOCAL COUNSEL IS BEING ADVISED OF THIS ACTION.

"JAMES M. CAHILL, GENERAL MANAGER NATIONAL BUREAU OF CASUALTY UNDERWRITERS"

In view of the fact that you do not have similar data to be considered by the Virginia Commissioners, why don't you withdraw this application?

Mr. Moncure: I object to the question. He is asking the witness to handle this application, and he is the witness.

page 303 } Commissioner Dillon: He doesn't have to answer it. Do you want to reply to the motion?

Mr. Moncure: Somebody else here has something to say.

Mr. Sacks: If I may, if Your Honors please, I rise in support of the motion that the application be dismissed for an obvious and apparent failure to comply with the statute.

Philipp K. Stern

If we don't have to have them comply with the statute, there is no reason to have any hearings, there is no reason to go through an examination of the data that is submitted; and so I do rise in support of that because I don't think there has been any satisfactory answer or reason why they *have't* brought before you the things that the General Assembly of Virginia says ought to be considered.

But, in addition to that, I urge consideration of
page 304 } what I think the letter and spirit of the Virginia law require, and that is, the thing that our colleague, Mr. Shadoan, brought up here this morning of candor, forthrightness, sincerity, and this thing applies and affects many a Virginian; and we are in a woods of complicated figures and statistics here on Mr. Stern's home territory.

Well, I say to you honestly, and from my heart, that you don't have to be an actuary to see what is happening here, and I submit to this Commission that additional reasons for dismissing this petition is an absolute and obvious lack of candor. Now, here are the two notes that I, as an amateur, I don't know anything about anything the actuary on those statistics put down.

I note from Mr. Shadoan's cross examination that it is in this record that when there is a trend factor, which is new to me until I got into these hearings, that goes up and supports the position of the insurance industry, you have
page 305 } the calculations here. You don't have to fish them out of the bag, you don't have to pull teeth from the witness. But when the trend factor goes down and would be in support of the motorists, you don't have it.

Now, there is an admission from the stand, as I understand it, that in bodily injury situations in Virginia, and this filing that the trend factor calculations are dealing with, we've got unity, and if it hadn't been for the cross examination the way Mr. Shadoan did it, I wouldn't have known, and you wouldn't have known, that the calculations show, not the graph which is the way they want to draw the picture, that the calculations show that there is a downward trend.

Now, they have not offered it here, and I submit to you that you can read through these statutes from 252 on. There are criminal sanctions when they withhold, when they
page 306 } give you misleading things. I am not asking for that, but the spirit and the letter of the law in Virginia are that they come in here and that they candidly and fairly put it on the table, and that they show they are entitled to it, all right. Now, they have not brought that.

And the second one is, I have found out, by listening closely to what Mr. Shadoan brings out, and there is no explanation here, that where the twenty per cent production costs allowance exceeds the actual production costs, the motorist has to pay for that, the Virginia motorist.

They just ignore it, they don't bring it to the Commission's attention, and the justification for it is the equalization, is because the insurance companies say when it exceeds twenty per cent, they have to pick up the tab.

Now, the General Assembly of Virginia *doen't*
page 307 } give this Commission, and I say it to you with respect, enough leeway to allow them to do that. They haven't come in here and honestly and sincerely and candidly put it on the table; and I urge to you, Members of the Commission, respectfully and earnestly that in addition to the fact that they have failed absolutely legally to place before this Commission what the law requires them to place, that in addition they have violated the letter and spirit of the Virginia law when they don't candidly come and place before you things that ought to be before you.

You have ample evidence in this record, I submit to you, honestly, to dismiss the filing, let them come back here, like they did voluntarily in Arkansas, when they have their filing in shape enough for you and the Virginia motorists to see that they are truly entitled to the fourth increase in five years.

I ask that you dismiss the petition.

page 308 } Mr. Moncure: May it please the Commission, that statute says the Commission shall give "due consideration".

Now, they speak of not putting it in dollars and cents. That formula has been in existence here and, as Judge Catterall pointed out, it is a budgetary allowance. The companies are allotted that percentage for these items. The nationwide data is before you, the Commission has all of this, and the Commission, of its own volition, can get any data anywhere it wants. There is no failure to comply.

If they want it in dollars and cents, take the sixty-four per cent shown for the losses and convert them into a hundred per cent, and the difference between the two is the formula.

There isn't any merit to any of these motions. There is ample hearing from the ten or twelve days that they set out the ground rules for this rate filing. Things
page 309 } that we haven't brought in here are things that were decided in that, and that has been made part of this record.

Philipp K. Stern

And to say that we haven't complied with the Virginia law when we have filed every dollar loss in Virginia on losses paid and every premium of sixty-four point six per cent allotted to that premiums; and we are operating under a formula that has been in existence and established by this Commission on countrywide experience, and exhibited here today.

We have complied with everything that the law requires. The proceeding will continue.

Mr. Moss: May I just say one thing, in answer to Mr. Moncure's argument?

Now, as I was reading along, and certainly you gentlemen know more about it than I do, but it doesn't say anything about "may" in the law. It says "shall be made in accordance with the following provisions", and to me that's as
page 310 } mandatory as it can possibly be in the statement.

So I do not agree with Mr. Moncure that it is a "may be" situation. It says "Due consideration shall be given" in the bottom paragraph, but up top it says "shall be made in accordance with the following provisions"; and there is nothing in there that gives you any arbitrary, as I see, basis for denying this provision.

Commissioner Catterall: I think the word "due" is the one that underlies. This way we don't let them use the nationwide loss ratios when they have credible data in Virginia.

Commissioner Dillon: The Commission will recess for five minutes.

Mr. Shadoan: I would like to say just one thing. It won't take but a second.

I agree with you there is due consideration, but what he has said is that we don't know what the experience
page 311 } is in Virginia; and if you don't know what it is, you can't give due consideration to it.

And we have established that it can be secured because it was secured in Kentucky by this Bureau.

4:10 P.M. Commissioner Dillon: The Commission will adjourn for five minutes.

Commissioner Catterall: And then give you an answer.

4:20 P.M. The Commission resumes its session.

Commissioner Dillon: You may leave the witness stand, as we are through with you.

Witness stood aside.

Commissioner Dillon: The statute requires the Commission to give due weight to all the relevant factors, and we consider that the data presented by the Applicant is sufficient to comply with the statute.

This has been the administrative ruling of this
page 312 } Commission ever since the statute was passed, and, therefore, we deny the motion.

Mr. Mann: May it please the Commission, I request that the Commission direct the Applicant to provide specific data regarding expense experience within the State of Virginia; and in addition to require the Applicant to produce a compilation as to the past and prospective loss experience in and about the State as required by the statute.

Commissioner Dillon: We just overruled the motion to dismiss on that.

Mr. Mann: Well, I am requesting specific data, Your Honors.

Commissioner Catterall: Specific data, supplied as requested.

Mr. Sacks: Well, if Your Honors please—

Commissioner Dillon: If we didn't think it was sufficient, we would have to grant the motion, I am afraid.

page 313 } Mr. Sacks: Well, Your Honors, if I may rise in support of it, my understanding is that the Commission has ruled that there is sufficient data, that it is not to be dismissed by the Commission as a matter of law, but the case proceeds, the hearing proceeds.

What we are asking as Interveners is that they be required to submit this so that we will have the benefit of it before—

Commissioner Dillon: Well, we will take that under advisement in the morning.

Senator Howell: Well, we want it so we can cross examine; I mean, we want to cross examine this expert on—

Commissioner Dillon: We are not going to let you cross examine him tonight.

Senator Howell: I understand that, but we want him—if it will take him three months to get it, we want the hearing to adjourn until we get it.

page 314 } Commissioner Dillon: Well, if it is going to take him three months to get it, from now until in the morning isn't going to make much difference.

We will take it under advisement in the morning.

Senator Howell: That's just another trip to Richmond.

Commissioner Dillon: The Commission will rise.

page 315 } June 1, 1967
9:30 A. M.

Commissioner Dillon: You may proceed.

Mr. Elliott: If the Commission please, at the close of the hearing yesterday, there were certain motions made, and based upon the provisions of Section 38.1-252.

I have given, at the Commission's request, further study to this proposition to determine just what is involved here.

It is clear that Section 38.1-252, the section governing ratings, and the making of rates. Only Paragraph (1) is applicable to automobile liability insurance. You will note that Paragraph (2) of that section refers to the kinds of insurance mentioned in Article 2 of this chapter, and they are the kinds of insurance which are under the jurisdiction of the, so far as filings are concerned, Virginia Insurance Rating Bureau, such as fire and automobile physical damage.

page 316 } Paragraph (2) specifically does not include Paragraph (13) of 38.1-240, which is the section dealing with motor vehicle insurance.

And Paragraph (3) provides that as to those kinds of insurance set forth in Paragraph (2), the requirements are as to what shall be shown in a rate filing, and what the Commission shall consider, and that refers to:

"Due consideration shall be given to past and prospective loss experience within and outside this State, to conflagration or catastrophe hazards, to a reasonable margin for underwriting profit and contingencies" and so forth.

And specifically, with respect to fire insurance that you shall consider five years experience. That's made adequately clear because in the latter part of that section it

page 317 } specifically refers to the uninsured motorists, in order to bring that to regulate, how the Commission is to deal with the uninsured motorist distribution in the making of rates.

Now, Section 38.1-241 is the section which deals with the information upon which this Commission acts on the rate filings for motor vehicle liability insurance.

Senator Howell: Excuse me. Members of the Commission, so that I may follow Counsel to the Commission, I can't quite follow him. Is he trying to sustain your ruling of yesterday that—

Commissioner Dillon: He is trying to acquaint the Commission with the statutes involved in that.

Senator Howell: And if you agree with the Commission's ruling that they don't have to bring in this data, I can't quite follow the purpose of the argument.

Mr. Elliott: Yes, I think that is right.

page 318 } Senator Howell: Because you all ruled yesterday.

Commissioner Dillon: Well, I know, but we have another motion before us this morning to require them to produce this material.

Senator Howell: Oh, I see. We don't rely on this for the production of material. We think we are entitled to that just as relevant information.

Commissioner Dillon: Go ahead, Mr. Elliott.

Mr. Elliott: Now, Section 38.1-241 provides that:

"Every insurer writing in this State a kind of insurance in which the provisions of this article apply" (and one of those is Section 13, the motor vehicle insurance) "shall file with the Commission, * * every manual or classifications, minimum rate, class rate, rating schedule, rating plan and

page 319 } rating rule, and every modification of any of the foregoing, which it proposes to use. Every such filing shall indicate the character and extent of coverage contemplated. When a filing is not accompanied by the information upon which the insurer supports such filing, and the Commission does not have sufficient information to determine whether such filing meets the requirements of this chapter, the Commission may require such insurer to furnish the information upon which it supports the filing."

It seems to me that the filing, together with the additional data that has been requested by the Commission, does support *prima facie* the filing and so far as the Commission is concerned, no additional data is necessary, because

page 320 } that is the data which the Commission has traditionally relied upon and is the data upon which rates have been based over the years of the regulation of these rates by the Commission.

Mr. Moncure: I would like to add to that that I am one hundred per cent in accord, and, in view of the threats of our friends that they are going to appeal the case, I would like to make certain that this additional data that seems pertinent that are made at the request of this Commission to its rate analysis, be filed in this case as exhibits, so that nobody can say they were not part of this record, because they are specifically referred to in the statute as the other data which you all have procured.

Commissioner Dillon: All right, sir.

Mr. Moncure: They are specifically:

A letter addressed to Mr. Hazlewood from the National Bureau of April 21, 1967—

page 321 } Mr. Shadoan: Just a moment, Mr. Moncure.

Mr. Moncure: Let me finish, please, Sir, and then you may address yourself to the subject.

Mr. Shadoan: Well, are you going to go through all of these?

Mr. Moncure: Sir?

Mr. Shadoan: Are you going to go through all of these exhibits?

Mr. Moncure: I am going to file these as an exhibit—

Mr. Shadoan: I would suggest that at the appropriate time, after we finish the cross examination, these exhibits will be introduced, instead of interrupting the procedure now to introduce further evidence.

Mr. Moncure: Let me answer that in this way. One of the single exhibits of five shown in this was pulled out from this file by him, and introduced in his cross ex-

page 322 } amination; so I want to make them all available to you.

Your Exhibit No. 5 is data secured by this Commission—

Mr. Shadoan: I am going to object to this simply on the grounds that it is interjecting evidence at a time which can only result in confusion. He will have a chance re-direct this witness and present this evidence.

Commissioner Dillon: Let's hold it up until you have him on re-direct.

Mr. Moncure: Judge, the reason I want to finish, if you don't mind, Sir, it says, and has just been read to you, such "filing and any supporting information", and this is the information that your Insurance Department requested.

Commissioner Dillon: We are going to permit you to file them as exhibits. There is no question about that.

Mr. Moncure: That's all I want to know. I

page 323 } don't want them left out. On April 21st—

Commissioner Dillon: Do it on re-direct. I think that would be more orderly.

Mr. Shadoan: Re-direct, I think he said, Mr. Moncure.

Commissioner Dillon: Put them in on re-direct.

Mr. Moncure: Re-direct?

Commissioner Dillon: Yes.

Mr. Moncure: Well, they may want to ask some questions about them, and I thought we would shorten it if we had them available now; but any way—

Commissioner Dillon: He may put them on himself; I don't know.

Mr. Shadoan: May I be heard for a moment with respect to what Counsel to the Commission has said?

Commissioner Dillon: Yes.

page 324 } Mr. Shadoan: I would like to say that there are two things; and taking the last first, I certainly agree with his interpretation of 241, which is that this Commission, if it believes that the data would lead to a better and more informed decision, can request that data.

It seems perfectly apparent that if in making rates you can be given the loss experience, which is exclusively Virginia experience, that it would be advisable and in the interest of the Virginia public to have the acquisition expense which is exclusively relatable to the Virginia experience.

This is available. It has not been secured in this filing. It is not a difficult thing to do because, as we will show and as you probably know from the Kentucky opinion, in December, upon the order of the Commission, a special call was issued to National Bureau members, and that acquisition data was

page 325 } produced by the Commission and the Commissioner was able to render an opinion within two months. So they got the data and had an opinion within two months, the same data that we want here.

It seems to me that, as a matter of logic, no one can argue with any force whatever that it is not more equitable to relate the Virginia production expense to Virginia experience if you are going to use the losses that way; otherwise, we might as well take the National loss experience and write rates in Virginia on National losses.

You can ask for this information under 241. We would request—we think that you ought to in order to be well informed and to make appropriate decisions—of course, maybe we won't be persuasive with respect to that.

I don't agree with the Counsel's interpretation of 38.1, Section 252.

It seems to me that it's clear that Sub-Paragraph (3) does apply to motor vehicle insurance for a number of reasons.

page 326 } In the first place, Paragraph (2), which he recited, is a specific paragraph in the nature of an exception, setting forth special provisions for the kinds of insurance which are set forth in Paragraph (2). It in no fashion relates to Paragraph (3). Paragraph—

Commissioner Catterall: It is all one sentence. It is all one sentence, separated by a colon.

Mr. Shadoan: That is correct.

Commissioner Catterall: Paragraph (2) and Paragraph (3) are one sentence.

Mr. Shadoan: Well, Paragraph (1) is separated from Paragraph (2) by a semi-colon also, Commissioner, and by that rationale the whole thing is all one sentence.

Commissioner Catterall: No. Paragraph (2) says that in this kind of insurance, and they expressly exclude automobile liability insurance.

page 327 } Mr. Shadoan: It—

Commissioner Catterall: It says that "in this kind of insurance shall be made as follows". So the two are tied together by that language.

Mr. Shadoan: Well, as far as the semi-colon is concerned, I invite to your attention that after the word "discriminatory" in Paragraph (1) there appears a semi-colon before the Paragraph (2).

Commissioner Catterall: A semi-colon?

Mr. Shadoan: Yes.

Commissioner Catterall: But after (2) you have a colon.

Mr. Shadoan: After (2) you have a semi-colon.

Commissioner Catterall: A colon.

Senator Howell: In here it's a colon. It's a colon in here.

Mr. Shadoan: It has two colons?

Senator Howell: But there is a colon at the

page 328 } beginning which *ites* the whole thing together.

Mr. Shadoan: Well, apparently it depends on which copy you have. What I have is a semi-colon, which is a pocket copy. Apparently it has now been changed to a colon.

Senator Howell: No, no. You've got the newest probably.

Mr. Shadoan: What I have is a photostat of the pocket copy of the latest edition of the Code.

Senator Howell: You've got a pocket copy?

Mr. Shadoan: And this has got a semi-colon after (2) and not a colon.

Mr. Elliott: The Supplement?

Mr. Shadoan: The Supplement, right, the pocket Supplement.

Senator Howell: The Supplement is missing from apparently the copies furnished the Commission.

page 329 } Mr. Elliott: This is the latest book.

Commissioner Dillon: This includes the 1966 changes.

Mr. Shadoan: There is a change there. Whether or not that is a typographical error, it would appear to me to be a matter that—but, in any event, aside from the colon provision:

In Paragraph (3) you have a specific reference to both fire

insurance and to motor vehicle insurance. I am correct about that, I believe.

To adopt the notion of the argument of Counsel would be to run directly in confrontation with the specific language of Paragraph (2); that is to say, that Paragraph (2) says "We are talking about all these kinds of insurance except motor vehicle", "colon". You go down to "colon" and what you follow is the specific language about the uninsured motorist fund.

page 330 } Commissioner Catterall: And you've got the word "and" between those two. That "Uninsured Motorist" was added after the Uninsured Motorist law was passed.

Mr. Shadoan: Yes, that's true. You have the word "and" and this is part of the independent clauses following that colon.

But, in any event, let me say one thing further. If this is so, it seems to me to be very unusual that in interpreting exactly the same statute in February of this year, the National Bureau took the position that it was appropriate, and the absence of the data was a sufficient reason for them to withdraw their application.

Commissioner Catterall: You mean in Arkansas?

Mr. Shadoan: In Arkansas.

page 331 } Commissioner Catterall: Do they have exactly the same language in Arkansas?

Mr. Shadoan: They have exactly the same language.

This language in Article 3, I am satisfied, Commissioner—I don't think we ought to take your time up with a history of this Bill, but I am satisfied without any doubt that this applies to automobile liability insurance, these provisions.

Commissioner Catterall: Well, you don't think that "conflagration" applies to liability insurance?

Mr. Shadoan: I think the provisions there were written to cover automobile liability insurance. If there is such a thing as "conflagrations" for casualty and fire, and obviously that refers to fire, it would be appropriate.

I do not think that the Legislature in Virginia or anywhere else limited their guidelines for automobile insurance to the "excessive, inadequate or unfairly discriminatory;

page 332 } but with respect to other kinds set forth this specific data here.

Commissioner Catterall: Well, the other statute that Mr. Elliott read is the one that deals especially with automobile liability insurance.

Mr. Shadoan: Two thirty-two?

Commissioner Dillon: Two forty-one.

Mr. Shadoan: Two forty-one? Two forty-one does not deal with ratings, the criteria for ratings.

Commissioner Catterall: No, it deals with information, that "the Commission may require".

Mr. Shadoan: Yes; but what we are talking about criteria for ratings.

Commissioner Catterall: The Commission has never required the information you now seek.

Mr. Shadoan: I am aware of that, and it is our contention has never followed the mandatory requirements of this statute; and the fact that the error has been
page 333 } made in the past is no reason why that, in the face of what is obviously correct, that is if we use loss experience for Virginia, we ought to use production expense for Virginia; and you should require that information and make a decision that is equitable to Virginia motorists.

Senator Howell: If the Commission please, I want to reply to Mr. Elliott's arguments. I want to make it clear to the Commission that Mr. Sacks, Mr. Moss and myself are here in our capacity as Legislators, as Interveners. We want to re-emphasize that we admit our lack of expertise and our lack of knowledgeability in the complex field of insurance rates. We can only appear here and make our presentations as we are. We can't become educated overnight, we cannot separate our Legislative responsibilities as we see them and become experts.

I make that statement because I in no way want
page 334 } our efforts, however inartful they may be or however artful they may be, to in any way diminish the legal thrust of Counsel for the AFL-CIO. The Virginia AFL-CIO have taken the dues of their members to bring to this Commission, in my opinion, one of most knowledgeable men in the field of consumer protection in the automobile insurance rate hearing field, Mr. Shadoan; and when I follow him sometimes, I think perhaps that I am dulling the edge of his very decisive surgical razor, and I don't want that to happen; and I ask you gentlemen who are Judges to divorce my approach from the legal, the very fine legal arguments and very fine legal points that have been brought to this Commission for the first time I believe in its history.

I merely want to take issue with Counsel for the Commission and the Insurance Commission and this re-
page 335 } spected Commission itself, basing all of its rulings on so-called "administrative rulings" that go back a quarter of a century; and I say this for this reason.

I have appeared before you individually and personally, and I ask your support in getting for Virginia a permanent George Shadoan, a permanent consumer counsel; and I have been advised that you all consider it a waste of money and a waste of time.

But the fact that you have been deprived of a George Shadoan through the years, cross examining, studying the statutes, putting on evidence has deprived this Commission of what has been recognized by all jurists and all administrative boards throughout the country, and that is that you all need, in the search for the truth, you cannot do without the George Shadoans, the adversary proceedings, the decisive and knowledgeable cross examination, the decisive
page 336 } and knowledgeable production of evidence, and because Virginia has placed this Commission more or less in the protection of a unilateral administrative cocoon, we are pulling apart and inviting you to the world of the consumer, and the contribution of the consumer for the first time. Never before I don't believe has Mr. Elliott been called upon to stay up at night and study this statute to see if it applies to automobile insurance or not. We submit it does.

We submit that the *ex parte* rulings that Justice Dillon and Justice Catterall and Justice Hooker have made in the past should be forgotten, and should be examined within the realistic world of an adversary proceedings, and the fact that we have not a single actuary—I'm sure Mr. Elliott will agree with me and Mr. Parker and Mr. Hazlewood—we don't have a single actuary on the Staff of the Insurance Commission of Virginia, not a single, solitary one. We have
page 337 } all admitted that the world of the actuary is a world known only to the actuaries. We know that the language of the actuary is a language only spoken and understood between actuaries; and, therefore, this Commission has never been in a position to understand these *ex parte* conceived and prepared filings; and when they come, I respectfully submit that neither Mr. Elliott nor Mr. Parker nor Mr. Hazelwood feel that they can knowledgeably tear into this curtain of actuary language.

And, therefore, we respectfully submit that it is no reflection upon this Commission to become pioneers in this century, to say "We are starting now with the first adversary proceedings, the first time Mr. Moncure has been able to sit here and earn his fee in the torturous forums of an adversary proceeding, that now we start to make our rulings."

I think it's a high challenge to this Commission,

page 338 } and I invite you to consider it, and consider the fine arguments of Mr. Shadoan, and the motion of Mr. Mann, and let us get every bit of information that is required by the statute, and then let us think for additional information that will throw the full light of facts and figures that will be knowledgeable to this Commission, so that we may have rulings that are fair to both sides.

Mr. Sacks: May I be heard very briefly in support of the motion?

Commissioner Dillon: Yes.

Mr. Sacks: If Your Honors please, it appears that the strong inference is that the Commission recognizes that the information that is required, certainly in some rate-making under 38.1-252 is not here. As I understand the tenor of what has taken—

Commissioner Catterall: No, I don't agree with that.

page 339 } Mr. Sacks: Well, as I understand the tenor of what is passing back and forth is that 38.1-252 of the "due consideration" and all the enumerated items—

Commissioner Catterall: Well, if that was one of the enumerated items applicable to automobile insurance, "due consideration" means to give it whatever consideration you think it ought to be given.

Mr. Sacks: That's true, Your Honor, but the point is there is an admission by the insurance industry that some of the things under Sub-paragraph (3) of 252 are not in the record, and, therefore, this Honorable Commission can't give it any consideration. You may come to the conclusion, on what is here, that it doesn't affect it. But how can you know?

Commissioner Catterall: We think the best evidence—you see, we are not fixing rates for each company at a time. We

page 340 } have to fix the same rates for all these hundred companies or so, and then, of course, the other independents would have much lower rates because there would be much freer competition in the future than there has been in the past; and for getting the expenses, we have always thought, and we now think, that the best available evidence is this nationwide expense.

Mr. Sacks: Well, now—

Commissioner Catterall: The point is, you all were hammering yesterday on the exact words of that statute as a grounds for appeal. And, as Mr. Elliott has pointed out, that statute does not apply to this case.

Mr. Sacks: Well, then, Your Honor, that's what I want to address myself to.

Mr. Elliott may be right, and the Commission may be right,

but this is a hearing for all of us to determine, you making the decision whether or not it does apply and
page 341 } whether or not we are not entitled to that information.

Now, if the Commission rules, and I say this with respect to you, that 252 does not apply to automobile insurance, then you are ruling contrary to the belief, the understanding and the intentions of the entire General Assembly of Virginia; and I say to you this, that in the 1966 session there was a bill that was the subject of much discussion in the Legislature. It was House Bill 97 which specifically intended to amend Sub-paragraph (3) as to automobile liability insurance, and to put in there that due consideration ought to be given to investment income on unearned premium reserves, on loss reserves and on capital assets. Now, that Bill ran the gamut of the Legislature. It started in the House, it passed through the House Insurance and Banking Committee. They took out capital *aasets*, so it came to the Floor of the House
page 342 } to be debated by one hundred members of the House of Delegates as to whether or not investment income on unearned premium reserves and loss reserves. It passed there. Nobody raised a single voice, either in Committee or on behalf of the insurance industry or on the House Floor, that it did not apply to automobile insurance, and every indication was that every one of the Delegates, and it passed. Nobody voted against it. I take that back. I think there were one or two votes against it in that instance.

It went to the Senate Insurance and Banking Committee. They took out of there the portion as to loss reserves, but they sent to the Senate Floor an amendment that under Sub-paragraph (3) that investment income on unearned premium reserves was to be considered, and again nobody raised a single voice in the Senate Committee that it didn't apply to automobile liability insurance. It passed the Sen-
page 343 } ate Floor that way and was sent back to the House because of the amendment. A Committee of Conference was formed; I was on that Committee of Conference. There were three Senators and three Delegates. Nobody said for a moment that it didn't apply to automobile insurance, and the Bill died because the Committee of Conference could not agree, and so the Senate wanted it one way, the House wanted it another.

So it may be, Your Honor, that you all are correct in this novel ruling. I say "novel" because it has never been ruled that way before, that this All Industry Bill doesn't apply to automobile liability insurance, but it is contrary to the belief,

the intention and the understanding of every member of the General Assembly. Now, assuming that what I say is correct and that it does apply to automobile liability insurance, I don't think there is a question in the world that we are
page 344 } lacking entirely in what ought to be considered.

Let me just end with this. I can't help but point out again that what's going on in this room affects the whole State, and it is so important that not only that justice be done here but that it appear to be done. And how can the insurance industry be harmed, how can they be harmed by being sent home to bring to you and subject to the scrutiny of these Interveners? What good is it to have an adversary, open, public hearing if they don't put it all on the table? How can they be harmed to bring it, but the motorists could be harmed if they may think they are not getting a fair hearing, when you decide it without that being here?

I also believe that I am correct that when House Bill No. 97, the one that I have just described,—that thorough journey through the Legislature—went through the Legis-
page 345 } lature, I stand ready to be corrected, I remember seeing Mr. Parker over there during some of the hearings, and I think he knew it was going through the Legislature, and I think Mr. Elliott studied that bill, and, Gentlemen, nobody has ever contended that it didn't apply to automobile liability insurance; and if we in the House had wanted to let it go through, that just unearned premium reserve income, it would have been enacted into law with a thorough understanding on one hundred and forty members of the General Assembly' part that it applied to automobile liability insurance.

So I don't think there is any question this is a *quasi* legislative, *quasi* judicial, hearing here this morning, that nobody has ever contended what's being urged here now that it doesn't apply to automobile liability insurance.

Commissioner Catterall: Why *didn't* didn't you
page 346 } insert Paragraph (13)? What you've got is an enumeration that expressly excludes Paragraph (13).

Mr. Sacks: You mean in the bill in the Legislature?

Commissioner Catterall: Yes. You start off with a paragraph that expressly excludes Paragraph (13). You see those included, (15), (16), and (17)? They would leave out (13), and (13) is as to whether it applies to automobile insurance.

Mr. Sacks: Well, Your Honor, you and I know that statutory construction can be—you can come to almost any interpretation with a strained construction or—

Commissioner Catterall: Not in a case as clear as that.

Mr. Sacks: Well, I'll say this, Your Honor, that I say again, and I have cited you an absolute instance where the Insurance Department and Insurance Counsel didn't
page 347 } bring to anybody's attention that it doesn't apply to automobile insurance, and what was debated on the Floor of the House and the Floor of the Senate and Committees was automobile liability insurance, and we cited these hearings, and that was the reason for it,—what was debated on the Floor of the General Assembly was the hearings that had gone on here pertaining to automobile liability insurance, and both members of the public and members of the insurance industry addressed themselves to that bill with the exclusive understanding that it was automobile liability insurance.

And I think that any construction by this Commission now that it doesn't apply is certainly contrary to the standing, understanding and construction that have always been given to that.

Mr. Moncure: May it please the Commission, I don't want but a minute.
page 348 } This Commission has been sitting in these sort of matters over the years, and I remember back when the formula, as I call it, was reduced by five per cent; and I think you had this room full of agents who were then getting twenty-five. Those experiences of this Commission, its rate hearing body that in itself had, if the gentlemen, be *yhey* actuaries or not, are fully capable of advising this Commission on the filings and the supplemental data being furnished here.

We speak of nationwide experience. We have heard testimony of what is wrong, a little fault in your formula. To take Virginia would be a useless gesture. We are not different from other States. Those calculations are somewhat different, a home office of one here and one the other; but this Commission knows from its previous hearings what's done in Virginia, and it can take judicial knowledge of it.
page 349 } And with all this talk about no capable men, both on the legal staff and on the actuarial staff. I haven't seen any actuary come into this Court and attack these rate filings. I've seen CPA's, and I can't sit here and have people say for the first time that Mr. Elliott hasn't spent midnight oil. I think Mr. Elliot is better advised on these matters than any resident in the State of Virginia, and knows it and is able to advise this Commission; and its own personnel can check the actuarial figures if they are not actuaries. And I am defying them to bring an actuary in here and pick anything wrong with these rate filings.

And it is no damage done to us. We are losing money on this insurance business every day we continue to write them on these present rates. This filing has been here for a long, long time. The briefs in No. 17680 were here for
page 350 } a long, long time. Delayed by whom? By these gentlemen. It doesn't cost us anything.

Gentlemen, this Commission has knowledge, it has judicial knowledge, it reads the newspapers, it knows how agents operate in the State of Virginia, and it does not need any more, and it has given due consideration.

And this threat of going to the Supreme Court—the interpretation placed by the Commission is correct. The advice of Mr. Norman Elliott is correct. We will fight out battles in the Supreme Court, and I don't like lawyers defying a commission or a court, "I'm going to *appela,* I'm going to appeal." If you are going to do it, do it; but don't threaten.

That's all I've got to say on the subject.

Senator Howell: Just one thing. I want to say
page 351 } the conspiracy of silence that exists among the actuarial profession in this country is thicker and stronger than any other.

Now, Mr. Moncure knows that the money that has been marshaled to fight this has cost individuals who only have modest incomes substantial sums, and you can't get an actuary for less than probably—I know Mr. Stern could tell us—it would cost us a thousand dollars a day probably to get one of them to go over this, and then he would probably want six or seven months to—you would come close to that thirty-nine thousand dollars that this Commission took from the taxpayers of Virginia and the insurance companies who pay into this defense fund to get Mr. Roberts; just one actuary with a limited examination cost thirty-nine thousand dollars.

And he stands up here and suggests that we don't want to bring an actuary in here because he could not
page 352 } dispute with these other actuaries. If we had the money, we could buy an actuary that trumped any actuaries they could get, because they all love to go into these figures if it's enough in it for them.

Mr. Moncure: The AFL-CIO can hire them.

Commissioner Dillon: All right. Let's stay in business here now. Anyone else want to say anything?

Mr. DuVal: Your Honor, let me just say that Mr. Mann, Mr. Harrison Mann, could not be here. He asked me in his behalf to renew his motion, and to urge that the material that the National Bureau companies could not produce yesterday be required to be filed in this proceeding before decision.

Mr. Moss: May I just say this, and perhaps I can begin

by asking a question. I don't want to delay the matter; but, in view of what has been said, first of all, I want it on record that I am in support of the motion; and,
page 353 } secondly, could I ask this question of the Commission: What possible harm could come, Gentlemen, in obtaining this information? Is there any particular reason why this ruling must be made within the next day or so or the next week or so, when you consider the momentous or the tremendous effect this will have across the State? Is there any reason why it has to be done immediately?

Mr. Moncure makes reference to some delay. I don't know that there has been any undue delay any time they have ever asked for a rate increase. It seems to be handled at reasonable dispatch as far as I am concerned.

Now, is there any reason, Gentlemen, why we could not have this information and would it be detrimental to this Commission or the State to ask it?

Commissioner Dillon: Well, I think our concern
page 354 } is would it be of any benefit, should we require the companies to go into all of this and spend this money if it is not going to be of any benefit to the Commission.

Mr. Moss: How could you tell, Sir, whether it is going to be of any benefit or not if you have never seen it?

Senator Howell: That's the question.

Commissioner Catterall: The way I feel about it is you are talking about general expenses all over the United States, and I don't know how you are going to split them down into forty different deposits.

Mr. Sacks: We are talking about—

Mr. Moss: Mr. Stern said he could do so, as I understand from his testimony, that they could be made available. *I* would just take a little bit of time to do it.

Mr. Shadoan: Commissioner, we are talking about production, and acquisition expenses.
page 355 } Commissioner Catterall: You mean just that twenty per cent?

Mr. Shadoan: Just that twenty per cent.

Commissioner Catterall: You man you want the acquisitions in Virginia, whether they are—

Mr. Shadoan: Just the one-fifth of the premium dollar.

Commissioner Catterall: Whether they get twenty per cent commissions?

Mr. Shadoan: What is the acquisition expense in Virginia? That's not hard to find out.

Commissioner Dillon: I thought he wanted all of the expenses.

Mr. Shadoan: What was requested, and the specific point that I was trying to make, and I see that I have been very unsuccessful, is that production expenses, the acquisition expense is a phenomena that is related to Virginia.

page 356 } Commissioner Dillon: But what was Mr. Mann's motion? We are arguing Mr. Mann's motion.

Mr. Shadoan: Well, I think that is what he is asking for.

Mr. DuVal: That was what Mr. Mann requested.

Commissioner Dillon: Just for the acquisition cost?

Mr. Shadoan: Production cost, yes.

Chairman Hooker: That's production cost, that's acquisition cost.

Commissioner Dillon: That is acquisition cost.

Mr. Shadoan: Yes.

Mr. Moss: It would seem to me, Gentlemen, that it's bound to help you in this.

Commissioner Catterall: Our latest hearing on that was when we reduced this from twenty-five to twenty per cent. The agents had been getting twenty-five per cent

page 357 } commission, and we reduced the acquisition cost, the total acquisition cost, from twenty-five to twenty per cent; so we know they were getting twenty-five per cent then, and they all took an appeal to the Court of Appeals.

Mr. Moss: May I ask the Judge this question?

Commissioner Catterall: Surely.

Mr. Moss: When was that study made?

Commissioner Catterall: About ten years ago, wasn't it?

Commissioner Dillon: No. It was about eight years ago.

Mr. Moss: All right, eight or ten years ago, either way, all we are asking is that this motion to be carried, at least to bring you the up-to-date information which may possibly shed some light. It could be that once we had the information, it would be detrimental to the side that

page 358 } we are taking, I don't know.

Commissioner Catterall: All the information we have is that the agents have been getting twenty per cent.

Mr. Moss: Well, it is comparable to me to a situation where, again, we are going and trying the case. If there was a witness who was present on the scene, and they don't bring him forward to testify, you can usually conclude it is going to be adverse.

Now, we think there is something wrong when they are objecting so strongly to having it here.

Commissioner Catterall: Well, anything that refers to—

Mr. Moss: If it could possibly shed any light on it, I would think that it would be appropriate to this hearing.

Commissioner Catterall: They are objecting because we haven't had it before, and they don't want to de-
page 359 } lay. They don't want to keep Norfolk from getting that ten per cent reduction. That's what they are worried about.

Mr. Moss: We will take a chance on that, Sir. We will be glad to take a chance on that. If that's the only problem, we will work that out, I am sure, with the motorists back at home.

Mr. Allen: Your Honors, I happen to know from talking to an agent fairly recently that one of the big agents—I might say it is the Travelers Agents—told me he was getting eighteen per cent commissions.

Mr. Moncure: How much?

Mr. Allen: *Eightteen* per cent.

Mr. Allen: Eighteen, and I think he had some kind of bonus arrangement too, but—

Mr. Moncure: That takes off two per cent.

Mr. Allen: But I don't know, but I'm just—we don't know about those things.

page 360 } Mr. Moncure: Judge, the agents all fussed, as Your Honors said, when you cut them back to twenty per cent. There may be some private arrangements, but this Commission gives us budgetary figures, based upon its own knowledge of the facility in this State in which they have administrative offices. We can get that data. I think the last time I happened to look at it, it wouldn't vary ten cents.

You can't, and they say acquisition costs. That includes these branch offices, and the breakdown of them, but the agents of this company there, the casualty companies, now, you deviate in companies. One other company wants to cut it to ten per cent. Some of them don't pay any, some of them are across the counter.

But we have filed the application for this group represented by the National Bureau of Casualty Underwriters, and I bet you they will average in Virginia the full amount
page 361 } they do nationwide.

That's due consideration to it. It's another delaying tactic.

10:20 A.M. Commissioner Dillon. The Commission will recess five minutes.

10:30 A.M. The Commission resumes its session.

Commissioner Dillon: The majority of the Commission

feels that, if we requested this information, it would not be of any benefit to the Commission. We have never required it.

Commissioner Hooker dissents from this decision.

So the motion is overruled.

Mr. Shadoan: If the Commission please, I just want to bring to your attention one thing just for the purposes of the record.

The brief filed by the National Bureau of Casualty Underwriters in Case No. 17680 before this Commission, which I think was filed in the last month or so, I am not
page 362 } sure, maybe two or three months, page 5 thereof reads as follows:

"Under Chapter 6 of Title 38.1, in making rates for automobile liability insurance, due consideration is required to be given among other things 'to a reasonable margin for underwriting profit and contingencies' Code 38.1, Section 252, Subparagraph (3)."

I mention it because it only indicates to me that the facility with which the National Bureau changes its legal position equals that with which it changes its factual position.

Commissioner Dillon: All right, Sir. You want to bring your witness back for cross examination?

Mr. Shadoan: Yes, Sir.

Commissioner Dillon: Come around, Mr. Stern.

page 363 } PHILIPP K. STERN, resuming the stand for further cross examination, testified as follows:

CROSS EXAMINATION

By Mr. Shadoan

Q. Are you ready, Mr. Stern?

A. Yes, Sir.

Q. Before returning to the trend factor, I would like just to ask you this. It was my understanding from your testimony yesterday that you were familiar with the history of the All-Industry Bill, and that you recognized that rates were made in accordance with the provisions of Paragraph (3) which reads about due consideration to be given to countrywide experience and State experience for losses and other factors. Is that not correct? I withdraw the question.

Did you not testify yesterday that one of the things you took into consideration in making rates was Paragraph (3) of Article 38.1, Section 252, which reads:

page 364 } "Due consideration shall be given to past and prospective loss experience within and outside the State" et cetera.

Was that not your testimony?

A. My testimony was that we are giving due consideration to all the elements which are enumerated in the All Industry Bill. There appears to be a difference in Virginia, and I don't think I should get involved in this part of this legal dispute that was going on this morning.

Commissioner Dillon: We have already decided that point.

Mr. Shadoan: I understand that you have decided it, Commissioner.

Commissioner Dillon: But when you—

Mr. Shadoan: I just wanted to make the record that the expert here, who is familiar with the history of the statute, takes a position that is quite the opposite of the ruling which you just made. That's all.

page 365 } Mr. Moncure: Let me say this, please, Sir.

Commissioner Dillon: Well, even if we saw it, it wouldn't make us change our ruling.

Mr. Shadoan: I understand that. As I say, I was trying to establish that for the record.

Mr. Moncure: He asked the question, "Didn't you say?" It's already in the record if he did say it, so I don't see how he makes a record by that.

Senator Howell: If Your Honors please, is this an objection by Mr. Moncure?

Mr. Moncure: It is an objection by me to repetition in examination of this witness.

Mr. Shadoan: I agree with Mr. Moncure. We will leave the point. How's that. I would like to—

Mr. Moncure: Now, Your Honors please, I am used to being in Court, and maybe I'm in the wrong pew,
page 366 } but nothing aggravates me more than a lawyer saying "I want to ask you this" or "I want to ask you that". He's here to ask, and we will get along faster if you will ask your questions without telling the Committee and the newspapers that you want to ask it. I must ask that you ask the questions direct to the Commission, directly, without—

Commissioner Dillon: Wait just a minute. Your objection is overruled.

Philipp K. Stern

Mr. Shadoan: I want to ask the Commission to instruct the lawyers to direct their comments to the Commissioners, and not to make speeches to one another.

Commissioner Dillon: If we could get them to do that, we would be happy.

Mr. Shadoan: All right.

Commissioner Dillon: If both sides will do that, we will just love it.

Mr. Shadoan: I think I can assure you that that
page 367 } will be my conduct.

Commissioner Catterall: We have no criticism of your conduct at all.

Mr. Shadoan

Q. Mr. Stern, in a different context in your direct testimony I believe I remember your saying that you had different tables for different purposes. I ask you now whether you have over the evening made a computation of the trend factor for bodily injury in Virginia for this filing which we can examine?

A. No, I did not have to make a computation during the evening. I told you I had it yesterday.

Q. Well, let me see it, please.

A. This would have been the normal way of calculating a trend factor if the average paid claim cost data was suitable in this instance.

I also submitted Virginia data on a chart which show that
page 368 } the bodily injury trend data, average paid claim cost data, limited to five thousand dollars, are inappropriate for Virginia, and my direct testimony stated why this is the case.

Q. Well, now, let me ask you this question. Isn't it a fact that in 1965 when you made your application to this Commission, and I believe it was Case No. 17535 or something like that, that once again you did not have a trend factor for bodily injury?

A. That is correct.

Q. And why was that?

A. For the same reason that the five thousand dollar limitation in Virginia creates the wrong impression that the average paid claim cost has been stable, when actually our total limits show that the average paid claim cost is constantly on the increase in Virginia.

Q. Now, are you finished?

A. If I could explain one more step.

Q. Go ahead.

A. I would like to present for comparison purposes only our countrywide data in relationship of the
page 369 } bodily injury paid claim costs limited to exclude the extremely large—

Q. Just a moment, Mr. Stern.

Mr. Shadoan: Now, if the Commission please, I don't want to stop any explanation, but this is not responsive. It's a speech.

Commissioner Dillon: Objection sustained.

Mr. Shadoan

Q. Mr. Stern, at the same time that you felt the five thousand dollar bodily injury, B. I. trend was unsatisfactory in Virginia in 1965, you found it utterly satisfactory to support an upward trend in Maryland; is that not correct?

A. Yes.

Q. Why is it bad for Virginia, but good for Maryland?

A. Because the data in Maryland apparently do not show the same inconsistent pattern between the five thousand dollar limited values, and the total average paid claim costs.

page 370 } Q. You have a little problem because the total limits in Maryland is fifteen/thirty, don't you?

A. Yes.

Q. So the explanation you give this Commission that the total limits makes it unreliable sort of makes the comparison difficult because the total limits in Maryland is fifteen/thirty too, isn't it?

A. In addition to total limits, there are other influences. In addition to the required limits, there are other influences which may cause unreasonable fluctuations.

Q. You didn't say anything about that in your letter of explanation to the Insurance Department of Virginia, did you?

A. In my judgment the fifteen/thirty—

Q. That's not the question, Sir. Did you hear my question?

A. Yes, I did.

My answer is I did not have to say anything be-
page 371 } cause in my judgment the explanation I gave was appropriate for Virginia.

Q. Now, this document which you have shown me, which I would like to be marked as the next exhibit—

Mr. Shadoan: What is the next exhibit?

Commissioner Dillon: It will be marked Exhibit No. 11.

Mr. Shadoan: No. 11.

Mr. Elliott: Wasn't that the exhibit you asked to be received as Exhibit No. 8 yesterday in this hearing?

Mr. Shadoan: No. The one that he marked Exhibit No. 8 didn't have a computation on it. He has produced one now that does have, so I want it marked as an additional exhibit.

Commissioner Dillon: Do you have Exhibit No. 8 there?

Bailiff: No, Sir. I don't have it.

Commissioner Dillon: No. We reserved it; it was not submitted.

Mr. Shadoan: Oh, I'm sorry. I thought that I had Exhibit No. 8.

page 372 }

Commissioner Dillon: No, I think not.

Mr. Shadoan: Okay, well.

Commissioner Dillon: Have you got Exhibit No. 8?

Mr. Shadoan: No, I don't; I'm sorry.

Commissioner Dillon: Do you want to continue to reserve that number?

Mr. Shadoan: No, I really don't care. I want a number assigned to this one.

Commissioner Dillon: All right, we will assign that No. 8. That will be No. 8.

Mr. Shadoan: What was this?

Mr. Elliot: That was a reproduction of what you just introduced.

Mr. Shadoan: No, it's not.

Mr. Elliott: Isn't it?

Mr. Shadoan: No. Okay, let's mark this No. 8, if it has not been marked No. 8 and mark that No. 11.

page 373 }

Commissioner Dillon: All right.

Mr. Shadoan: Because there is a distinct difference.

Commissioner Dillon: This one will be Exhibit No. 11, and the one you have in your hand will be No. 8.

Mr. Shadoan: I have the letter and everything, but it has not been marked.

Mr. Moncure: He filed it yesterday as Exhibit No. 8.

Commissioner Dillon: We reserved it, but we never did mark it.

Mr. Elliott: It was supposed to be Exhibit No. 8.

Mr. Moncure: It followed a letter which I wanted to file later, and that's why I recall it.

Mr. Shadoan: Just a moment. In the copy I

page 374 } have, with your concurrence, we will mark as Exhibit No. 8, and everybody will be happy.

Mr. Elliott: Well, what about the one we just put in?

Mr. Shadoan: That's only a portion of it. They want the entire exhibit and I concur in that.

Commissioner Dillon: Well, withdraw the one you put in.

Mr. Shadoan: Will you mark this as Exhibit No. 8 instead of this one?

Mr. Moncure: That is the letter dated what? April 21, 1967?

Mr. Shadoan: Right. Do you have an extra *copies* of that?

Mr. Moncure: I do not. In fact, this is the Commission's copy that I pulled out of their file because I didn't have one.

Mr. Shadoan: All right.

Commissioner Dillon: Now, have you withdrawn the other No. 8?

page 375 } Mr. Shadoan: The No. 8 that you have marked we will withdraw.

Commissioner Dillon: All right. Now, go ahead.

Mr. Moss: And that has no exhibit number at all then?

Commissioner Dillon: The whole letter is Exhibit No. 8, as I understand it.

Mr. Shadoan

Q. Now, let me pursue this for a moment, will you, Mr. Stern? In your letter of April 21, 1967, you gave the data for computing a trend factor, but you did not include a computation; is that not correct?

A. Yes, that is correct.

Q. And you explain that:

"It is our belief that the average paid claim cost data for bodily injury liability do not clearly indicate the
page 376 } presence of a trend and, therefore, a factor of 1.000 was applied".

Then you go on to point out that "it "is not realistic in light of the 15/30 minimum" limits "required in Virginia." Right?

A. Yes.

Q. But my point is, it was realistic in Maryland in 1965 where the minimum limits were the same. Is that correct?

A. Yes.

Q. And that trend indicated an upward adjustment—right? Right?

Philipp K. Stern

A. I don't remember it, but I think you showed it to me.

Q. Exhibit No. 9 indicates a factor of one point zero nine zero, which is an upward adjustment, isn't it?

A. Right.

Q. Now, the—you do have or have made a private—I will withdraw that.

The letter which you submitted to the Department did not have a computation of the line of best fit nor a

page 377 } computation of the factor, did it?

A. That is correct.

Q. It simply had your conclusion in narrative form—right?

A. Right.

Q. Now, you have produced upon my request what you had already done, which includes a computation—right?

A. Yes.

Q. And that shows a downward factor—right?

A. Yes.

Commissioner Dillon: Before we proceed let me get these exhibits straight.

The Bailiff has only Exhibits Numbers 4, 5, and 6. We are missing No. 7.

Mr. Moncure: No. 7 is the filing.

Commissioner Dillon: No. 7 is the filing. That's

page 378 } right. No. 1 is the record in the investigation.

Mr. Elliott: No. 2 is the opinion.

Commissioner Dillon: No. 2 is the opinion, and No. 3 is reserved for—

Senator Howell: My insurance policy.

Commissioner Dillon: For your insurance policy.

Senator Howell: That's right.

Commissioner Dillon: Excuse me. Go ahead.

Mr. Shadoan

Q. Now, before we leave the trend factors, am I correct that your trend factor has no component within it to give recognition to the frequency of claims?

A. That is correct.

Q. And am I correct that many companies who develop a trend factor use a frequency of claim factor in developing the trend; is that correct?

A. I would not be able to confirm that or deny

page 379 } it. I don't know.

Q. Well, you are familiar with the actuarial technique which requires recognition of the frequency of claim in developing a valid trend, aren't you?

A. What requirement is that?

Q. You are familiar with the actuarial technique in developing a trend factor which includes a recognition of the frequency of claim, are you not?

A. There is no such technique. There are various techniques of reflecting changing conditions. If you are implying in your question that there is a definite requirement for using frequency together with other things every time you wanted to determine a trend, the answer is "No". There may be a trend in frequencies at one time and then may not be a trend at other times.

Q. What I am saying is in filings, in insurance rate filings, it is customary, is it not, to have a computation of
page 380 } a trend factor for B. I. and P. D.? There is such a computation found in filings—right?

A. Yes, based on average paid claim cost.

Q. Yes. Now, is it not a fact that the independents, for example, State Farm and some of the others, when they compute their trend, they use in their computations a factor to reflect the frequency of claims; isn't that right?

A. I don't know about that.

Q. Well, you are familiar with the fact that the Kentucky opinion completely disallowed your trend computation because you did not use a frequency of claim, you know that, don't you?

A. Yes. There was a lot of confusion in the Kentucky decision, but the fact is that the filing was approved as filed.

Q. I am not asking whether it was approved.
page 381 } I'm asking you whether or not the Kentucky opinion did not explicitly reject your trend computation because it did not include a recognition of the frequency of claims. That is the question.

A. I think that was in their decision.

Q. And you are familiar that there are other insurers who make filings that include recognition of frequency of claims, aren't you?

A. There may be such insurers. I don't know.

Q. You just don't know?

A. No.

Q. And you have not taken the opportunity to investigate since your trend factor was rejected in January by the Kentucky Commission to find out whether other people do it that way?

A. I had no reason to.

Philipp K. Stern

Q. Because you were not concerned with what the Kentucky Commissioner said, I suppose. I withdraw that.

page 382 } Can your loss ratio decrease and your trend factor increase at the same time, Mr. Stern?

A. Yes, it could.

Q. Turning again just briefly to the loss development factor which you have in your filing, am I correct from a theoretical point of view that the validity of using incurred losses hinges upon the validity of the loss development factor? Do you think that's a fair statement?

A. No, I wouldn't put it that way. I would say that the use of incurred losses requires the use of the appropriate loss development factor.

Q. Then, if the loss development factor is inaccurate in any significant way, then the use of incurred losses is not going to be a valid practice, is it?

A. Yes.

Q. What I said was correct?

A. Yes.

page 383 } Mr. Shadoan: Now, if the Commission please, there was a request sometime back by Mr. Allen to Mr. Elliott, requesting that he be allowed to see a pamphlet prepared by the New York Insurance Department; and Mr. Elliott secured that pamphlet from Mr. Cahill, but he felt he could not release it because it was the only copy he had; and if that is available, I would like to see it at this time.

Mr. Elliott: I will go to my files and get it.

Mr. Shadoan: Mr. Elliott, do you object if I continue while you are getting that?

Mr. Elliott: No, Sir. Go right ahead.

Mr. Shadoan: All right. Well, I'll do that, and we won't waste the Commission's time.

Mr. Shadoan

page 384 } Q. Assuming for the moment, Mr. Stern, that your loss development factor is perfectly accurate and, therefore, your incurred losses cannot be challenged, that if they are aggregate they are valid. With that assumption in mind, isn't it a fact that the use of incurred losses affords an inherent inducement to weak companies to underestimate their claims in order to write more business, and for strong companies to overestimate which indicates that they are making a low profit?

A. No.

Mr. Elliott: This is what you wish?
Mr. Shadoan: Yes. Thank you. I think it is.

Mr. Shadoan
Q. You would not agree to that?
A. No.
Q. Why not?
A. The reserving policy of companies is subject to supervision and regulation by insurance departments.
Q. Well, what I—
page 385 } A. And falls into an entirely different track from the use that is made of the data in rate-making. Each company's reserves have to be adequate for the company's condition.
Q. Now, what I asked you was not whether there was a control by the insurance departments' supervision. My question is whether or not this is not an inducement. That's the question.
A. I can't see any inducement.
Q. Well, let me ask you this. Are you familiar with the fact that, what was it in the last two or three years about seventy-six high risk companies became insolvent and the investigation showed that in almost every case it was because they underestimated their claims; isn't that a fact?
A. I have no direct knowledge of that.
Q. Well, do you have any indirect knowledge of it?
A. No, except—
Q. Except what?
page 386 } A. Except for what I read in the papers. I have not studied these cases at all.
Q. You are not familiar with the Senate Sub-Committee's investigation, Senator Dodd's investigation?
A. Only from what I read in the papers.
Q. Are you familiar with the experience of the Chesapeake Insurance Company and the Florida Exchange Company here in Virginia?
A. No, I am not.
Q. You are not familiar with them?
A. No. I will explain to you why I am not familiar with that.
Q. Sure.

Philipp K. Stern

A. One reason is that the experience on sub-standard business is excluded from our rate-making data. There is no reason to concern myself with that experience.

page 387 } Q. I understand that. As a matter of fact, none of your companies, despite the fact that they have been losing money all this time, have become insolvent, have they?

A. I hope not.

Q. You don't know whether any of them have become insolvent or not?

A. I don't think any have recently.

Q. You have no reason to believe that any of them have, do you?

A. No.

Q. All right. Now, with respect to the cause or the experience of companies that have become insolvent, you are not aware of why they have become insolvent at all; is that right?

A. No.

Q. Okay. With respect—let's take the big companies, let's take Hartford, that's one of our biggest companies, isn't it?

A. Yes.

page 388 } Q. Now, wouldn't you agree that, aside from the supervision which they have, that there is an inducement to them as a conservative business measure to overestimate their claims, their losses?

A. No.

Commissioner Catterall: May I make an inquiry of Counsel? Are you working up to asking us to reverse ourselves on the Maddrea formula?

Mr. Shadoan: No, I'm not.

Commissioner Catterall: It sounded to me as if you were.

Mr. Shadoan: No, I'm not working up to ask you to do that, Commissioner Catterall.

Would I be out of line to ask for just a moment, I don't think a recess is necessary, for me to look at this pamphlet to see if I can find what it is I was searching for under loss adjustment.

Commissioner Catterall: It would help us to understand the cross examination if you would tell us what the point of the cross examination is.

page 389 } Mr. Shadoan: Well, the point that I am trying to find out here is I believe we established yesterday that this witness recognized that there has been a study by the New York Insurance Department which in-

dicated that the loss development factor used by the National Bureau was about three per cent off, which is a significant deviation; and I am trying to find the section of this report if indeed it is the correct report, that reflects that conclusion.

11:00 A.M. Commissioner Dillon: The Commission will recess five minutes.

11:10 A.M. The Commission resumes its session.

Mr. Shadoan: If the Commission please, before resuming examination, I am informed that Counsel for the National Bureau will stipulate that Mr. James P. Maynes
page 390 } —the last name is spelled M-a-y-n-e-s—of 3201 Sunset Avenue, Richmond, Virginia, is a holder of policy with the Glens Falls Insurance Company, which is a member of the National Bureau of Casualty Underwriters, whose policy number is FE-374771, and the policy is currently in force with respect to automobile liability insurance, and that Mr. James Maynes is a member of the Virginia State AFL-CIO.

And if that stipulation is correct, I would like for it to be entered at this time.

Mr. Moncure: It is so agreed.

Commissioner Dillon: Are you going to put a copy of that policy in the record?

Mr. Shadoan: I suppose we had better do that.

Commissioner Catterall: I don't think you would need that.

Commissioner Dillon: We don't need it, I don't
page 391 } think. I can do away with this reserve number.

Senator Howell: Yes, just do away with it.

Commissioner Dillon: All right.

Bailiff: Do away with No. 3?

Commissioner Dillon: Yes.

Mr. Shadoan: Now, I would like to state that I have been unable to find what I was looking for in this booklet, so I will have to let it go on that point.

Mr. Shadoan

Q. Mr. Stern, am I correct that the filing before this Commission is made upon what you say is the latest available Virginia experience and that is for the accident year 1965?

A. That is correct.

Q. Now, am I correct that the filing which was considered by the Arkansas Commissioner two or three months ago had experience from the calendar year 1966 in it?

page 392 } A. I don't think it did.

Q. Well, now—

A. I would be surprised if it did, but I don't remember it.

Q. Let me ask you this. Just straighten me out if I'm wrong. My understanding is that you folks have undertaken a new policy because of computer equipment. You have more recent data, and your weight is of more recent data, eighty-five per cent, and then the next most recent year, fifteen per cent. Am I mistaken in that?

A. Yes, I think you are. You are confusing this with another aspect of our rate-making formula. In States that have lesser volume than Virginia, specifically States when the premium volume for the latest year is less than twenty million dollars of premiums at present rates, we are using more than one year for Statewide rate level determination. In Virginia we are using one year because the volume is large enough to be credible.

page 393 } Q. Now, in those States in which you use two years' experience, it is because their volume is less than twenty million dollars, and that gives you a greater credibility factor?

A. Using two years gives us more stability.

Q. But not more credibility?

A. Well, the credibility increases if you use two years, yes.

Q. Well, you have credibility tables which you use to determine whether or not the population of statistics is sufficient to give you adequate credibility, do you not?

A. We don't use these tables in Virginia.

Q. Why not?

A. Because the Bureau of Insurance does not approve of them.

Q. Does not approve of your credibility tables?

A. That's right.

page 394 } Q. When did they take the position that your credibility tables were not sufficiently accurate to be approved?

A. Probably, many years ago, more than fifteen years ago.

Q. How do they determine whether or not your territorial classifications are accurate if they do not accept your credibility data?

Q. We have never had the problem in Virginia because we

have enough volume so that even the territorial experience is fully credible.

Q. In other words, in Virginia they approve your territorial classifications without using any actuarial method to determine whether the statistics are credible?

A. That is not correct.

Q. Well, would you explain in what fashion it is incorrect?

page 395 } A. The Commission has not approved a very great refinement of territories in the past. We only have seven rate territories, and we just added two recently for which we do not yet have experience. Therefore, every territory is large enough by itself to be fully credible by any actuarial standards.

Q. Well, my question was, and I think that you probably misunderstood it, was that no actuarial standard is used; isn't that right?

A. No, it is not.

Q. Then what is the actuarial standard that is used to show that these territorial classifications are statistically credible?

A. Keeping the territories large enough gives you full credibility by any actuarial standards.

Q. Then why did you submit the actuarial tables that were rejected then, if that was the case?

A. I don't think I did.

Q. I mean, when they were rejected fifteen years ago or whenever it was, why were they submitted then?

page 396 } A. That is way before my time. I wouldn't know.

Q. But you know that there has never been any other actuarial standard of credibility that has been submitted in its place because the territories are large enough that there is really no question about the credibility of the losses?

A. That's right.

Q. Are there any other States where you don't use credibility tables?

A. There are many States where we simply state the experience is fully credible. We don't have to show the tables.

Q. Now, I want to be sure that I am not mistaken in your answers, about my first question.

My understanding was the reason you gave a greater weight to more recent experience is because the more recent experience was a better indication of what we could

page 397 } expect in the future. Now, am I wrong in that?

A. No, you are right.

Philipp K. Stern

Q. Well, now, I thought you said before that the reason you used this is because these States with below twenty million didn't have a sufficient volume to give you a stable prediction?

A. Now, Mr. Shadoan, the criterion of twenty million dollars is established as a test stone for credibility and stability. We do want to reflect in our Statewide rate level the latest conditions, and they give the best estimate of the future.

At the same time we want to maintain a reasonable degree of stability. If a State, because of its smaller volume, invites greater fluctuations, we give up part of the responsiveness in the interest of stability and use an average.

Q. Now, am I correct also that the 1965 data included in the present Virginia filing is the latest available
page 398 } data to you, the latest data available to you for this hearing?

A. If you are talking about accident data, yes.

Q. And am I correct further that in the hearing that was held in Arkansas in February of this year there was no 1966 experience presented?

A. I can't testify to that. I don't remember right now whether we had any 1966 experience. I don't think we did.

Q. Can you suggest any reason why you might have 1966 experience available in Arkansas two months ago, but not have it available in Virginia today?

A. First, I would like to know whether we have it, if I may refresh my memory of it by asking—

Q. Certainly. I have no objection to it. I don't know about the other people. I just want to get the material.

A. I wonder whether anybody knows.

NOTE: Witness asks other actuary.

page 399 } A. (Continued) No; apparently nobody has any indication, nobody from the National.

Q. Well, what I'm asking now is, if it happened, and I can assure you that I will find out and put it in the record, if it happened, do you have any explanation for it?

A. Yes. If it happened, it was possible to do it, but I don't know whether it did.

Q. What I am asking you is there any reason why you could get later data for Arkansas than for Virginia?

A. Could you state that question again, please?

NOTE: Question read as follows:

Philipp K. Stern

Q. Is there any reason why you could get later data for Arkansas than for Virginia?

A. There may be reasons, yes.

Q. Well, now, you are the Manager of the Actuarial Division of the National Bureau of Casualty Under-

page 400 ⟩ writers—right?

A. Yes.

Q. What are the reasons?

A. The preparation of a rate filing takes a considerable amount of time. We start at one time with the latest available data which may be in November or December of 1966, that may be accident year 1965. It could be that somewhat later we are able to compile data at one-half year more recent, which would be the year ended June 30, 1966; but I doubt very much that Arkansas was on that basis.

Q. Yes, Sir. As I have said, we will determine, and whichever way it turns out, I will put this in the record unless somebody objects to it, so the record will be straight.

But am I correct that your filing before this Commission was rendered or submitted on February 10, 1967?

A. I think that's the date, yes.

Q. And that was only about ten days before the

page 401 ⟩ hearing on the filing in Arkansas—right? The Arkansas hearing started on February 27th, wasn't it?

A. I take your word for it.

Q. Yes.

A. I don't know.

Q. Am I correct, Sir, that for twenty-five years prior to 1951 the National Bureau had a profit provision relating to automobile liability insurance in the amount of two point five per cent?

A. The provision was two point five per cent. I don't know whether it was twenty-five years or not. The provision was two point five per cent. I don't know whether it was for twenty-five years.

Q. And at that time the National Bureau, the 1951 meeting of the National Association of Insurance Commissioners announced its intention to raise it to a uniform level of two point five per cent; is that correct? I'm sorry—to five per cent?

A. That is correct.

page 402 ⟩ Q. And as a result of that announcement, a subcommittee of the National Association Insurance Commissioners did a study of what would be the appropriate profit provision for the casualty lines; is that not correct?

A. Yes.

Q. And was it not the conclusion of that sub-committee that the appropriate amount should be three point five rather than five?

A. That was the opinion of the sub-committee.

Q. Yes.

A. But it was never accepted.

Q. Yes. We are going to get into what happened to that report in just a moment. First, I want to establish what the recommendation was.

A. Yes.

Q. And was it not also their recommendation that that three point five per cent should be related to the

page 403 } base of stockholders's equity rather than to the base of premium volume?

A. Yes.

Q. And was it not also the recommendation of that sub-committee that in arriving at the three point five profit provision, consideration should be given to sources of investment income as well as underwriting profit and loss?

A. I believe that was in there.

Q. And following the submission of that report, did not the National Bureau of Casualty Underwriters prepare a rather extensive memorandum in reply in opposition to that report—

A. Yes.

Q. —which it submitted to every department of Insurance in the United States?

A. Yes.

Q. And has that sub-committee report to your knowledge ever been voted upon by the National Association of Insurance Commissioners?

A. To my knowledge it has never been voted upon by the National Association of Insurance Commissioners.

page 404 } Q. And did the rates and rating sub-committee of the Casualty and Surety Committee of the NAIC undertake a study last year to determine the sources of profit which are appropriate to consider for casualty rate-making?

A. I think such a study is going on.

Q. And are you familiar with the questionnaire that they sent out to the various insurance departments throughout the United States?

A. Not in detail.

Q. Am I correct that their report with respect to what they had done last year was rendered in September or October of 1966?

A. I don't have these dates handy.

Q. Was it the Fall of 1966?

A. I assume a report was made.

Q. And am I correct that the National Bureau memorandum was brought up to date, that is to say, the 1952 memorandum was brought up to date for the first time on December 15 of 1966?

page 405

A. That is not correct. It is constantly being kept up to date.

Q. Has there been any other memorandum prepared?

A. Yes.

Mr. Shadoan: Would you mark these in order? What is this?

Bailiff: This would be No. 12.

Mr. Shadoan: Then these would be 12, 13, and 14.

Commissioner Dillon: They will be received as Exhibits Nos. 12, 13, and 14.

Mr. Elliott: Have you got copies of those?

Mr. Shadoan: I'm sorry, I don't, and, as I have said before, I am going to request the Commission to allow me to take these out and make photostatic copies of them.

Q. Mr. Stern, I am going to pass you what has been marked as Exhibit No. 14, and ask you to read just the first few lines of it.

page 406

Mr. Moncure: I rise to a point of order. This is dealing with investment income of the companies which I thought we were not going into here. It is "RETURN ON STOCKHOLDERS' EQUITY FROM INVESTMENT AND UNDERWRITING INCOME". Isn't that one of the things that we are not interested in here? Are the others of the same nature?

Mr. Shadoan: Yes, Sir.

Mr. Moncure: Then I move that we do not consider these as long as the Commission has already ruled on these two points.

Mr. Shadoan: I offer them as exhibits.

Commissioner Dillon: Well, you can put them in, and we will accept them and mark them "rejected".

Mr. Shadoan: That's right. Now, let me iden-
page 407 } tify these, and make my proffer. of what we would be presenting them for:

Exhibit No. 12 is a Report of the sub-committee on cost and profit factor study of casualty lines, dated April 17, 1952, Committee members being the Superintendents and Commissioners of New York, North Carolina, California, Minnesota and Florida.

Exhibit No. 13 is a Memorandum submitted by the National Bureau of Casualty Underwriters to the National Association of Insurance Commissioners, in support of the Uniform Profit Provision of five per cent for underwriting profit and contingencies for all kinds of insurance, and in reply to the Report dated April 17, 1952, of the Sub-Committee that I have mentioned.

Exhibit No. 14 is a Memorandum dated December 15, 1966, entitled "RETURN ON STOCKHOLDERS'
page 408 } EQUITY FROM INVESTMENT AND UNDERWRITING INCOME".

The proffer which I make with respect to these exhibits is that they are relevant to the determination to be made in this hearing for two reasons:

The first is that they are germane to what an appropriate profit factor should be, the basis upon which the profit factor should be determined.

The second is that these are material to the credibility and trustworthiness that should be given to the testimony you are receiving in support of their application.

And if they are rejected—

Commissioner Dillon: They have been rejected.

Mr. Shadoan: I have been given a copy of the Arkansas filing which we will ask to be marked as Exhibit No. 15; and for the record, this does not include any data for the accident year of 1966.

page 409 } Commissioner Dillon: That will be received as Exhibit No. 15.

Commissioner Catterall: There is no need to put that in the record. You are just stating a fact, and that is the only fact we are interested in. There is no use to encumber up the record with that.

Mr. Shadoan: Well, I said that I would, and that is the only reason I am doing it.

Commissioner Catterall: Well, you have kept your promise, and now you are released from it.

Commissioner Dillon: You have stated what you want in the record.

Mr. Shadoan: All right. I withdraw the exhibit.

Now, if I understand the ruling correctly, I want to be sure, it is that I am precluded from pursuing this matter further on my alternative ground that it bears
page 410 } upon the credibility of the witness. Is that correct?

Commissioner Dillon: That's true.

Mr. Shadoan: I would like to ask just one further question, Your Honors. It's a matter of interest, it may be the Commissioners would like to have the answer to it too, maybe not.

The stock companies argue that it is inappropriate to consider income, investment income, because this is like taking property rights away from the stockholders.

Q. And as an old time Mutual actuary, would you mind telling me what the explanation is for the Mutual's argument against considering investment income?

Mr. Moncure: Wait a minute. That calls for this witness' opinion on a conflict between the mutual and the stock companies, and is not germane to this hearing, and he is still dwelling on—
page 411 } Mr. Shadoan: I will withdraw the question if there is an objection.

Q. Am I correct that with respect to the difficulty of acquiring the acquisitions expense experience in Virginia, that that would not require more than a month to secure it if you sent out a special call to your members?

Mr. Moncure: Now, if Your Honors please, on that, this Commission has ruled that—

Mr. Shadoan: Why do you say the Commission has ruled?

Mr. Moncure: —it is not requiring that, and once we rule on a thing, you are beating a dead horse—

Mr. Shadoan: I am not beating a dead horse. I think the records will reflect that this information was secured in Kentucky without any great delay, and I think it bears upon whether or not the decision of this Commission is reasonable.
page 412 } Mr. Moncure: You are beating a dead horse still. The Commission has ruled.

Philipp K. Stern

Mr. Shadoan: The Commission has ruled—
Mr. Moncure: And you keep objecting to this ruling.
Commissioner Dillon: Let me ask you this. Will you not dwell on this if we permit him to answer?
Mr. Shadoan: Yes.
Commissioner Dillon: All right. Go ahead and answer.

Mr. Shadoan
Q. It took you about a month to get it in Kentucky—right?
A. It took longer than that.
Q. Well, the call went out, did it not, in December, and the decision was rendered in February—right?
A. Yes.

page 413 } Mr. Moncure: If Your Honors please, we are talking about another State with different statistical data, and because they get it there at one time—
Commissioner Dillon: All right.
Mr. Moncure: —it is not germane to this—
Mr. Shadoan: All right. I will submit that as an exhibit.

Q. How long would it take you to get it for Virginia?
A. Well, Your Honors, I can't tell you. It's not going to take a year, but it will be more than a month.
Q. Not a year, but over a month?
A. Yes.
Q. Okay.

Commissioner Dillon: I think that's enough on that.

Mr. Shadoan
Q. You are not in this filing asking for a reduction in the rates for the excess coverage policies, are you?
page 414 } A. No, we are not. This filing only concerns itself with basic limits manual.
Q. Well, now, am I correct that the way you compute these things, that an excess rate policy is included within your population of standard limits as long as the claim does not exceed the standard limits? What is the verbiage that you use for classification? Let me withdraw that.
What is the difference between excess rates and non-excess rates?
A. What basic limits.
Q. Okay.

A. We talk about fifteen/thirty limits here.

Q. All right, fifteen/thirty limits. Then you talk about excess limits in Virginia, you are talking about claims in excess of fifteen/thirty; is that right?

A. When we talk about "excess limits", "increased limits" is the right term. We talk about coverage purchased by the insured for limits higher than fifteen/thirty.

page 415 } Q. Okay. Now, if I have a policy which says one hundred/three hundred coverage, and I have an accident for which I am held responsible, and a ten thousand dollar judgment is rendered against me, and one of your companies has to pay it, that claim goes into your basic limits computation of loss expense; isn't that right?

A. Yes.

Q. It's only when under such a policy that the claim which you pay is in excess of the fifteen thousand dollars, that we have a loss experience which is relevant to your computation of rates for the increased limits. Is that right?

A. Yes, only the portion above fifteen/thirty of the losses.

Q. Now, am I correct also that if you are making a substantial profit, substantially in excess of the allowance for profit, upon excess or increased limits coverage, this has nothing to do with the present filing because the

page 416 } remedy is to change the rates for increased limits coverage; is that correct?

A. That is correct.

Q. And that is what Commissioner Catterall indicated the other day, I believe?

A. Yes.

Q. Now, am I also correct you are in fact experiencing a profit that is substantially in excess of the manual allowance for excess coverage in Virginia, around seventeen per cent?

A. That is not correct because you cannot look at excess losses in computing a premium in the same manner as we look at the fifteen/thirty standard limits.

Q. What perspective do you use when you look at these?

A. First, increased limits tables have to be reviewed on a broad basis. One State will never produce enough stability—very few States would—to determine the data properly.

Q. Do you make rates for increased limits on a countrywide basis?

page 417 } A. They are substantially on a countrywide basis, but there are some States that don't fit into the pattern.

Secondly—

Q. So—I'm sorry, go ahead.

A. Secondly, increased limits tables are reviewed at less frequent intervals than the basic limits manual rates are reviewed—increased limits tables are reviewed at less frequent intervals than the annual review of basic limits rates.

Q. Have you finished?

A. I would like to add to this. One State may create the impression for a brief period of time that the loss ratios are actually below what is expected of this type of coverage, but that situation may change very soon.

Mr. Shadoan: Now, I'm having the docket mark this Exhibit No. 15.

Commissioner Dillon: No. 15 was the one previously marked.

page 418 } Mr. Shadoan: Yes. No. 15 has been previously marked and withdrawn; and as soon as it is marked I will identify it for the record.

Commissioner Dillon: It will be received as Exhibit No. 15.

Mr. Shadoan

Q. Now, Mr. Stern, I am going to ask you some questions about what has been marked as Exhibit No. 15, which purports to be a letter dated May 22, 1967, regarding Case No. 18386, addressed to Honorable Henry E. Howell, Jr., George Allen, and Stanley Sacks, from Norman Elliott, and including within it or attached to it, a letter dated May 19th, bearing your signature, with certain exhibits attached:

Exhibit One, an Explanatory Memorandum, and Exhibit A.

Do you have a copy of that, Mr. Stern, before you?

A. I have a copy of my letter, yes.

Q. Do you have a copy of the exhibits?

page 419 } A. Yes.

Q. Okay. Will you look at Exhibit One just for a moment? Exhibit One is entitled "AUTOMOBILE LIABILITY INSURANCE Private Passenger Cars (Non-Fleet) Premiums and Losses for Coverage Above 15/30 Limits Bodily Injury." Are you looking at them? Is that what you are looking at?

A. Yes.

Q. Okay. In the columns, you have a column that is in the parentheses (2), and it says "Factor to Adjust Losses"—right?

A. Yes.

Q. What is that factor? Is that a trend factor?

A. It is a trend factor, yes.

Q. A trend factor sufficiently accurate to be used with excess limits; is that right?

A. Yes. I will modify that. Normally we would not review or exhibit the excess limits experience for one

page 420 } State. As a substitute for it, we would use a broader base. When we were requested to prepare Virginia data, we did the best we could, but normally we would base all of this calculation on countrywide or broad data.

Q. I want to pursue that just a little further, Mr. Stern, because it may well be that I don't understand some of your previous testimony.

A. All right, Sir.

Q. As I understand this exhibit you have prepared here, you have a trend factor for bodily injury for excess limits coverage for the State of Virginia; is that a misunderstanding?

A. No. Actually this trend factor and this explanation did not get clearly into the Explanatory Memorandum, this trend factor was calculated by applying a statistical procedure to countrywide data showing claims for losses by size of claims. It's a fairly complicated procedure, and it would take me a long time to try to explain it, and I don't believe it would help.

page 421 } Commissioner Dillon: I wonder if it wouldn't help Counsel if I made this statement. We plan to have a separate proceeding on this excess limits coverage.

Mr. Shadoan: I don't think it would help because, among other things, what I am going into right now is what seems to be very puzzling to me, that is the explanation for the applicable trend factor for B. I. for five thousand, because they didn't have a sufficient population of data and various other reasons, but in this exhibit we have one for excess limits.

Commissioner Dillon: I see what you are trying to do.

Mr. Shadoan

Q. And what I'm trying to get from you, Mr. Stern, is simply an explanation of how you regard as consistent to use a B. I. trend factor in an exhibit such as this when you are unable to do so in the filing of the basic limits

page 422 } before this Commission?

Philipp K. Stern

A. Mr. Shadoan, I think you missed the point I made in the prior sentence. I said that this factor is based on countrywide losses. We used countrywide data to get a statistical distribution, and to that countrywide distribution, was applied the information we obtained from Virginia total limits paid losses. That is quite different from my prior comments on the unreliability of Virginia paid losses limited to five thousand dollars per case.

Q. Do you have a separate filing for the reduction in the rates for excess coverage in Virginia?

A. We do not, and we do not know or believe that a reduction would be indicated.

Q. Well, this exhibit that you prepared at the request of these gentlemen, what does it show that your experience has been for profit in excess coverage?

A. It shows loss ratios in Column (4), in round

page 423 } figures, of fifty-three per cent, thirty-seven per cent, and fifty-two per cent, average forty-seven per cent for three years.

But I explained to you before that data for one State are insignificant.

Q. What is the—

A. If I may, if I may explain something from a prior filing on increased limits, in 1962 we filed a change in the excess limits in Virginia.

For example, on commercial cars we explained that we wanted to change the tables in accordance with a change made countrywide, and the statement was made that the table is overall adequate in Virginia and because of distribution it would produce a slight increase of three point three per cent, yet for the period then under review of the Virginia loss ratios were seventy-two per cent, sixty-six per cent, and ninety-five per cent, or an average of seventy-eight per cent.

page 424 } Q. Now, when was that?

A. That was in 1962. Here, too, we disregarded completely the Virginia data which would show a needed increase, a tremendous increase, but we disregarded it. We said that the commercial car increased limits experience is adequate countrywide, all it needs is a slight tug in the table. That is best proved that we in the past did not rely on State data as we do not rely on State data today.

Q. What was the expense for 1961 and 1960? We've got a three year period here, and you took one year in which you had—

A. I did not work it up.

Q. Okay. You took one year in which you sustained losses in excess of the allowance which you have just said was the reason that you are not changing excess coverage in Virginia, when for three years you are having a substantial profit in excess of the allowance; isn't that right?

page 425 } A. I did not say that because one year could change it. That's the reason for not basing rates on one State's material.

Q. That's right. I'm sorry, I misquoted you with respect to that; but it is a fact, is it not, that for the last three years in Virginia, from an expected—I withdraw.

What is the expected loss ratio in Virginia for excess coverage?

A. You don't review—

Q. Along your expectation, you've got one, don't you?

A. No, you do not.

Q. You don't have one?

A. You have to take a variety of circumstances into account that affect the transactions that go with increased limits coverage.

Q. I want to be sure that I understand what you are saying. You are saying that there is no allowance for profit and contingencies?

page 426 } A. I didn't say that.

Q. Well, that's my question. Is there one, and, if so, what is it?

A. We would expect the same allowance for profit in equal limits rates, but a much bigger allowance for contingencies.

Q. What I am asking is, Sir, what is the loss ratio which is expected in the breakdown of the excess premium dollar? What is it?

A. There is no need to pin that down. It has never been pinned down. It is certainly lower than the expected loss ratio for the normal basic manual rate-making requirements.

Q. Are you telling me that there is no breakdown of the excess premium dollar used in Virginia?

A. No, there isn't.

Q. There is not?

A. No.

page 427 } Q. And there is no standard by which this Commission measures whether you have made money in excess of that which was expected?

A. That is not a correct conclusion. The fact that you don't have one limit to which you can key does not mean that you cannot have a variety of criteria which will establish a standard.

Q. Is it fair to say that the matter of making rates for excess limits coverage is so complicated that you don't have an expectation in specific numbers of the loss ratio; is that fair?

A. Well, the complication of the mechanics that go into the review of this type of experience has nothing to do with the type of standards you need for a review of experience. You can establish the standards without an understanding of the mechanics.

Q. What I am trying to get at is the standards, and you are saying that there is no standard of loss expectation which is used in a percentage way with reference to the

page 428 } premium dollar?

A. I think I said the opposite.

Q. You said there was?

A. The fact that we don't have one number you can key to does not mean that you cannot establish or do not have actually a number of criteria which establishes one standard.

Q. When you referred to the 1962 experience and you talked about your loss experience, it was significantly in excess of some expectation. What were you talking about then?

A. I did not say that. I said that if you looked at the Virginia data, you would have concluded, you could have concluded that the loss ratio exceeded the expectation.

Q. Well, what was the expectation of the loss ratio when you were talking about 1962?

A. I can only repeat what I said before. It is not one particular figure. It is a variety of circumstances

page 429 } that affect the granting of coverage.

Q. Your expectation is a variety of circumstances which affect the granting of coverage?

A. Yes; market conditions, reinsurance situations and various other things.

Q. All right. Am I correct that you are under no obligation to make filings at any specific time in Virginia; that you use your discretion as to when you shall make a filing?

A. I don't think that is correct.

Q. Will you explain in what fashion it is incorrect?

A. The Bureau of Insurance and Commission know that we get new experience each year; and if we did not present a review of the data, I am sure we would get an inquiry for

a review. As it is, we have continually submitted such a review and made rate filings except if, because of
page 430 } the long delays in getting rate revisions through, we sometimes have to skip a year. For example, last year we had 1964 data available, and we were waiting to work them up for revision, but the investigation held it up, and we simply had to skip it for that one year.

Q. Well, now, what lines of insurance do you make rate filings for in Virginia? Where is the National Bureau? It's twelve, I think.

Bailiff: Twelve?

Mr. Shadoan

Q. Go ahead and answer the question.

A. We make rate filings for various subdivisions of automobile liability insurance, general liability insurance, burglary, theft, and boiler and machinery insurance.

Q. You have five lines—right?

A. Yes.

Q. And you have been making filings every year with respect to automobile liability for the last several years; is that correct?

page 431 } A. It is substantially correct, yes.

Q. What about burglary and theft?

A. Some are reviewed, mostly from different letters. They are not put on every year.

Q. I'm asking filings, Sir. I'm asking filings.

A. I don't have the record with me, but we may not have made filings every year.

Q. I want you to look at page 33 of Exhibit No. 13, which relates to your underwriting gain and loss experience in 1931 through 1950, and so on. Will you look at that?

A. Yes.

Mr. Moncure: May I interrupt to see what we've got here?

Mr. Shadoan: Certainly.

Mr. Moncure: This is all insurance but workmen's compensation that this deals with.

Mr. Shadoan: If there is an objection, I wish
page 432 } it would be stated. I don't understand.

Mr. Moncure: I'm asking you a question. Excuse me, Sir.

I see from the showing here—

Mr. Shadoan: I think your remarks ought to be directed to the Commission.

Mr. Moncure: —that it covers all fields of insurance but workmen's compensation; and I submit that it has no application to a rate hearing to fix automobile personal injury and property damage rates, and I object to it, or any examination of the witness on them.

Mr. Shadoan: Now, if the Court please, there is no question pending. In order to save time, however, I would be very pleased to make my proffer before the Commission rules, if the Commission would like to hear what I ex-
page 433 } pect to prove before it rules.

Commissioner Dillon: Proceed.

Mr. Shadoan: I expect to show that this exhibit demonstrates that over a period of twenty years you have an experience in other lines of insurance there—one is a section of twenty years running—you are making profits around nineteen per cent.

We expect to show through this and a subsequent examination that in these five lines of insurance, which really do make up the business of the member companies, there is a variety of experience of profit and of loss.

Now, when they are losing money, they make annual applications; and when they are making lots of money, they just don't get around to it; and that this should be considered in the context of whether or not this application
page 434 } warrants the increase which is requested.

Commissioner Catterall: I don't think that's relevant.

Commissioner Dillon: I don't see how it could possibly have any effect on this application.

Mr. Shadoan: That's my proffer.

Commissioner Dillon: We sustain your objection.

I might state again, on excess limits we are going to see that they come in.

Mr. Shadoan: I am leaving the excess limits questions.

Commissioner Catterall: And we hope that Mr. Shadoan will be here.

Mr. Shadoan: I sort of doubt that I will be, Commissioner.

Senator Howell: If Your Honors please, I would like to just—I think we are entitled, and I know the Commission would want us to get that to which we are en-
page 435 } titled.

Mr. Maddrea made inquiry about the excess profits on excess limits, and we wrote for the information

through Mr. Elliott, and it was furnished to us on or about May 22nd; and I think this is one of the inquiries that was precipitated by this proceedings, and, of course, we have to prepare for these things. We know that this is a line of insurance which every day the policyholder is paying too much for which is apparent from the figures. And how soon are we going to have this hearing which apparently will reduce the rates?

Commissioner Dillon: Very soon.

Senator Howell: You all haven't set a date?

Commissioner Dillon: We haven't set a date, but we will.

Senator Howell: Are you going to require a filing on this part, Sir?

page 436 } Commissioner Dillon: Yes, Sir.

Mr. DuVal: May it please the Honorable Commission, I would like to move that the Bureau be required to file with you in the course of this proceeding a complete statistical analysis showing their loss experience and production in the writing of excess coverage rates, and this Commission as part of this proceeding make a determination that the rates for excess coverage are excessive; so that if the Commission indicates or determines in this proceeding that the rates for writing the statutory limits would require an increase, with which we disagree, but, if this is the finding, at the same time the motorists, the policyholders, may have the benefit, we believe, reduced rates for writing excess coverage.

page 437 } Commissioner Dillon: We would have to have a separate hearing. The Commission is of opinion that we would have to have a separate hearing on excess coverage.

Mr. DuVal: Your Honors, it seems to me that this could be adjourned for the purpose of having that hearing; for, after all, this is the same kind of underwriting. I hold excess coverage. I also pay a costly premium for the statutory limits.

And it seems to me that, if the Commission is going to decide that I should pay increased rates for my statutory limits that, if I am entitled to pay lower rates for my excess coverage, these are matters which should be combined and submitted together without further delay.

Commissioner Dillon: There won't be much delay; we will assure you of that.

page 438 } Mr. DuVal: Well, I would like to make that motion now.

Commissioner Dillon: All right.

Mr. Sacks: If Your Honor please, I wonder if we could inquire how long it would take—I don't mean a lengthy examination—for those figures to be supplied to the Commission because it seems to me just patently unfair that there would be any haste to raise the basic part of the premium for a Virginia motorist, and try and separate it, and tell the Virginia motorists that "you may be entitled to a decrease in part of your premium", but we have to wait later to have that.

If these people can supply the information here within the reasonable time it's going to take this Commission—

Commissioner Dillon: We might ask Mr. Stern how long it will take him to furnish the Commission with
page 439 } the necessary information.

A. It will require a very large, major effort of using our machines and using our brains, and it is not something we can produce in four weeks or anything like that.

Mr. Sacks

Q. Mr. Stern, can't you get that information here within a matter of a couple of weeks, if you really try?

A. We certainly couldn't.

Q. And what's the reason why you can't?

A. Because it is a tremendous job.

Q. Well, why does that differ from all these other? What is it in your mind that—

Commissioner Dillon: Let me just ask him how long it will take. He is on cross examination now, and I think it would be a little out of order for you to ask him.

Mr. Sacks: Well, all right, Sir. I'm caught on this point, but let's get on with it.

page 440 } Commissioner Dillon: Just let me ask him—

Mr. Sacks: All right, Sir—fine.

Commissioner Dillon: —and I will see if I can get the information from him.

A. I think we can finish it in four months. I am very optimistic

Commissioner Dillon: In four months?

A. Yes.

Mr. Moss: Isn't it only fair, Mr. Commissioner, that if this is going to be an offsetting factor, which I am convinced it will be, that this rate increase should be denied at least

until we find out how much they are making in excess, on the excess, on the *overage?*

Commissioner Dillon: Of course, I don't know how much they are making on this, but I don't think it will offset their losses on the premiums.

page 441 } Mr. Moss: This is the point I was trying to make a little while ago. They are in a big hurry to get the increase, but they want all the time in the world to bring in what they are making on the *overage;* and I don't think that's fair.

Commissioner Dillon: We will take your motion under advisement. Go ahead, Mr. Shadoan.

Mr. Shadoan: I would like that marked as an exhibit.

Commissioner Dillon: Received as Exhibit No. 16. We receive the exhibits as we go along. We mark them and receive them.

Mr. Shadoan: I'm sorry. We have three I believe that have been rejected so far.

Commissioner Catterall: You have three rejected.

Mr. Shadoan: I'm getting down to the rejected list very shortly.

page 442 } Bailiff: And, Your Honor, one number, Exhibit No. 3, that is not in the file.

Commissioner Dillon: Yes, that's right, just leave it open. Mark it withdrawn.

Mr. Shadoan: Exhibit No. 16 is a two-page document, the first page of which is dated May 5, 1967, bearing the letterhead of the State of Arkansas Insurance Department; and the second is a copy of a telegram to the Honorable John Norman Harkey, Insurance Commissioner of Arkansas, and signed by Mr. Cahill, the General Manager of the National Bureau.

Commissioner Dillon: Has that one been read into the record on yesterday?

Mr. Shadoan: Yes, that is the one read into the record earlier. I would like for it to be received, and I would like to ask a couple of questions about it of this witness.

Mr. Moncure: May I see it? I have never seen it. I heard you mention it.

page 443 } NOTE: Exhibit No. 16 handed Mr. Moncure.

Mr. Moncure: If Your Honors please, I see no pertinency in a telegram relative to the action of this Bureau and of the Arkansas Bureau.

Philipp K. Stern

Commissioner Dillon: Let's see what his question is. Let's see what he wants to know.

Mr. Moncure: I object to its introduction as an exhibit.

Mr. Shadoan

Q. Mr. Stern, I have read this letter before, telegram, rather, before, and it states that it is withdrawing its filing which was submitted on November 17th "in view of questions concerning commissions to producers of Arkansas automobile liability business".

Now, my question to you is what is the consideration which requires Arkansas to be aware of the expense for producers of Arkansas business in the opinion of your Bu-
page 444 } reau, but does not require the Virginia Commission to know what the producers—

Mr. Moncure: Don't answer that.

Mr. Shadoan: I have not finished the question.

Mr. Moncure: I just don't want him to answer it. I thought you had finished.

Mr. Shadoan

Q. —but does not require the Virginia Commission to be aware of what the expenses are for producers of Virginia insurance?

Commissioner Dillon: Put that to rest.

Mr. Shadoan: We haven't got his answer of why it is necessary in Arkansas but why it is not necessary here.

Commissioner Dillon: Haven't we ruled that it is not necessary in Virginia?

Senator Howell: No, Sir.

Chairman Hooker: Two to one.

Mr. Moncure: If Your Honors please, I'm not sure, I can't read the Court's mind, when you are dealing with two Courts, or a lawyer either.

page 445 } Commissioner Dillon: I think we have made a decision on it.

Mr. Shadoan: Well, I understand that the decision has been made. I am simply asking this witness—

Commissioner Catterall: Wasn't the News Leader answering that yesterday? They said you were such a bugaboo that it scared them, and they withdrew?

Mr. Shadoan: Well, I'm not sure of this, Sir. I would hope that the Commission's decision in this case is not based upon such considerations. I take it that the question is ob-

jected to and ruled out of order. I have asked that it be received.

Commissioner Dillon: We put it in as an exhibit. It has been read into the record two or three times and—

Senator Howell: As an Individual Intervener, if Your Honor please, I want to state that Mr. Smith, who
page 446 } is in the Courtroom and who is knowledgeable with the average commissions paid, has stated that it is twelve to fifteen per cent at the outset, whereas, there was some suggestion here that twenty per cent commission was paid to an agent in Virginia, and a loading is allowed.

Commissioner Catterall: Mr. Allen said eighteen per cent.

Senator Howell: I know, but he was wrong.

Commissioner Dillon: Mr. Allen hasn't said so.

Senator Howell: What I'm saying to you, if you all are interested in knowing, there is a gentleman who is knowledgeable, Mr. Smith, sitting on the back row there, and he knows what the average commission is; and on the outset it is twelve to fifteen per cent.

Now, I don't think these people want to go into
page 447 } it because it might be in violation of the Creighton Anti-Trust Act or some other act, the way they manipulate these commissions; but it's from twelve to fifteen per cent at the outset, and that's why I think you ought to go into it.

Commissioner Dillon: We are certainly not going to let you argue our decision now. We will let you argue motions.

Senator Howell: I think all of this stuff is done to keep the Commission in the dark.

Commissioner Dillon: We are certainly not going to let you argue our decisions, in your answer.

Mr. Shadoan: I would now like to ask the Commission to receive as Exhibit No. 17 a document which has multi-pages, but they are in two pieces. First is a cover letter dated May 4, 1967 to George Allen, Jr., Esquire, from Mr. M. Wallace Moncure—is that the way it is pronounced?

Mr. Moncure: That's right.

page 448 } Commissioner Catterall: Moncure.

Mr. Moncure: That's close enough.

Commissioner Catterall: Moncure, accent on the last syllable.

Mr. Moncure: It's closer than I pronounce yours.

Mr. Shadoan: Well, everybody has trouble with mine, Mr. Moncure.

Mr. Moncure: Mine too, Sir.

Mr. Shadoan: The second part of it is the brief on behalf of the National Bureau of Casualty Underwriters which I would like to be received because of the information which I read into the record from page 5 earlier.

Commissioner Dillon: Is this No. 17?

Mr. Shadoan: No. 17, yes.

Commissioner Dillon: Received as Exhibit No. 17. You have no objection to your letter?

Mr. Moncure: I don't know what it is, but if I wrote it, I don't object to it.

page 449 } Commissioner Dillon: I've got one in one of these cases that I wrote.

Chairman Hooker: And wished you hadn't.

Commissioner Dillon: No, I don't care.

Mr. Shadoan: Exhibit No. 18 is a two-page document which is marked at the top righthand corner as Exhibits G and H; and the first page purports to show the "Underwriting Loss for Accident Years Ended June 30, 1963 and 1964" in Maryland; and Exhibit H is what we agree in Virginia is a pretty chart showing the underwriting losses on automobile liability insurance in Maryland.

Commissioner Catterall: Well, we agree that's an insult to our intelligence if you want us to.

Mr. Shadoan: That the chart is an insult?

Commissioner Catterall: That old man waving money around like that. That's for people who can't read and write.

page 450 } Mr. Shadoan: The National Bureau saw fit to use it in support of its application.

Commissioner Catterall: It shows what they thought of Arkansas.

Mr. Shadoan: That wasn't in Arkansas.

Chairman Hooker: Maybe it was some of the modernistic money.

Mr. Shadoan: I agree, however, that it does indicate a different approach, Mr. Commissioner.

I would like to have that received in the context of the earlier examination.

Commissioner Dillon: What is this, Exhibit No. 19?

Bailiff: Exhibit No. 18.

Commissioner Dillon: I thought we had marked Exhibit No. 18. This is received as Exhibit No. 18.

Mr. Shadoan: We would offer to the Commission Exhibit No. 19, a multi-page document, which purports to

page 451 } be a series of reports in 1966, of the Rates and Rating Organizations Subcommittee of the Property, Casualty and Surety Insurance Committee of the National Association of Insurance Commissioners; and I hope that that would be received.

Commissioner Dillon: That will be received as Exhibit No. 19. You want to see these, Mr. Moncure?

Mr. Moncure: I don't care about that one, not if they are not going to introduce any evidence on them, and they can go in the record.

Mr. Shadoan: I don't plan to ask questions. I just want to put them in the record.

Will you mark this, please?

Commissioner Dillon: That is Exhibit No. 20.

Mr. Shadoan: Do you want to see this?

Mr. Moncure: Yes.

page 452 } Mr. Shadoan: May I inquire parenthetically whether there is anybody that is happy about what I'm doing, or unhappy, and that is keeping a list of these exhibits that I can use later on? Are you keeping a list?

Bailiff: Yes, Sir, I am keeping a list.

Commissioner Dillon: Yes. They are being kept.

Mr. Shadoan: Okay. Of course, I want to withdraw some of these and make copies.

Senator Howell: Xerox them.

Commissioner Dillon: They are kept.

Mr. Shadoan: This Exhibit No. 20, which I offer purports to be a cover letter dated January 7, 1966, from the Insurance Commissioner of Maryland to me, attached thereto the opinion of the Insurance Commissioner of Maryland in the hearings held there on December 17th through 22nd, 1965.

page 453 } Mr. Moncure: I object to that. I don't think any letter of the Commissioner of Maryland addressed to an attorney handling a case has any bearing on the Virginia rates.

Mr. Shadoan: I would be glad to withdraw the letter and simply append the opinion. The letter doesn't really say anything, Mr. Moncure.

Commissioner Dillon: Do you object to the opinion?

Mr. Moncure: I object to the opinion coming in here. It has no bearing on this hearing, a letter written—I would like to see it.

Mr. Shadoan: I am going to hand a copy of it for you to see.

Philipp K. Stern

Commissioner Catterall: It's just as persuasive as *Corpus Juris Appendant.*

Mr. Shadoan: Well, I would like to offer the opinion because the Commission—

Commissioner Dillon: I think it should be
page 454 } received. It will be received as Exhibit No. 20.

Mr. Moncure: I object to a filing of opinions in Arkansas—

Mr. Shadoan: This is not Arkansas.

Mr. Moncure: —and Maryland.

Senator Howell: This is Maryland.

Mr. Moncure: In Maryland or any other States, where we do not have—

Commissioner Dillon: Well, will you show me, will you point out where they will hurt anything?

Mr. Moncure: I don't think it will hurt anything, Judge, but they are encumbering this record up so I don't have time to read it all through.

Commissioner Catterall: If they offer the volume on insurance in *Corpus Juris Secundum,* would you have any legal objection?

Mr. Moncure: No legal objection, no, Sir.

Commissioner Dillon: Well, we will receive
page 455 } that.

Mr. Shadoan: Exhibit No. 21 is the opinion of the Insurance Commissioner of Kentucky which we would like to be received also.

Commissioner Dillon: No. 22.

Mr. Shadoan: It's No. 21, I believe, Commissioner.

Commissioner Dillon: Received as Exhibit No. 21.

Mr. Shadoan: Now, rather than having these marked, and I take it that the Commission would rule they are non-admissible or I think it is discretionary with the Commission, I have here some addresses by men such as Frederick Hill, who is Assistant Vice President of the Investment Research Department of Insurance Securities Incorporated, which is entitled "Annual Reports to Shareholders of Insurance Companies—Adjusted Earnings" and I anticipate this will not be received.

page 456 } Mr. Moncure: You are dealing with the income factor that the Commission didn't want to hear; and I object to it.

Mr. Shadoan: I would like to finish what I am saying. I am anticipating that these will not be received, and if that's the ruling, I will save everybody's time.

Commissioner Dillon: What we will do is reject them, and let you put them in, and reject them, in case you want to do that.

Mr. Shadoan: All right. Well, would you put these in and mark them "Rejected".

Commissioner Catterall: Why don't you put them all together and just give them one number, as a group of papers offered and rejected.

Senator Howell: "A", "B" and "C", I think, is customary.

page 457 } Commissioner Dillon: Put them in as 22A, 22B, and and 22C, and 22D. We will staple these together, and mark them "Rejected".

Mr. Shadoan: Now, as Exhibit No. 23 I would request that the Commission receive in evidence the following pages of transcript from Case No. 17357 before this Commission in 1965. The page numbers which I wish received as this exhibit are:

Page 493 through page 497;

Page 634; and

Page 655.

Commissioner Dillon: You certainly have no objection to that?

Mr. Moncure: That's just a memorandum to the Commission to look at it, as I see it. I don't see what's in the exhibit.

Commissioner Dillon: Well, it won't hurt anything.

Commissioner Catterall: Well, you want those for your record on appeal?

Mr. Shadoan: That is correct.

page 458 } Commissioner Catterall: Well, either now or later you could ask for anything in the record on appeal.

Mr. Moss: That is, if we have to appeal, Judge.

Commissioner Catterall: I thought you promised to appeal.

Mr. Moss: No, Sir.

Mr. Shadoan: I think what he meant was that should the Commission deny the application, they would not appeal.

Commissioner Dillon: He wouldn't want a reduction. That will be received as Exhibit No. 23.

Mr. Shadoan: Exhibit No. 24, which I would request be received also, and let me indicate that I am proffering these because these are the transcript references to which I referred in my opening statement.

Commissioner Dillon: Is that in the last rate hearing?

Mr. Shadoan: That that I just offered was
page 459 } from the last rate application before this Body.

Commissioner Dillon: And what is that:

Mr. Shadoan: Well, I'm going to offer now testimony of National Bureau witnesses to which I referred in my opening statement which was received before the Maryland Insurance Commissioner on December 17, 1965.

Commissioner Dillon: Well, let's mark that Exhibit No. 24, and we will reject it.

Mr. Shadoan: If you would just indicate the numbers, Sir, I will offer those later.

Commissioner Dillon: Exhibit No. 24, rejected.

Mr. Shadoan: Similarly, we would offer from the Arkansas hearing in February of 1967 a number of transcript references, and for the purposes of this record I would
page 460 } like to identify the pages, so that when I present the pages later, we can know what I am talking about. I understand that the Commission is going to—

Commissioner Dillon: Mark them as "Rejected".

Mr. Shadoan: Right. That would be Exhibit No. 25, wouldn't it?

Commissioner Dillon: Exhibit No. 25.

Mr. Shadoan: The pages from the Maryland transcript are:

Pages 119 through 122; and

Pages 272 through 275;

Consisting of the testimony of Mr. Daniel McNamara, the Secretary, before the National Bureau of Casualty Underwriters.

The transcript pages from the Arkansas hearing are:

Transcript Pages 259 through 261;
page 461 } Page 267;
Pages 368 through 390;

Page 379; and

Page 398;

Consisting of the testimony of Mr. R. J. Jewel, the Southwestern Regional Manager of the National Bureau; Mr. W. Lanes, who is an actuary for the Bureau—

Commissioner Catterall: You are going to combine those all together and submit them together?

Mr. Shadoan: I will submit all of those as Exhibit No. 25.

Commissioner Catterall: They will all be bound together so this is just a memorandum to the Bailiff as to what he is to expect?

Mr. Shadoan: This is a statement for the record so that when it is submitted, if the decision of this Commission were found to be erroneous, they would know that what
page 462 } I submitted was, in fact, what I proffered.
Commissioner Dillon: Received as Exhibit No. 25.

Commissioner Catterall: That had better be copied right in the record.

Mr. Shadoan: The pages? I'm sorry, what was that?

Commissioner Catterall: No, I mean that thing you read from. That had better be copied right in the record.

Mr. Shadoan: Oh, yes.

Commissioner Dillon: And then he is going to submit the pages later.

Mr. Shadoan

Q. Mr. Stern, am I correct that the Kentucky Commissioner has required that you make annual filings beginning January 1968?

A. I don't remember that.

Commissioner Catterall: Now, what on earth has that got to do with our proceedings?
page 463 } Senator Howell: Showing modern commission practices across the country.

Commissioner Catterall: We are just as modern as Kentucky is.

Commissioner Dillon: Did you object to this?

Senator Howell: No, there would be no objection.

A. I can't pinpoint the day. He probably did, if you say so.

Mr. Shadoan

Q. Are there any other places where you are required to make annual filings, Mr. Stern?

A. We are making annual filings. There are very few exceptions which are caused by some delays—

Q. Did you understand my question?

A. Yes.

Q. The question was, are there any other places where you are required to make annual filings?
page 464 } A. Yes.
Q. Where are they?

A. Every State expects us to make an annual filing.

Q. Why did the Kentucky Commissioner feel compelled to issue an order to that effect?

A. I don't know.

Commissioner Catterall: What do you mean by an "annual filing"? You don't get an annual request for increases?

A. Oh, no.

Commissioner Catterall: How about people who object to three increases in three years?

Mr. Shadoan: We have heard that the National Bureau on occasion even files for a decrease, Commissioner.

Commissioner Catterall: Well, if there is going to be a decrease, you wouldn't mind having it every year.

Mr. Shadoan: It's not the filing that on behalf of the AFL-CIO we object to. We would like to see page 465 } annual filings if they were appropriately done.

Commissioner Dillon: Well, the companies in the last five years filed each year because they have asked for increases every year.

Mr. Shadoan: Yes, and when they deserve increases they should receive them.

Mr. Elliott: 1964 they were suspended.

Commissioner Dillon: In 1964 they were suspended.

Commissioner Catterall: That was delayed by this investigation. We didn't want to get both rings of the circus going at once.

Mr. Shadoan

Q. Have you done a study at any time which would indicate what the effect of the eight per cent excise tax elimination has been?

A. I have some general information on the effect of it.

Mr. Shadoan: Would you read the question to him again, please?

page 466 } NOTE: Question read as follows:

Q. Have you done a study at any time which would indicate what the effect of the eight per cent excise tax elimination has been?

A. The answer is: No, I did not make a study, but I have general information.

Q. Did your general information include the statement of the National Underwriter, of December 3, 1965, that the industry would realize a hundred million dollars savings as a result of that change in the tax law? Is that a part of the general information which you have?

A. I read that article, yes.

Q. Did you place any credence in that article?

A. No.

Q. Do you have other information that indicates that the effect of that excess tax elimination is not sufficient, that it should be reflected in your filing with respect to property damage, I would assume?

page 467 } A. Yes.

Q. And this general information which you received, we have just established, consisted of conflicting opinions; is that right? The National Underwriters' opinion, you have just rejected.

A. You mean conflicting with the National Underwriters', in that opinion article?

Q. What I am saying is your general information consists of conflicting opinions about the effect of the elimination of the eight per cent excise tax on automobile parts; is that right?

A. I cannot say that this is right because your question is ambiguous.

Q. Well, let me see if I can—I don't want to be ambiguous. The National Underwriters' opinion expressed a dollar figure of savings with which you disagree; is that right?

page 468 } A. I disagree with an article written and published in the National Underwriters, but not the National Underwriters' entire opinion.

Q. You disagree with that article—right?

A. I disagree with that, yes.

Q. You have other general information that is in conflict with that, that you do agree with; is that right?

A. Yes.

Q. All right. And in view of this conflict of opinion, you have not seen fit to do a study to see what the effect would be; is that right?

A. No, that is not correct.

Q. You haven't done a study, have you?

A. If you can define to me what you mean by "Study", I may be able to answer your question. I can make a study in thirty seconds, if I have to. I can see something on television—

Q. I think that has been demonstrated.

page 469 } A. — make conclusions, and then there is a study or I can make a study that takes six months or longer.

Philipp K. Stern

Q. I think that has been demonstrated too. What, in your opinion, will be the effect of the elimination of the eight per cent excise tax?

A. I think there will be no effect on the loss level for property damage liability insurance for a variety of reasons.

Q. Now, is that opinion based on a thirty second study or a six months' *sutdy?*

A. I don't think I have to answer this question.

Q. You said you can make studies in thirty seconds and in six months, and I would like to know where in between this opinion—

A. That is exactly in between those.

Q. Three months?

A. Three months, and fifteen seconds.

Q. Was any memorandum made as a result of that study, Sir?

A. We probably have some memoranda in our Research Division, yes.

page 470 } Q. Now, what are the nature of those memoranda; do you know? Have you ever seen one?

A. No, I have not seen one, but I have talked to people about them.

We have information from various sources including Federal Government agencies that have made some investigations, which indicate that in almost no cases was the saving of that elimination of the excise tax actually passed on to the consumer; and that was the main reason for—

Q. Well, the question was—

A. —our decision not to include any adjustment in our loss level for this elimination of the tax.

Q. The question which is relevant to whether or not the rates should be increased for property damage, however, is not whether it was passed on to the consumer, but whether or not the insurance companies receive the benefit when they pay the bill; isn't that right?

page 471 } Commissioner Catterall: Well, you are thinking about ordinary collision insurance. They don't pay these bills to the garageman. They pay his lawyer.

Mr. Shadoan: That is correct unless it's a subrogated claim.

Commissioner Catterall: Well, that would be very few claims. You are speaking of very few.

Mr. Shadoan: Will you indulge me for just a moment?

Commissioner Dillon: Would you all like to have a recess now until after lunch?

Mr. Shadoan: Yes, we would.

12:20 P.M. Commissioner Dillon: All right. We will recess until 2:00 o'clock.

Mr. DuVal: May it please Your Honor, I unfortunately am not going to be able to be here this afternoon, so I ask that my written opening statement be placed in the record at the proper place, part of which I used, I didn't use it all, but—

page 472 } Commissioner Dillon: Yes, we will put it in the record.

Mr. DuVal: I appreciate it, Your Honor.

Commissioner Dillon: Thank you for coming.

Mr. DuVal: Thank you very much.

Mr. Moss: Your Honor, what time do we come back?

Commissioner Dillon: 2:00 o'clock.

page 473 } 2. P. M.

The Commission resumes its session

Commissioner Dillon: Mr. Shadoan, you may proceed.

CROSS EXAMINATION—(Continued)

By Mr. Shadoan

Mr. Stern, you may recall, what may seem to you a long time ago, but actually was only yesterday afternoon, your testimony that there was an increased rate of inflation according to your information from the Department of Labor. Where did you get that information?

A. According to something I read recently.

Q. What was the article you read recently?

A. I read an article from the New York Times.

Q. But you said you had information from the Department of Labor?

A. I said this was a quotation from the Department of Labor.

Q. And in the context of your testimony you

page 474 } stated that there was a 4.4 per cent failure to recoup your losses, and that that was because inflation was increasing at such a rapid rate; is that correct?

A. That is right.

Philipp K. Stern

Commissioner Catterall: I understood it was 3.2 per cent.
Mr. Shadoan: I understand that is the guide line.

Q. Mr. Stern, however, I would like to know what you base your conclusion on other than the article in the New York Times?

A. I read the bulletins from the Bureau of Labor statistics as they come through and read what the newspapers say as they come through, and I think there is every *bindication* that inflation is increasing every year.

Q. What is the trend factor you are applying in your property damage portion of your rate in your application to the Commission?

A. We are saying that the annual dollar rate of change in Virginia on paid claim costs is nine dollars and seventy six cents, and we expect that the average paid claim
page 475 } cost will increase from the time of the latest accident year at mid point of the coverage of the revised rate at the rate of 1.163.

Q. Your trend factor is 1.163; is that correct?

A. That is correct.

Q. What is the increase in rates you are requesting for property damage?

A. 18.5 per cent.

Q. Would the trend factor computed by your actuarial approach, take into account change in the excise tax and any increase in inflation?

A. I don't understand that question. You said "Would it?".

Q. Does it?

A. It does not take into account any effect of the excise tax, and I am sorry I don't remember the rest of your question.

Q. Any increase in inflation?

A. No, it does not.

Commissioner Catterall: But you said *at* it in-
page 476 } creased 1.163. When *yould* that be?

A. When we filed originally it would have been at May 1st, 1968, but we did not get to it until later and it will be somewhat greater because we did not make the earlier date.

Mr. Shadoan

Q. I have here a letter, which I will ask to be marked as Exhibit 26.

Commissioner Dillon: It will be received as Exhibit 26.

Mr. Shadoan

Q. I am going to read you a portion of the first paragraph:

"I am enclosing a table showing automobile repair and maintenance indexes and per cent changes for the period December 1965 to March 1967. This series is calculated quarterly for the United States city average only. As you will note, there was no net price change between December 1965 and March 1966. This is the first quarterly period since September 1961 which has failed to show a price
page 477 increase. This appears to indicate that the effect of the excise tax cut was offset by increased labor and parts charges."

I am going to pass this on to Mr. Moncure, and after Mr. Moncure looks at it, I will ask you to look at it and the appendicies and supplements. Do you regard that information from the Department of Labor's Statistical Division as being consistent with the information you have testified to concerning this matter before this Commission?

A. It is not. We have this information I had the office called at lunch time, and I believe there was a letter written by Commissioner Ross—

Q. Do you have it with you?

A. No.

Q. Will you identify your source of information for us and I ask that you be perfectly frank about it, so we can check on it?

A. I don't know what you mean by saying "be perfectly frank".

Q. I am being frank in asking you to give me frankly how you made this check, was it done by telephone or
page 478 how was the check made on this information?

A. I asked Miss Walker to call and make a check with the Research Department.

Q. Is Miss Walker the lady sitting back here?

A. Yes.

Q. And she gave you this information?

A. She said that we had a letter from Commissioner Ross.

Q. Do you have that with you?

A. I did not have it. I relied on the information given me that our Research Department had the information. I—

Mr. Moncure: Let him finish his answer.
Mr. Shadoan: I am sorry. Go ahead, Mr. Stern.

A. It indicated that from the survey made by our Research Department that the Bureau of Labor did not pass on any price reductions due to the elimination of the excise tax.

I want to point out to you that on some pamphlets from the Department of Labor on their statistics when I
page 479 } asked the lady in charge of the New York Office of the Bureau of Labor, when I asked her about it, she stated to me that the Bureau of Labor in its statistics, it collects its indices so that it compares prices with what is *alled* "an equal basket of goods", and so forth.

In a case like this the Bureau of Statistics might eliminate the price increase because of the quality—because the quality would not be the same—

Q. Wait a moment. Quality does not have anything to do with the price we pay on insurance, what we are concerned with here. What we are concerned with is the increase and not the quality; isn't that correct?

A. We are very much concerned with quality.

Q. Where do you indicate the quality in the policy?

A. It does not have to be stated in the policy.

Q. The only thing you have referred to is paid claims cost?

A. Yes.

page 480 } Q. It does not have anything to do with quality?

A. It certainly does. If I have—

Mr. Shadoan: I didn't ask you that.
Mr. Moncure: Wait a minute. Let him finish his answer.
Mr. Shadoan: I am sorry. Go ahead.

A. For instance, I have two cars and on one, which is an older car, I have a straight windshield, straight across, and on the other one a modern car with a wrap around windshield. Both serve the same purpose, but one is a better quality than the other.

So the Bureau of Labor statistics eliminates these quality indices from its data and the Rating Bureau bases its case on something higher.

Q. You mean the Labor Department puts out statistical information on this matter as if they were dealing with 1950 windshields?

A. It certainly does. That is one of the *of the* things pointed out. That the Labor Department bases its in-
page 481 } dices higher and the cost index is over-stated.

Philipp K. Stern

Q. I don't think I have been unfair, but am I correct that you don't feel that the Bureau of Labor's index is correct or applicable?

A. I have said that some of the Bureau's statistics are applicable but they differ in application.

Q. What reference do you have that causes you to make that statement?

A. You gave me this letter which says that automobile prices did not change, and in connection with that, you asked me what effect the excise tax had on the manner in which the Bureau of Labor statistics calculated its taxes, that it has not changed the effect, and I will offer some evidence to show—

Q. I am going to let you offer it later.

A. What is the date of that letter?

Q. May 16th, 1967.

A. This is signed by Mr. Arnold E. Chase.

Q. Assistant Commissioner?

page 482 } A. Assistant Commissioner of the Bureau.

Q. And, after reading this letter, you found out from Miss Walker that there was a letter from Commissioner Ross to you. Do you know how you got that? Was that in response to an inquiry?

A. Yes. The Research Department wrote to Senators Kennedy and Chase, who had said that the influence of the tax had not trickled down in—

Q. What was the inquiry?

A. I don't know.

Q. You don't know what your Research Department informed them?

A. I gave as much information as I could to our Research Department and they wrote these two senators and the inquiry was referred to the Secretary and it went through the departments and finally got to the Bureau of Labor Statistics.

Q. Assuming the letter that was referred to you—referred to you you might say by third hand—and it says what you say it does, do you let such information stand on

page 483 } the same footing as a letter that comes from the Statistical Department of the Bureau of Labor in answer to a letter to that Department that says: "This is what we want to know"? Do you think its validity is on the same basis?

A. It has the same validity, or more validity. I would like to say—

Q. You did not answer my question.

Mr. Moncure: Let the witness finish his answer, please.
Mr. Shadoan: I am sorry. Go ahead.

A. I was trying to tell you—you had been asking me about what I had in my bag—

Q. I am not interested now in what you have in your bag. Let me tell you that my last question to you will be: "Do you have anything further in your bag to support your application?" and you can then answer that, but I want you to answer now the question I am asking you.

Have you not just testified that your information is the result of some political speeches, or some letter
page 484 } that these Senators wrote to the White House or to the Commissioner of Labor; isn't that what you are saying?

A. No.

Q. If you wanted information, why did you not write the Department of Labor instead of these two senators?

A. Because these two senators indicated that they had some information.

Q. Now, aside from the conversation that Miss Walker had with the Research Department, what basis do you have for saying that the information now before you is not reliable?

Mr. Moncure: If the Commission please, this is not being fair with the witness. He has answered the question—

Mr. Shadoan: But I want the witness to answer my direct question.

Mr. Moncure: Will you please let me finish my objection.

Commissioner Dillon: Let him get his objection in the record.

Mr. Moncure: The question wants the witness
page 485 } to read into this letter, Exhibit 26, something that is not there. The letter is nothing but an index of previous data and it is absolutely silent as to what things were taken into account, and I say he is arguing with the witness and trying to get him to state that this is more valid.

Commissioner Dillon: He said that he did not think it was as valid.

Mr. Moncure: He said that—

Commissioner Dillon: He made the statement that he thought it was not more valid.

A. My statement is that, based on a review of the numerous pamphlets I receive from the Bureau of Statistics of the

Labor Department—for example, there is one article published in the technical notes as to automobile prices on different models, and states after the initial statement:

page 486 } "Generally, annual prices for 1966 models are higher than 1965 models generally. . . ." and so on—

and then it gives all the extra adjustments that have been made. "Each price has been adjusted for additional features and quality movements. So introductory prices for 1966 automobiles were lower on the average than those of 1965—when taking into account the recent downward trend, the new car prices continue.

That was written by Miss Margaret Stoltz, and indicates that this basis of the Bureau of Labor statistics is in error.

Q. May I ask you one question about that article. What is the process of logic by which you equate the prices of new cars with the automobile index you say is invalid?

A. The adjustment for new parts. For taking individual parts of automobiles, and eliminating each of them, and every part is adjusted for quality improvement.

Q. Did you not read that the prices on new cars are lower?

page 487 } A. No, they are higher.

Q. What did you say, that after adjustments are made, the prices are lower?

A. Yes, but I say that insurance companies cannot accept that because they are paying for something different.

Q. What you are saying is that this article which says the prices of new cars are lower, proves that the automobile cost index is wrong when it says there is no increase? Is that what you are saying?

A. No, I will go through that again.

Q. What else do you have to show that the Department of Labor's index is wrong?

A. I did not say it was wrong. I said it measured something different from what insurance companies have to pay for. That indices measures something that they have to pay for, but insurance companies have to pay for more than that, they pay for more pleasure, and if the cars are damaged, the insurance companies have to pay for a great deal more than that.

Mr. Shadoan: I would like to offer this as the
page 488 } next exhibit.

Commissioner Dillon: It will be received as Exhibit No. 27.

Mr. Shadoan

Q. I have before me what has been marked "Exhibit No. 27, which appears to be a copy of a letter, dated April 25th, 1967, signed by Mr. T. Gryson Maddrea, and reads as follows:

"Department of Labor,
Statistical Division,
Washington, D. C.

"Gentlemen:

"Will you please forward me a copy of the automobile repair cost index for 1965 and 1966?

"I am particularly interested in the effect of the repeal of the eight per cent Federal excise tax on new car automobile parts which was effective January 1, 1966. I want to know if this effected any reduction particularly in Virginia.

"In case the 1966 index is not available, could
page 489 } you give me some information on this subject
from your preliminary figures?"

I will ask you if you have addressed any such letter similar to this to the Department of Labor?

A. No, I don't ask for ready-made answers. I asked for source material and got it.

Q. And you got it?

A. Yes.

Q. Would you indicate to me what your inquiries were and when they were made?

A. All right. I will give you that. I have only a superficial knowledge of the meetings of the Statistical Department.

Q. I am not asking you what your knowledge is. I am asking you what different inquiries were made. Can you give us that please?

A. Yes. I put together a long term comparison of various cost indices—

Q. I am not asking you about what you put together—I am asking you about your inquiries. Could you give us that answer please?

Philipp K. Stern

A. I called on the telephone and asked for a
page 490 } technician who could answer some questions about
an apparently nonsensical answer I had received
from making a long term investigation of industry.

Q. Were there any written inquiries?

A. No. I talked to the first young technician and she said "That is a difficult question to answer. I will have to refer it to somebody else." I asked the next person and that person gave me the same answer that it was difficult to answer. "May I have the supervisor of our New York Bureau call you back?" And the supervisor did call me back the same day and I had a telephone conversation with her about the meaning of the consumers' price index in relation to actual costs, and she sent me this material which was picked up by messenger.

Q. Let me ask you this—do you regard the inquiry on the Exhibit No. 27, is it—

Commissioner Catterall: Yes.

Mr. Shadoan: —is ambiguous?

A. It is not ambiguous, but the person an-
page 491 } swered, answered it to you in the context of his
work, his way of measuring prices, which is quite
different from the way we, you and I and everybody else
usually pay for prices.

For example, if you look at the Bureau of Labor Statistics index, you will find that automobiles today only cost about one hundred and thirty per cent more than in 1936. In 1936 you could buy a new Ford for six hundred dollars, and the Bureau of Labor Statistics index tells you today you can buy this Ford, a 1935 or 1936 Ford, for about fifteen hundred dollars, and that is after successively eliminating the improvements in quality.

Commissioner Catterall: You mean a Ford today is as good as a Cadillac was thirty years ago?

A. That's about what it adds up to.

Commissioner Catterall: I won't ask you for the exact difference.

A. Yes, Sir.

Senator Howell: If Your Honor please, it costs
page 492 } five thousand dollars for a Model A, but that
doesn't have anything to do with it.

Philipp K. Stern

Commissioner Catterall: No, but the witness has given the same answer ten times, and I don't think he can make it any clearer. If we are going to compare products over the years, you've got to compare the present product without the present improvements.

Mr. Shadoan

Q. You mean to tell me, Sir, that when I have a letter that says,

"I am particularly interested in the effect of the repeal of the 8% Federal excise tax on new car automobile parts"

that the Bureau of Labor Statistics through its Assistant Commissioner gives me an answer that is invalid without even qualifying it? That's your testimony, isn't it?

page 493 } A. I did not say that. I said it is valid in the context of his way of measuring prices. It is not valid in the context of our work here, and that is to determine what the cost will be of replacing damage of destroyed automobiles.

Q. And your conclusion is based upon telephone calls, no written communications—

A. No, no.

Q. —and no written memoranda?

A. No. My information is based on reading material put out by the Bureau of Labor Statistics.

Q. There has been this reading you have sort of absorbed, and after absorbing it, you have reached a conclusion that it has never been reduced to a memorandum; is that right?

A. No, it has not, except—

Q. Except in the filing which asks for a sixteen per cent increase.

page 494 } Senator Howell: I rise to ask the Commission if it has any observations to make regarding the informality of the marshaling of statistics as demonstrated by this witness. I am sure Judge Catterall has something on his mind.

Commissioner Catterall: Well, I assume that his statistics are based on the actual payments that have been made.

Senator Howell: No, he is projecting this.

Commissioner Catterall: Well, he has one of these scale models, you know, that doesn't look—

Senator Howell: That's what concerns me.

Mr. Shadoan: I believe that I tried to cover that with respect to the trend factor that did not take into account the elimination of the excise tax.

Commissioner Catterall: Of course, the insurance companies under liability are paying the injured party whatever his lawyer can settle for; and it seems to me that what you are talking about here might be relevant to the
page 495 } property damage not in this case, but in a comprehensive or collision case.

Senator Howell: Mr. Commissioner, have you ever made an inquiry as to how many people with a claim never go to see a lawyer? Would it surprise you to know that eighty-five per cent of the claimants never consult an attorney?

Commissioner Catterall: Well, maybe the insurance companies beat them down.

Senator Howell: Well, they do *bea* them down to a pulp with this five per cent on profits.

Commissioner Catterall: These figures that the filings are based on are the actual *figuress* that result from this beating up process or beating down process.

Mr. Shadoan: Well, if the—

Commissioner Catterall: Well, what he says about the—

Mr. Shadoan: These statistics are 1965 statistics. I don't think I would be making a false statement. I know
page 496 } I am not going to file a brief. They are 1965 statistics before the elimination of the tax. The trend factor computation he has said does not take into account the tax. The Department of Labor Statistics say that the prices are not increasing twelve per cent. He does not agree with that.

Mr. Moncure: That's not what he said.

Commissioner Catterall: He said ten times—

Mr. Shadoan: Why he doesn't agree with it.

Commissioner Catterall: Why he doesn't agree with it, yes.

Mr. Shadoan: I am sure there would be some other reasons if he testifies again tomorrow.

Q. What else do you have in your bag that you want to produce now to support the application?
page 497 } A. I think that is too sweeping a question, Mr. Shadoan. I can't answer that.

Q. Well, a few moments ago when you were not answering my questions at all, you were pulling things out of the bag.

Commissioner Dillon: Well, let's assume that if he does have anything else that Mr. Moncure will introduce it to us?

Mr. Shadoan: No, Sir. I was just thinking that if he brought them out now, I wouldn't have to re-cross, but that is fine.

Mr. Moncure: If Your Honors please, I have two exhibits I wanted to put in when he first started. I will file them now.

Senator Howell: They are not in the bag.

Commissioner Dillon: You want to file your exhibits now?

Mr. Moncure: I want to file these two exhibits. The first one is a letter addressed to Mr. Hazelwood of the Commission, dated May 5th, filing at the request of

page 498 } the Commission certain statistical data supporting this filing.

And the next one is a letter of similar nature filing requested statistical data dated May 9, 1967, which is part and parcel of this filing; but I want them as exhibits, so they will have to be duplicated and photostats made for the record.

Commissioner Dillon: They are Exhibits Nos. 28 and 29.

Mr. Moncure: Now, I have just one or two questions I want to ask Mr. Stern if nobody—You want to examine him?

Senator Howell: Yes, Sir.

Mr. Moncure: I thought you all were through with him.

Senator Howell: Mr. Shadoan is through with him, but he can put his feet off the desk. We are just beginning to strike.

Commissioner Dillon: All right. You may pro-

page 499 } ceed if you all can decide who is going to start.

Senator Howell: Mr. Sacks is going to start and I'm going to continue until Mr. Allen gets back, and then Mr. Moss.

Commissioner Dillon: You want us to wait until Mr. Mann comes back too?

Senator Howell: We want all the help we can get.

Mr. Sacks: I don't think he will be here by that time. If he comes in, we might ask him.

Commissioner Dillon: All right, go ahead.

Mr. Sacks: All right, Sir.

CROSS EXAMINATION

By Mr. Sacks

Q. Mr. Stern, I believe you testified to the effect that as relates to expense items that if there were an expense item that was especially applicable to Virginia, you would have that expense item; is that correct?

page 500 } A. Yes, I do.

Q. And am I correct in inferring from that in the rate-making process in which we are interested that specially applicable expenses to the State of Virginia are relevant to this inquiry? Expenses pertaining to the State of Virginia are relevant, are they not, in this inquiry?

A. Only those especially applicable to the State of Virginia.

Q. That is what I say, but will you agree that if generally, to begin with, that if they are expenses that are specially applicable to Virginia, they are relevant in this *proeding?*

A. It is very difficult to answer this question. *Your* started sentences with "generally", and you put in the word "specially" in there—

Q. Well, I—

A. It is a contradiction, and I can't possibly answer "Yes" or "No".

Q. No. Well, I don't mean for it to be. What

page 501 } I mean is, instead of talking about special expenses, specific expenses, I am talking about the general proposition. You agree that, generally speaking, if we can determine that there are expenses that are specially applicable to Virginia, that is something which this Commission ought to have the benefit of in ruling on any rate increase; isn't that true? I'm not asking—

A. Well, I assume I understand your question. I would say "Yes".

Q. All right, Sir. So what all of us, no matter what side we are on, that is, the insurance companies or industry side or the side of the motorists, what we ought to try to do is to eliminate this issue, is to see are there any specially applicable expenses that can be determined. You will agree with that, won't you?

A. Yes.

Q. All right, Sir. Now, the expenses that we as Interveners can examine are found, are they not, and I would direct your attention to page 7 of your testimony that was

page 502 } filed before the hearing, the second paragraph.

You say there in the second paragraph:

"The expense provisions in the rates are set forth on Sheet 11 of Exhibit A.:

Now, starting there, Sheet 11 of Exhibit A, that is the por-

tion of the supporting information with the filing that pertains to expenses; is that correct? Sheet 11 of Exhibit A.

A. That is information, yes.

Q. All right, Sir. That's one place you are talking about expenses?

A. Yes, Sir.

Q. In addition, you say:

" "In addition to the expense items supported by the review of the Insurance Expense Exhibit they include the usual budgetary provisions for production cost allowance and for taxes, and a margin of 5% for underwriting profit and contingencies."

page 503 } Well, now, am I correct in assuming that Sheet 1, Exhibit A, and the insurance expense exhibits for the various companies of which I happen to hold up, one of the London and Lancashire Company, Limited, one of the Royal Globe Insurance Group, this is where we look to expenses in this particular rate filing; am I not right?

A. You are right except that we do not look at individual company insurance expense exhibits. We review a compilation which we submitted to the Department in the letter dated April 21, 1967, and I read from that letter yesterday, from that exhibit.

Q. Well, what do you mean by—is that what you mean when you say "Review of the Insurance Expense Exhibit"?

A. That is correct, yes.

Q. But is that a summation or totalling of the individual companies?

A. It is a compilation of all member companies' supplemental data from the insurance expense exhibit.

page 504 } Q. All right, Sir. Well, now, Mr. Stern, do I read the insurance expense exhibit correctly that, and I only address myself to two of these items, that advertising costs of an insurance company are included in acquisition expenses or production expenses; is that correct? Maybe you need the form.

A. I have a copy of it here.

Q. I assume it is the same—

A. It is—

Q. Under Part I, Allocation to Expense Group, then you have Column (2)—

A. Yes.

Q. —under Other Underwriting Expenses?

A. Yes.

Q. Now, coming down to Number (4), Advertising, in this particular one that I have of London and Lancashire almost half a million dollars. Now, I ask you, Mr. Stern, am I reading that correctly that when we have been talking

page 505 } about production cost here, and the twenty per cent, and what is production cost and what is not production cost, advertising expenses of an insurance company are included within that production cost?

A. Advertising to promote production would be in that category.

Q. All right, Sir. Well—well, now, what other kind of advertising is there?

Mr. Sacks: That's what I want to know.

Commissioner Dillon: Well, they have the comic strip.

Mr. Sacks: I was going to get to that, Commissioner.

Q. What I want to know is—you are familiar with the form —is there any other kind of advertising cost charged in any other manner than as production cost?

A. I don't think there is any other company advertising in any other category.

Q. Now, Mr. Stern, do you know as Actuarial

page 506 } Manager, I think we said you were, of the Bureau, do you know of your own knowledge of any advertising campaign that was waged here in Virginia by the insurance companies prior to these hearings?

A. I wouldn't call it a campaign waged, I would say there were a few informative advertisements in the newspapers, yes.

Q. Well, it depends on how you look at it, but what I call a "campaign waged", you call "informative advertisements". But then you are following me and you are aware of the fact that some advertising was conducted in Virginia prior to these very hearings?

A. Yes.

Q. Am I right?

A. Yes.

Q. Now, you helped prepare those advertisements, didn't you?

A. I think I was asked to check one or two figures, yes.

Q. Well, you did more than that, didn't you?

page 507 } Didn't you for the National Bureau, Mr. Stern, supply information that was included in those

half-page newspaper advertisements that appeared all over Virginia before these Commissioners have to rule on whether or not you are entitled to a rate increase?

A. Mr. Sacks, I don't do everything in the National Bureau. There are many other people *tht* do many things. I only checked a couple of numbers.

Q. A couple of the numbers? We've seen a couple of those *numers* here today but the one I show you that I happen to have here appeared in the Richmond Times Dispatch on Tuesday, April 25, 1967, entitled "A Frank Discussion of Your Automobile Insurance Rates" and so forth and so on, you are familiar with that advertisement, aren't you?

A. Yes.

Q. And you are familiar with that part about "New Rates For Virginia", are you not?

A. I have read it, and I suppose I'm familiar with it, yes.

page 508 } Q. Well, did you help prepare some of that?

A. I told you I only checked a couple of numbers which appeared in some of these items.

Q. All right, Sir. Now, Mr. Stern—

Commissioner Catterall: The figures, the statistics.

Mr. Sacks

Q. You checked over the statistics which appear in there, didn't you?

A. Some of them, yes.

Q. And you used the National Bureau of Casualty Underwriters' time and facilities to complement or to help make up this advertisement, didn't you?

A. To the extent that I checked a couple of numbers.

Q. All right, Sir, a couple of numbers when you said in this advertisement that "on the average, the new rates proposed will not increase the car insurance costs of Virginia drivers by more than $6.32 a year for liability insurance

page 509 } and 54 cents a year for comprehensive and collision insurance" you—

A. I checked the first number. The second number I didn't check.

Q. All right. Now, did you check any other statistics that had to do with Virginia and supply them for this advertisement?

A. In fact, I don't think I did. I don't think there were any others which involved me.

Philipp K. Stern

Q. Now, Mr. Stern, did not the member and subscriber companies of your organization who are coming here and asking that the Virginia motorists pay an increase in their automobile liability insurance, didn't they in effect pay for this advertisement which is nothing in the world but an attempt on the Bureau's part to clear the way for an increase of the motorists' rates?

A. Do you want me to answer both questions or only one?

Q. Well, answer one at a time, if you can. I'm
page 510 } sorry if I don't question you artfully, Mr. Stern, but—

A. I'm not criticizing you.

Q. Well, I don't mean to give you a double question, Mr. Stern, but—

A. I have to give right answers.

Q. —but I'll tell you what's bothering me. In this maze of figures where the half million dollars in advertising appears as a production cost for one of your member companies and where you are here again for the fourth time in five years asking for the Virginians to pay more, it appears to me that part of the cost of what appears to be propaganda is assessed against the Virginia motorists. Now, can you tell me if I am right or wrong in my assessment of that?

A. I think in effect you are wrong, factually and philosophically.

Commissioner Catterall: Louder, please.

A. (Continued) Number One—I said I think Mr. Sacks is wrong, factually and philosophically.

page 511 } I take the second point up first. You included in your question a statement and you referred to propaganda. I don't think it is propaganda. I think it is a matter of communications. Everybody has the right to communications and free speech. It so happens that in our society communications cost some money.

So there's nothing wrong with somebody going before any group of people and explaining what he is going to do.

On the factual part of your statement, on the first part of your statement, these advertisements were placed by a larger group of companies, an organized group of stock companies, larger than the members and subscribers of the National Bureau; and these companies paid for these advertisements through the assessments they have to pay to their organiza-

tions; and the cost for that assessment does not go into the category the functional group of acquisition, future provision and collection expense. It goes into a category
page 512 } "Boards and Bureaus", which is Category Number Five, and you will notice that the Item 5 in Part I of the insurance expense exhibit is functionally allocated to general expenses, and not to acquisition cost.

Mr. Sacks

Q. Well, Mr. Stern, taking those up in reverse order, first of all, my understanding is that you say it isn't charged as advertising cost, that it is charged as "Boards, Bureaus and Associations", which is general expense?

A. Yes.

Q. All right, Sir. Now, do you know that as a fact, I mean you are at the Bureau, do you know that the individual companies charge it that way?

A. Yes, I do.

Q. All right. But the Commission and the Interveners and anybody here, we really have to accept that; we have no way of—

A. No, you don't.

Q. What's the check on that? That's what I want to know.

page 513 } A. There is a set of regulations generally referred to as "Regulation 30 of the Uniform System of Accounts". That regulation is by now a thick book of rules and interpretations, and that tells the companies exactly where to put any item of expense, and anybody who wants to check on that, for example, examiners of insurance departments very carefully check that this is allocated the way I explain it.

Q. All right, Sir. Then, if it is done properly, it isn't charged as an advertising expense, it is charged as a general expense? Is that correct?

A. As long as it can be done properly.

Q. Well, now, Mr. Stern, isn't that just as true that the motorist is paying for that as a general expense because there is an allocation of the premium dollar for general expense?

A. Of course. Everybody is paying for all expenses.

Q. Well, that's—

page 514 } A. You are paying for—when you buy soap, you are paying for the commercials and for the entertainment you get.

Q. Well, then, you agree with me that my suspicion was

right, the policyholder, the motorist, is being charged in his premium for these advertisements that you put on in Virginia to try to get his rates raised?

A. Well, now, yes. The answer is "Yes", but not—

The assessment for Bureaus and Boards of the Companies is approximately one-tenth of one per cent of premium. The cost of these ads is infinitesimal in comparison to the total cost.

Q. But are you saying, you brought in philosophy, are you saying that it is morally right to charge the Virginia motorist something that he ought not to be paying just because it is actuarially or statistically, it's a small part?

A. Well, who decides what is morally right in this case?

page 515 } Q. Well, I understand. Do you agree that, do you advocate that the motorists ought to be paying for these advertisements?

A. Yes. I am paying for lots of advertising when I buy goods and services. We all pay for it.

Q. Well, who—

A. If this were a misleading ad, I would say I would have some more impressions about it; but if it is true, it is an exercise of free speech. Why shouldn't it be done?

Q. But, Mr. Stern, isn't it everything that it obviously purports to be, a move before the rate increase to change the climate in Virginia or maybe to even influence the Commission?

Commissioner Dillon: I didn't even see it.

Mr. Moncure: Now, if Your Honors please, I object to that type of question. There is enough of it.

Mr. Sacks: Well, I did—

page 516 } Mr. Moncure: I urge a truthful statement of what the proposed increases cost the public at so much a head.

Senator Howell: Is he objecting, Your Honor?

Mr. Moncure: It is not so. It is not pertinent in this case, and I object to any further questions along that line.

Commissioner Dillon: We have heard enough on that.

Mr. Moncure: We have had enough of them today.

Commissioner Dillon: I personally have never seen one.

Mr. Sacks: Well, I don't say you have, Your Honor, but I'm saying this, that he has agreed that the motorist is paying for it.

Philipp K. Stern

Commissioner Dillon: That is all you need.

Senator Howell: Judge Catterall saw it.

page 517 } Commissioner Catterall: I saw it, and I can take judicial notice that when I buy cigarettes or soap or gasoline, I have to pay part of the cost of those wretched billboards along the highways.

Mr. Sacks: To sell them; to sell them, and I am not asking, Your Honor, about their advertising to sell the policies, when they talk about "You are safe, you are in good hands", I'm not asking about that. I'm asking him about these things that appeared all over Virginia before they came here to ask for the rate increase.

Commissioner Dillon: Well, I think he has admitted that it would take more, and that's enough.

Mr. Sacks: All right, Sir.

Q. Well, may I ask him this? How much was spent, Mr.—see, it pertains only to Virginia, and you and I were talking about expenses that can be ascertained for Virginia *lone,* and you said that they are relevant. Now, how

page 518 } much was spent for these ads in Virginia?

A. I don't know.

Q. Can we find out? You helped prepare them.

A. We could find out.

Q. Well, how long would it take us to find out how much these advertisements cost for Virginia?

Mr. Moncure: Gentlemen, it is not in the rates. It's not taken into account here. It is out the budgetary portion of it. What difference does it make? If it's our money we spent—

Commissioner Catterall: I would like to make one observation namely, that if they should fail to make this five per cent we have been talking about or any part thereof, it would come out of the stockholders.

Mr. Shadoan: Except for those subscribers of the mutual companies.

Mr. Moncure: The point is, it isn't computed

page 519 } in the rates in the loss portion.

Commissioner Catterall: This doesn't cover mutuals; this is all stock companies.

Mr. Shadoan: Well, they have subscribers that are mutual companies, Commissioner Catterall.

Commissioner Catterall: Oh. Well, maybe they ought to have part of their dues back.

Mr. Shadoan: Yes, Sir, I think they should too.

3:00 P.M. Commissioner Dillon: The Commission will recess for five minutes.

3:10 P.M. The Commission resumes its session.

Mr. Sacks

Q. Mr. Stern, I think I was asking you about the cost of these advertisements that had appeared in Virginia and which are, of course, expenses that are especially ap-
page 520 } plicable to Virginia; and I think you had said you did not have the information yourself as to the total cost of all these advertisements in Virginia. Did you say that, Sir?

A. That's right.

Q. All right, Sir. Now, do you or anybody from the Bureau here today have that information with them?

A. No.

Q. Isn't it something that can be readily obtained in a matter of the next few days, maybe even a phone call?

A. I told you this was not an endeavor of the National Bureau.

Q. I understand, but well why did the National Bureau, then why did you help prepare the advertisements?

A. Because it referred to work I have done.

Q. All right, Sir. Now—

A. I did not prepare it, I helped the advertis-
page 521 } ing. I checked, as I told you, one or two numbers.

Q. Well—

Commissioner Dillon: Let me ask one question and see if I can clear up this a little bit.

These advertisements, I understand, that, while I didn't see them and wouldn't have read them if I had seen them, appeared recently; is that right?

Mr. Sacks: They did, Sir.

Commissioner Dillon: And would those figures have been sent to the Bureau by this time?

A. No.

Commissioner Dillon: So the Bureau would have no way in the world of knowing the cost?

Chairman Hooker: They could get them from the Times Dispatch, I reckon, couldn't they?

page 522 } Mr. Sacks: Well, Your Honor, they appeared in every newspaper, I think, in Virginia.

Senator Howell: And Virginia weeklies.

Mr. Sacks: It's not just, and I think I would agree that it may be infinitesimal, comparatively speaking, but they appeared in the morning papers and night papers all over the State of Virginia, and it appeared more than one time; and I think the cost is getting into something that grew, that ought to be recognized. These half-page ads run into money, and I think they ought to be.

The witness has said before in this hearing that, if there was an expense, that it was in Virginia alone, and this is one that would have a bearing on the inquiry.

Commissioner Catterall: He also said it wasn't spent by Virginia companies alone. He said it came out of the treasury of some big association that's even bigger than the Bureau that is here today.

page 523 } Mr. Sacks: I understand, Your Honor—

Commissioner Catterall: And it wouldn't have the slightest effect on the rate. It is perfectly immaterial.

Mr. Sacks: Well, if—

Commissioner Catterall: We don't forbid any Virginia company to advertise.

Mr. Sacks: I understand, and nobody says they should be forbidden to advertise.

Commissioner Catterall: It wouldn't affect anybody's premium by as much as one cent.

Mr. Sacks: Well, Your Honor may know that, but I don't know that, and the record doesn't show it.

Commissioner Catterall: I can take judicial notice of that.

Mr. Sacks: Well, I know, but if you are going to foreclose me from putting any evidence in, what is the use of having a hearing?

Commissioner Catterall: I am not foreclosing

page 524 } you. I am just giving you my views of the irrelevance of any item that adds up to one cent annually per premium.

Mr. Sacks: I would like to respectfully bring to your attention that there isn't any testimony here of what it cost, and how anybody could say that it has nothing to do with the rates, that it is not that much.

Commissioner Dillon: I don't see how in the world we could possibly get that information in this short time, even if it were material.

Philipp K. Stern

Mr. Sacks

Q. Mr. Stern, couldn't you get it with a phone call to the Insurance Information Institute with whom you have been working in order to prepare these?

A. I don't think it is any of my business to ask the Information Institute what they paid for that.

page 525 } Q. Well, if the Commission requested that you get that information, couldn't you get it by a phone call in a matter of twenty-four hours?

A. Well, I could have a phone call through in twenty-four hours. I guess if the Commission ordered me to do it, I would try to do it.

Q. You would have no objection to doing it, would you, and put it in record?

A. Yes, I do.

Q. What's your objection?

A. It is immaterial.

Q. Well, now, you are ruling on that, but—

A. No. I am not ruling. You asked me would I have any objection.

Q. But you have no personal objection; you don't mind using the phone and doing it if the Commission asks you to do it?

A. I sure do. Why should I?

page 526 } Mr. Sacks: All right, because I ask the Commission to give him reason to do it by asking him, please, to get that information. A phone call will do that, Your Honor.

A. I didn't ask Mr. Shadoan how much it cost if a labor union goes on strike, and they tell the public why the union is on strike. I think they should do it.

Mr. Sacks: That has nothing to do with a million and a quarter motorists' premiums either.

A. If it has to do with the prices that are paid for them, we would.

Mr. Sacks:

Q. Well, if you had an income less than that, I think you would be allowed to ask them.

Commissioner Dillon: I think we have spent enough time on this. I think the Commission is unaniously of the opinion that wouldn't make any difference if we feel it is

page 527 } material, but we think it is immaterial.

Mr. Sacks: All right, Sir.

Commissioner Dillon: We are not going to tell the companies how they can advertise.

Mr. Shadoan: If the Commission please, may I say just one thing, Chairman Dillon?

Commissioner Catterall said something it seems to me to be a repetition of the problem that I differ with very seriously.

One cent of the premium is twenty per cent of the provision for profit. It is not a small item and if they are spreading a penny of the premium to convince the public in Virginia that this rate increase is desirable, they are spending one-fifth of their expected profit, and that's not insignificant.

Commissioner Catterall: No, no. It's not twenty per cent. It's one cent on a premium of one hundred dollars.

page 528 } Commissioner Dillon: On a premium of one hundred and fifty dollars.

Commissioner Catterall: One cent of a premium of one hundred and fifty dollars. It's less than one cent on a premium of one hundred and fifty dollars.

Mr. Shadoan: You are not thinking of the premium dollar?

Commissioner Dillon: No.

Mr. Shadoan: I thought you were figuring the premium dollar.

Commissioner Catterall: And ad that is addressed to the public, "Listen, folks, it is only going to cost you fifty-two cents a month more, so why fuss about it?" and that is the sort of advertising you get with labor unions, with everybody, and the telephone company has the symphony on the air; and the American way of life is to advertise and we have no right to prohibit them to advertise.

page 529 } Commissioner Dillon: I don't think we can keep people out of the press.

Mr. Shadoan: Well, I was not suggesting that form, and I'm glad I clarified it, because I thought the Commission had said one per cent of the premium dollar, and I say there has been too much sluffing off of these items as not being very important.

Commissioner Dillon: It's just one cent.

Mr. Sacks: Well, Your Honor—

Commissioner Dillon: We are not going to ask them to do it.

Mr. Sacks: If everything in here was purely factual and not on one side of an adversary proceeding, I don't think we would raise it. I think they have a right to advertise to sell their policies, but when they talk about how many millions of

dollars they have lost of which there is serious
page 530 } question whether or not.

Commissioner Dillon: And there has been a lot in there about how many millions they have gained too.

Mr. Sacks: I understand that, but not by an advertisement, Your Honor.

Commissioner Dillon: But they have to advertise to get that in the paper.

Mr. Sacks: Well, let me just point this out, and then I want to ask the Commission to introduce two exhibits.

The part of this advertisement that—the Commission members say they haven't seen it.

Commissioner Dillon: I haven't seen it.

Mr. Sacks: I feel this is perfectly proper because it is just advertising, and says:

"In fact, for the last ten years the automobile industry has been paying out more for claims and operat-
page 531 } ing expenses than it has been getting in premiums."

Then they go on to talking about:

lost 343 million dollars in 1965 alone."

Now, I don't believe that they ought to be allowed to charge the motorists with increased premiums when there is another side of it; for example, Forbes Magazine of February 15th says

Fire and casualty insurance companies like to claim that they frequently lose money on the policies they write, that the only thing that keeps them in the black is what they call 'investment income.' It's an interesting argument but not a watertight one."

"How weak is the argument of hard times for the industry is nicely illustrated by the case of New York's
page 532 } big Continental Insurance Co. The record shows that Continental 'lost' $233 million in the underwriting business from 1957 to 1965. But in actual fact, Continental was busily piling up cash. Over these same nine years the company's total assets have climbed from $1.3 billion to nearly $2 billion, and its stockholders' equity has risen from $60 a share to around $100."

Now, Your Honors know what I am talking about. There is a controversy as to whether they are losing money or they are making money, and whether the accounting system—

Commissioner Dillon: Well, we agree with you on that.

Mr. Sacks: All right, Sir. Now, what we are putting into the record and asking you to determine is that they have no right to blindly charge the motorists with that

page 533 } sort of propaganda in the rates.

Commissioner Dillon: Do you want to introduce that?

Mr. Sacks: I do.

Commissioner Dillion: That will be Exhibit No. 30.

Mr. Sacks: And the one entitled "HOW TO GET RICH WHILE LOSING MONEY", "It's easy if you're in the fire and casualty business."

Commissioner Dillion: You want to introduce that?

Mr. Sacks: Yes.

Commissioner Dillon: It will be received as Exhibit No. 31.

Commissioner Catterall: Why don't you

Mr. Sacks: I don't think that it's proper. That's why we haven't done it.

Now, I just have one or two other questions I would like to put in the record, if I may.

page 534 } Mr. Sacks

Q. Mr. Stern, we have just come through discussing one item that pertains to expenses in Virginia alone, and we don't have in the record how much it is. I would ask you if you could look at the insurance expense exhibit sheet and tell me where are the lobbying expenses, the thousands and thousands of dollars that are paid by the insurance companies to lobbyists to gain favorable legislation? Where is that charged in the insurance expense exhibit; who is paying the bill?

A. If there are any people engaged in explaining to legislators what the insurance business does, it would probably be again through a trade association. The trade association would collect the necessary funds through assessments, and those funds again would appear under the item "Boards and Bureaus and Associations", which is functionally assigned to "General Expenses".

page 535 } Again I say, and I want to make it clear, what I said before, the assessment to Boards and Bureaus amounts to approximately one-tenth of one per cent premium, not one cent from every dollar, one-tenth of one per

cent, and that includes all the activities of trade associations.

Commissioner Catterall: It includes that trip to Jamaica, doesn't it?

A. If anybody wants to make it, yes.

Mr. Sacks

Q. Mr. Stern, you say if any insurance companies are paying for lobbying services, *fir* first of all, you know good and well that they do that regularly and continually, don't you, or do you say for the record there's some doubt in your mind about that?

A. No, no, I know it is done.

Q. All right, Sir. Now—

A. Everybody does it.

Q. All right, Sir. Everybody who is organized that way. Nobody is doing it for the people, are they?

page 536 } A. Well, the people are organized themselves. Everybody is doing it.

Q. Who is doing it for the motorists?

A. They have—

Commissioner Catterall: Whoever got the limit raised to forty thousand dollars is doing it.

Mr. Moss: Well, that's the whole Legislature, Your Honor.

Commissioner Catterall: Well—

Mr. Sacks: There wasn't any lobbying for it.

Commissioner Catterall: They didn't need any lobbying for that.

Senator Howell: The insurance industry agreed on that, Judge.

Commissioner Catterall: Did they consent to that?

Senator Howell: Yes; in order not to get to fifty, they agreed to a five thousand increase.

Commissioner Catterall: So that was how we

page 537 } got the forty, and not fifty in the tax here.

Senator Howell: They were very happy just to raise it five.

Commissioner Dillon: Well, who put the fifty in?

Senator Howell: Mr. Lyman Howell, one of the great stabling influences in the House of Delegates, a Democrat, of Emporia, Virginia.

Commissioner Dillon: A very fine young man.

Senator Howell: Very fine.

Mr. Sacks

Q. Mr. Stern, when you say that, if they are doing *sny obbying,* it is done through memberships in Boards, Bureaus and Associations, you are not stating as a fact that some companies don't pay their lobbyists directly? It's not always done through association membership, is it?

A. I really don't know.

page 538 } Q. You don't know that? All right, Sir. Now, do you have figures with you or does anyone with you from the National Bureau as to what was paid in Virginia for lobbying which would be an expense, applicable to Virginia alone, of course?

A. No.

Commissioner Catterall: Can't you get all that up at the Secretary of State's office?

Mr. Sacks: I'm asking Mr. Stern if he has it.

Q. Has an attempt been made to get that?

A. No.

Q. So what did you mean when you said that if there was an expense paid that was specially applicable to Virginia it would be relevant to this hearing? Isn't that exact to such extent?

A. I think I went through that yesterday and explained to you that depending upon the organization of the

page 539 } insurance company, certain general administration expenses are functions that are carried out in home offices, branch offices, and so forth, and billed to various offices, and it's very difficult to keep these things separately by State, and sometimes utterly impossible.

Commissioner Catterall: What did you have in mind when you said *seom* were especially applicable to Virginia?

A. Particularly on tax assessments—

Commissioner Dillon: Premium tax and assessments, and where are the other items?

A. Well, for example, uninsured motorists fund in some States, but they have that amount.

Commissioner Dillon: But there's five per cent administration countrywide?

A. That's right.

Commissioner Dillon: And that's where this is paid from?

A. Yes, Sir.

Commissioner Dillon: Five point some per cent?

page 540 } A. That will do—one-tenth of one per cent is approximately.

Mr. Sacks

Q. Mr. Stern, just a few more now, and I'll be finished with you and pass you on to Senator Howell. I thought you might be interested in knowing that.

Then it is true, is it not, that if the lobbying expenses for the insurance companies is included in general expense that the policyholder of a company is paying some of the costs of the lobbying, isn't he?

A. Yes.

Q. All right. Now, the one that I happen to have in my hand, again one of the Royal Globe Companies, shows that the figure for Boards, Bureaus and Associations, that is with lobbying, and that includes the advertising that we speak of, is three million, five hundred and forty-five thousand, eight hundred and twenty dollars, there and a half million dollars by that one company, which includes just for

page 541 } Boards and Associations, which includes just for lobbying and advertising, now can you tell me what the nationwide figure is, the total spent for Boards, Bureaus and Associations, of which motorists are paying a portion?

A. No, I can't tell you that. I don't have that figure.

Q. You don't have that information?

A. No, but I want to make it clear,—the way you asked the question you left the impression that this item "Boards, Bureaus and Associations" is lobbying and advertising. That is not true. There are many other functions included, including my sitting here and other members of the staff coming here, and spending eleven days in Virginia last year, and so on.

Q. I understand.

A. All that is included in this.

Q. But the advertising and lobbying expenses are included in that?

A. It is included in that. I am still saying it is an infinitesimal amount.

page 542 } Q. But you can't tell us what it is?

A. No, I can't.

Q. And this Commission or the Interveners or nobody else can find out how much it is from anything that's filed here

with your filing? We just don't have that information in a record, do we?

A. You don't have it because it is

Q. And it's irrelevant in your opinion and that's why you didn't bring it?

A. It is *ireelevant* and has been so considered in many, many years of rate-making in all States.

Q. Yes, Sir. So that seems to characterize just about everything, that because it has always been done in a certain way, that's the reason why you believe it should continue to be done that way?

A. No, that is not true.

Whenever it is necessary to change, we are responsive to change, and we do so.

page 543 } Mr. Sacks: All right.

Commissioner Dillon: All right, Senator Howell, do you want to cross examine?

CROSS EXAMINATION

By Senator Howell

Q. Mr. Stern, would you turn to Sheet 4 of your Exhibit A, the third column, second line, referring to the Norfolk Territory? Would you give me a lay explanation of what the sixty-one point zero eight represents?

A. Well, exactly what it states in the column heading, it is the present average rate for fifteen/thirty bodily injury coverage in Territory Two.

Q. Which is the City of Norfolk?

A. Yes.

Q. And Column (4)? Thirty-five point thirty-four?

Column (4), there, again, this is the pure premium, or the average loss cost per car for fifteen/thirty bodily

page 544 } injury coverage in Territory Two.

Q. All right, Sir. And Column (7), minus eleven point six?

A. That is the change for Territory Two produced by the usual formula distributing the Statewide record of change between Territories.

Q. And what experience was used in arriving at the fact that drivers in the Norfolk area Territory have become so safe that they are entitled to a decrease in their bodily injury premiums of eleven point six per cent?

A. That is a combination of the Territory experience compared with the Statewide experience, and the Statewide ratable change that every Territory must share.

Q. Mr. Stern, you have been here for two and a half days, and you are getting a little hard of hearing. I asked you what years.

A. Oh, I am sorry. I did not hear you ask what years.

Q. I didn't think you did. What years were used?

A. Well, it says in Column (4), 1963-1965.

page 545 } Q. So when you came here in 1965 and asked and got what amounted to a million dollars more in premium dollars, at that time Norfolk, based upon its experience, was entitled to an eleven per cent decrease in premiums?

A. Mr. Howell, you know that we have to use past experience for rate-making. We have no way of foreseeing the future in this rate of refinement.

Q. Well, my point is the imperfection of the twentieth century actuarial science, that lag required our people to pay more for premiums when, if you had had the up-to-date data we would have gotten an eleven point six decrease?

A. The same lag would occur if Norfolk drivers should get bad and should deserve an increase. It would take the same length of time to catch up and increase their rate; and that is the principle on which rate-making has to be

page 546 } based.

Q. All right, Sir. I am not accepting your answer, but I will move on to another point.

The Column (9) figure, forty-two dollars, does that represent what the Norfolk driver will have to pay for that portion of his liability policy devoted to the bodily injury factor?

A. That is the rate for the driver whose car qualified for Class 1-A.

Q. And have you got a—down in Norfolk, since ninety thousand of our people are militarily oriented and you automatically surcharge them, and about twenty per cent of our population are longshoremen, and you automatically surcharge them, can you tell us what percentage of the Norfolk drivers will enjoy this 1-A decrease in premiums?

A. I don't know of any surcharge to the people who are militarily oriented, whatever that means, and

page 547 } longshoremen. We have no such provision in our rating system.

Q. Have you ever looked at the underwriting policies that

these agents that are supposed to get these commissions go by?

A. No. You know that these policies—these underwriting standards are not publicized.

Q. Well, did you look at the Appendix which was a partial revelation of some of the discriminatory practices of the underwriters? Mr. Harris' Appendix A to the Investigatory Report of the Commission that was completed on March 17th?

A. I have read it, yes.

Q. Did you see what he said about military personnel?

A. I think I remember it.

Q. And would you agree that not one per cent of the military personnel in Norfolk get in a 1-A bracket?

A. I don't know that.

Q. But you would—you don't know, but you would agree that it is a minority of the military that are able

page 548 } to buy a 1-A rated policy?

A. No, I don't.

Q. You don't know that. As a matter of fact, you don't know anything about the underwriting and the selling of the policies?

A. That is correct.

Q. All right, Sir. Now, are we to attribute any significance to Column (9) when it says "10/20 1A Rate" when we compare it to Column (3) which is "$15,000/$30,000 Limits"? Do we need to adjust by any lawful factor or trend?

A. No.

Q. In other words—

A. Column (9) shows the rate that will be printed in the Manual for Class 1-A for ten/twenty bodily injury limits coverage.

Q. Now, have you computed in this rate hearing what is going to happen to the 1-B people? How much decrease are they going to get in the Norfolk Territory?

A. I have an exhibit here.

page 549 } Q. Is that Sheet 6 of Exhibit A?

A. The actual rate is calculated from the table on Sheet 6 of Exhibit A.

Q. All right, Sir. Do you have the computation in dollars and cents because that is what my people are interested in?

A. Yes. I have an exhibit on that.

Senator Howell: George, that was in the bag.

Q. If you have an extra copy, I would appreciate having it.

A. Yes, I think I do.

Q. Give us two because we want one to go in the evidence, in all probability.

NOTE: Papers handed Senator Howell.

Commissioner Catterall: Which is Norfolk, Number Two?

Senator Howell: Yes, Territory Two.

Commissioner Catterall: Territory Two, a dollar's difference.

page 550 } Senator Howell

Q. Now, Mr. Stern, this is primarily for information purposes. I notice there is a dollar difference in the 1-A Class—you have a present rate of eighty-four dollars, and you are proposing eighty-one dollars, and they will only save three dollars. Is that an accurate deduction of those figures appearing in those three columns? Better have one, Judge.

Commissioner Dillon: Do you want to introduce this?

Senator Howell: Yes, I want you to have one.

Commissioner Dillon: Well, I'll take one, but do you want to introduce it as an exhibit?

Senator Howell: I am introducing it now. I think it involves the new math, and I'm not very familiar with it.

Commissioner Dillon: All right. It will be received as Exhibit No. 32.

page 551 } Senator Howell

Q. Is that a fair deduction, Mr. Stern? In other words, does one from four still leave three?

A. It says so on the exhibit.

Q. Yes, Sir. So the only dollar saving to the 1-A policyholder is three dollars, is that right, Sir?

A. That is correct.

Q. And 1-A is the safest, most preferential, prestigious driver that you can find in the Norfolk territory?

A. No, there are better ones.

Q. What rating do they get?

A. Farmers, they pay even less.

Q. I know, but we have a few in Dismal Swamp, but I don't

know whether they belong in the Norfolk Territory. Does Chesapeake come in the Norfolk Territory?

A. I don't know.

Q. I don't either. But the City of Norfolk, we have no farmers in the City of Norfolk, so, so far as the

page 552 } City of Norfolk is *concern-d,* your 1-A rating is the most preferential, prestigious and preferred risk that the National Bureau is able to find and categorize?

A. I cannot subscribe to your description.

Q. All right. Now, what is the most preferential, prestigious then, and preferred?

A. We don't subscribe to those. We have classes defined in the Manual, depending on the use of the automobile, the presence or absence of under-age drivers and another person's automobile.

Q. All right. Well, I'll move on to another question.

I want to now go back to your filing, Exhibit A, Sheet 4, in which you had the present rate of 1-A drivers at sixty-one dollars and eight cents, and for anyone it would appear that you are representing to the Commission that the rate would be forty-two dollars, and that represented a nineteen dollar and eight cent decrease; whereas, when you pull

page 553 } out of the bag Exhibit No. 32, you only have a three dollar decrease. Can you illuminate me regarding that apparent conflict?

A. Yes. If you will read this heading of that exhibit, you will understand where you are mistaken. The heading says, "Comparison of Present and Proposed Family and Basic Automobile Liability Policy Rates of the Automobile Casualty Manual 15/30/5 Limits Liability, $1,000 Medical Payments Insurance and Virginia Uninsured Motorists Coverage."

This is a comparison of the total basic premium an insured must pay in order to satisfy the basic requirements.

Q. I was hoping to get home by Flag Day, which is sometime in June, and I asked you not to give me something not related to Exhibit A, Sheet 4. I wanted to know what the 1-B and the 2-A, 2-C, 3—1-AF, 2-AF and 2-CF drivers in my City of Norfolk are going to pay. You just gave me the 1-A, the preferential plan, and I represent a lot of people

page 554 } who should be 1-A, but aren't at the present time.

A. In other words, you want to see what 1-B will pay?

Q. Yes, Sir. I want to get something to which I can relate it to Exhibit A, Sheet 4. I don't want you to be clever and give me an apple to go with a pear. I want apples to compare with apples.

Philipp K. Stern

A. All right. I will try to be helpful.

Q. Well, give me an apple then.

A. All right. If you will turn to Exhibit A, Sheet 7—I'm surprised you didn't do that before—you will find the rates for Class 1A, 1B, any class, in any Territory.

Q. That's what I was asking.

A. And all we need is the current Manual for checking the same.

Q. I don't have one.

A. And read experience in the present rates.

page 555 } Q. All right, Sir. Now, can you tell me—what I'm trying to do is on Exhibit A, Sheet 7, you have for Territory 02, which is the City of Norfolk, you have the bodily injury factor at forty-two dollars. That's the present cost, as I understand it?

A. No.

Q. No? What is it?

A. That is the revised rate.

Q. Sir?

A. That is the revised rate.

Q. That's the revised rate?

A. Yes.

Q. All right.

A. Ten/twenty limits.

Q. Well, can you give me anything for the fifteen/thirty? That's what everybody has to buy in Norfolk. I want to find the comparable figure to sixty-one dollars and eight cents which you have without saying on Exhibit A, Sheet 4, that only applies to the 1-A driver. Now, I want this Commission,

page 556 } and I know they are interested in it, at least they should be interested in it, what is it going to cost the 1-B driver? Do you know?

A. You are looking for something that doesn't make sense, and let me explain to you why.

Q. I'll determine that. Right now I want to know, do you have a figure that will tell the people of Norfolk who have a 1-B rating how much they will have to pay for the mandatory fifteen-thirty coverage?

Senator Howell: Mr. Elliott, do you have this information?

A. Forty-eight dollars plus one point zero nine.

Q. When you get through figuring, I'm going to ask you if you prepared this data for this filing?

Philipp K. Stern

Commissioner Catterall: Why doesn't Exhibit No. 32 answer the question you are asking now?

Senator Howell: Judge Catterall, I want all the help I can get, and, as a matter of fact, if you feel you can
page 557 } answer my questions, I would much prefer to direct them to you than to this witness, Sir.

Commissioner Catterall: Well, Exhibit No. 32 is the dollar amount. I was just wondering—

Senator Howell: Exhibit No. 32?

Commissioner Catterall: Yes.

Senator Howell: That's the homeowners policy. It doesn't have anything to do with what I was asking him. That's when he got me over in the pears when I am trying to compare apples.

Commissioner Catterall: Overall?

Senator Howell: Over—I mean this so-called "Family and Basic Automobile Liability Policy", whatever it is, apparently it doesn't have anything to do with the filing.

Commissioner Catterall: Isn't that what you have to have for your basic rates if you have to give financial responsibility?

Mr. Elliott: No, it's got medical payments in
page 558 } there, Judge.

Commissioner Catterall: Oh, the medical payments are what throws this out.

Mr. Elliott: Yes, Sir.

Commissioner Catterall: If you want medical payments in addition to what the law requires if you have to furnish financial responsibility; is that right?

Commissioner Dillon: And the uninsured motorists are in there too.

Commissioner Catterall: Well, you have to have that.

Commissioner Dillon: No, you don't have to have it.

Senator Howell: Judge Catterall, is it relevant or irrelevant? I would love for his Exhibit No. 32 to be relevant because then I could really get this case dismissed for erroneous filings. This is something that was in the bag that he suggested could be compared with Exhibit A, Sheet 7.

If the Commission feels it can be compared, I
page 559 } am ready to proceed on that basis.

Commissioner Catterall: Well, what is this Exhibit No. 32? I am completely baffled.

Senator Howell: It came out of the bag when I asked him to give me a sheet—

A. This is an exhibit which has been used in all prior filings

as information on the case to show the difference between present and revised rates for the coverages described in the headings.

Commissioner Catterall: Well, does it properly describe the coverages?

A. It certainly does, if one reads the headings. If he wants something else, he has to say so. What Senator Howell is looking for is a comparison of the average rate with some non-existing average rate for 1-B, and that I cannot give you.

page 560 } Senator Howell: If the Commission please, the only thing that is a part of the filing is Exhibit A, Sheet 4. It doesn't say to what category of policyholder it is applied to, but we found out that it applies only to the 1-A driver.

Now, my point is, if the Commission and if Mr. Harris will re-examine those eighteen companies that we put into evidence in the investigation, they will find that seventy-five per cent of the people in Norfolk, merely because of their occupation, because they are bulldozer operators, because they are bricklayers, longshoremen or military related do not go into 1-A. If they get written, they go into 1-B or 1-C or 4-F or 1-AF.

Commissioner Catterall: They give the 1-A, and then they have a schedule of multiplicands that you apply to it before the manual of credit.

Senator Howell: I know, but my—

Commissioner Catterall: You want the witness to do that multiplication for you.

page 561 } Senator Howell: No. My point is that I think that he is required to show, if he comes up here trying to suggest to us that he is decreasing the premium on the policy of the average Norfolkian, he's got to file what it is going to cost the various category drivers in Norfolk. He is giving us a little bit of honey, but I think when we get to the bottom it is going to get sourer and sourer, and for the average motorist in the port city of Norfolk.

Commissioner Catterall: Well, the filing has got to tell you what the rates are before they can print the Manual.

Senator Howell: I agree with you, but this filing does not.

Commissioner Catterall: And the witness says you have to multiply by one point zero nine.

Mr. Moss: He doesn't say that on the exhibit.

page 562 } Senator Howell: But, if Your Honor please, that's a part of the conspiracy of confusion.

Philipp K. Stern

Why should I have to come here with a slide rule in order to cross examine this expert from New York on what they are going to charge the people of Norfolk?

Commissioner Catterall: Well, it's all going to be printed in the Manual. He can give you—

Senator Howell: That's after they have had it; I mean, that's after they have been given the hook.

Commissioner Catterall: Well, multiply it by one point zero nine to give us the answer.

Senator Howell: All right, Sir. Well, we are going to be here until Flag Day. That's very apparent, because I can't multiply them.

Commissioner Catterall: You can't multiply it?

Senator Howell: He should have an exhibit here, really.

page 563 } Mr. Elliott: There it is all worked out, I think, Sir, in the Manual.

Mr. Moss

Q. It can't be done, can it, Mr. Stern?

A. Sure it can be done.

Senator Howell: Maybe Miss Waters can help.

A. The rate for Class 1-B in Territory Two for fifteen-thirty coverage bodily injury would be fifty-two dollars and thirty-two cents.

Senator Howell:

Q. Now, who goes in this 1-B class? They apparently are more preferential and preferred and prestigious than 1-A. You mean that will be the new rate; is that what you are saying?

A. That's correct.

Q. All right. I am with you. And what was the old rate?

A. Fifty-four times one point zero eight—I mean nine.

Commissioner Dillon: Fifty-four times one zero

page 564 } nine.

Commissioner Dillon: He said one zero eight.

A. That's right; one zero nine.

Commissioner Dillon: He said one zero eight. I was taking his word for it.

A. Fifty-eight dollars and eighty-six cents.

Commissioner Dillon: Fifty-six, how much?

A. Fifty-eight dollars and eighty-six cents.

Philipp K. Stern

Senator Howell

Q. All right, Sir. Then, in order to save time, rather than requiring you to supplement your filing by going through the seven or eight classifications, this 2-C class that you have down in Norfolk where you are charging them two hundred and thirty-five dollars, instead of sixty-one dollars and eight cents, give me the rate on a 2-C driver under—for the fifteen and thirty limits.

page 565 } A. The revised rates?

Q. The 2-C driver under the fifteen/thirty limits, Column (3), old and revised, present.

A. Let me explain it to you again. Column (3) is an average rate. It is the average of the rate that applied to Classes 1-A, 1-B, 1-C, 2-A, 2-C, and so on. You are asking me to compare an average rate with a Class rate which is part of the average. It just doesn't make sense.

Q. All right, Mr. Stern, let me ask you this. It's true that no one in Norfolk is going to get the average rate, are they?

A. Obviously not.

Q. And so it is applicable to no class of drivers in the City of Norfolk?

A. Nobody said it is.

Q. And in the State of Virginia, this Exhibit A, Sheet 4, is applicable to nobody. Is that right, Sir, for the whole State of Virginia, Culpeper to Emporia, to Lawrenceville, to Washington, and so on?

A. That is absolutely wrong.

page 566 } Q. Sir?

A. It is absolutely wrong.

Q. Well, do you mean something—I won't go any further with that. Is it possible for you to tell me what a 2-C driver is going to have to pay in Norfolk under the present and the proposed multiplication?

A. Of course it is possible.

Q. All right. Well, figure it out for me because I'm interested in that individual. He's paying more than you—

Commissioner Dillon: I might just be lucky and get the average.

Senator Howell: But nobody is going to get the average, Mr. Commissioner.

Commissioner Dillon: Is it possible that I could get the average?

Philipp K. Stern

Senator Howell: No, Sir, impossible. You are either going to be better or worse than the average.

Commissioner Dillon: Some people might hit it right on the nose.

page 567 } Senator Howell: No, Sir, you just can't do it.

Commissioner Dillon: I don't see why you can't. If you can be one dollar over or one dollar under, why can't you hit on the nose?

Senator Howell: Statistically it's one of those statistical impossibilities.

Commissioner Dillon: To me it is.

Senator Howell

Q. Are you ready?

A. Yes.

Q. All right. 2-C present rate, Norfolk?

A. 2-C present rate fifteen/thirty B. I. limits, one hundred and fifty-five dollars and eighty-seven cents; revised rate, same limits, one hundred and thirty-nine dollars and fifty-two cents.

Q. All right, Sir. Now, is it true that every class of driver in the City of Norfolk is going to receive a lower

page 568 } premium for the bodily injury factor of the liability policy when this—if this proposal of yours insofar as it affects Norfolk is granted?

A. Yes, Sir.

Senator Howell: Now, I want the Commission to follow this next question because it is going to be extremely significant.

Q. Now, will you tell us why—first, what are the factors, I want specifically in lay language the factors that have brought this across the board decrease to the City of Norfolk? What is it that we have done that even makes the National Bureau feel they have to ask, even under your formula, for a rate decrease for the City of Norfolk?

A. The fact that the loss ratio at present rates for Norfolk is approximately fifteen per cent better than the Statewide average.

Q. And is one of the factors that because of the

page 569 } categories classification of the policyholders have produced more premium dollars than the experience justifies?

A. It is the other way around. They have produced fewer losses than was expected the last time the rates were made.

Philipp K. Stern

Q. All right, Sir; but you have put in a category based upon the number of accidents or potential accidents that your scientists on your side of this table *prognositcate* will occur?

A. I am trying to follow your questions, but they are involved with so much that I don't know how to answer.

Q. All right, Sir. I am quite complimented that I have been able to—

Commissioner Catterall: He wants you to admit that you guessed wrong the last time.

Senator Howell: Your Honor, I don't want him to do that.

page 570 } A. I don't have to admit that we guessed wrong because, as I explained before, that is a principle in rate-making. There is a time lag because we are putting these things on past experience; and the same time lag will apply or did apply when Norfolk rates had to go up because of bad experience.

Q. All right, Sir. Now, here's what I'm really interested in. We have a company that I'm going to designate as "Company Three". Mr. Harris looked at the actual company, and looked at their underwriting policies that were being applied and had been applied in the City of Norfolk for the last ten years.

Now, this company said that every cook employed should be put into a surcharge category, that every painter employed in the City of Norfolk should be in a surcharge category, that is, they should be in a 2-C category, other than a 1-A category.

page 571 } A. If anybody has any such rules, that company would be penalized by the Insurance Department. You can't put people into a higher rated class because you don't like them. You may not like to insure them, but you can't surcharge them and put them into a different category. You can't say that a single driver who has an eighteen year old son driving a car so that he will get a 2-C rate rather than a 1-A rate. Certainly not.

Senator Howell: I'm going on to another field of endeavor. Mr. Elliott, will you go get me those eighteen exhibits that I that I say here—I don't think Mr. Harris *every* saw them, the eighteen that I lodged—

Commissioner Dillon: We are not going into the underwriting policies.

Philipp K. Stern

Senator Howell: Well, I am saying to this Commission—

Commissioner Dillon: We have nailed it down, and we are just not going to get into it.

Senator Howell: If Your Honor will please, just one minute. I have looked at the underwriting

page 572 } policies. I have seen that in the City of Norfolk they say that every cook, every hospital attendant, every painter, every cleaner, every laborer, every waiter or waitress shall be surcharged. Now, this gentleman has said that if that is taking place, they should be penalized.

Commissioner Catterall: You misread the wrong surcharge. That must mean that they put a black mark against them or something like that. It couldn't mean that they could put them in a different category. That would be utterly illegal.

Senator Howell: It does mean it.

Commissioner Catterall: It doesn't mean it.

Senator Howell: Judge Catterall, did you ever look at those eighteen companies that I pulled out of there?

Commissioner Catterall: It couldn't possibly

page 573 } mean a premium surcharge. That would be so obviously criminal that nobody would run the risk of doing it. All those things mean that you are talking about are—

Mr. Elliott: They are guides.

Commissioner Catterall: They say "Well, that is three reasons for not hiring somebody."

Senator Howell: Not writing them?

Commissioner Catterall: That's all that means. It has nothing to do with surcharges on a premium.

Senator Howell: I am calling to tender for the Supreme Court of Appeals the records of the Continental Insurance Company, and ask that it be filed here. I don't know whether that is the company or not. It is designated as "Company Three" in our brief, but I will take a chance on that being it, and I am going on to another.

I am asking that it be produced, be assigned a

page 574 } number, and rejected, and put in the file.

Commissioner Dillon: We ruled in this case, Senator Howell, that we were not going to make these underwriting policies public, and it would be a public record if we introduced them, let them in here as evidence.

Senator Howell: All right, Sir. You can delete, you can take a razor and cut the company out, but Mr. Harris has filed Appendix A to your investigation, that he has been over this, and I am saying that even when you are engaged

in the atomic energy, when we had it on trial, the United States Government said that the model of the atomic bomb that had been espionaged that they had to produce it and go as evidence.

And I am only saying that if this Commission ruled that these routine, universal regulations that go out to salesmen all over the country, that that rises above the
page 575 } atomic secrets in the United States of America and cannot be tendered even if you take a razor blade and masking tape and blot out these companies, because I would want to blot out too if I had anything to do with them, we want it—

Commissioner Dillon: We understand that.

Senator Howell: We want it to go in, tendered, marked as an exhibit, assigned a number and rejected; and you can put any security on it you want, but I want to show what they are doing.

Commissioner Dillon: Well, I don't want to rule on that unless—

Commissioner Catterall: Well, we have already ruled and decided that we have no jurisdiction over things you are talking about; and if we have no jurisdiction, that is it.

Senator Howell: This expert has said that you
page 576 } all would penalize them if it occurred so it has become a relevant part of this hearing.

Commissioner Dillon: You weren't talking about the same thing. You are talking about a different thing.

Senator Howell: All we do is note our exception for the refusal to permit us to tender this evidence, which we do; and now we go on.

Q. Would you once more tell me the reason why every driver in the City of Norfolk is to receive a rate decrease, Sir, if your proposal is accepted?

A. Because the average experience in Norfolk was better than the average experience Statewide.

Q. Now, that is for the years 1964 and 1965?

A. No; for the years 1963, 1964 and 1965.

Q. All right. Now, that means that on the aver-
page 577 } age the safest drivers in this State are in the City of Norfolk, and that record has averaged that over a three year period?

A. No, it doesn't mean that at all.

Q. If it doesn't mean you are charging them too much,

and if it doesn't mean they are having fewer accidents, how in the world do you wind up with us being entitled to an eleven per cent across the board average decrease? It is just a gift to us because we have been up here three times contesting these hearings?

Commissioner Dillon: If I thought it were, we would throw this out right now.

Senator Howell: That's what I am trying to find out, if Your Honor please. I've got him on cross examination, and I don't want to be resurrected yet.

Q. Tell us what factor. You say it doesn't have anything to do with that you have put too many of us in this 2-C category, and thereby—

page 578 } A. I didn't say that.

Q. Well, is that the reason that you put—

A. Certainly not.

Q. That's not the reason, that's not the reason that you have overcharged us in view of the fact that we are the safest drivers in the State; that's not the reason, is it? Is that right; that's not the reason?

A. No, we did not overcharge you.

Q. All right, Sir. And the reason is not because we have fewer loss claims because we are the safest drivers in the State, that's not the reason?

A. No, but you are putting two things together.

Q. All right.

A. You have fewer losses or lower losses than expected. That doesn't mean that the drivers of Norfolk are necessarily the best ones in the State. There may be better ones.

Q. Well, let me ask you this.

page 579 } Commissioner Catterall: The safest drivers are in Class 7, if you look at the exhibit.

Senator Howell

Q. Let me ask you this question, Mr. Stern.

Commissioner Catterall: Class 7 contains the safest drivers.

Mr. Elliott: He's talking about the territory.

Senator Howell: Territory 7?

Commissioner Catterall: Yes. They've got the safest drivers.

Senator Howell: They are not getting it. They used to be, but they are not getting—are they geting more of a decrease than we are?

Commissioner Dillon: No, but they are still lower.

Senator Howell: That's not relevant to my line of inquiry, Mr. Commissioner.

Mrs. Wootton, what is the last question? Judge
page 580 } Catterall got my thinking disoriented there.

Commissioner Catterall: I just tried to save some waste.

Senator Howell: Do you remember my last question?

Commissioner Catterall: You have asked him six times why the Norfolk drivers got the decrease.

Senator Howell: And I haven't gotten an answer yet. Do you know why? If you can tell me, really I can move on.

Commissioner Catterall: Well, I can tell you. These rates are fixed on statistics, the number of dollars that are paid out by the company, and it may be that the Norfolk drivers are just lucky. They may not be safe at all, but for one reason or another their accidents don't cost the company as much money as was anticipated. He has said that a million times.

page 581 } Senator Howell: But that's not quite what we are getting to, Judge Catterall. I want to refine the Judge's general observation just a little bit.

Q. You have been an actuary for many years, haven't you?

A. Yes.

Q. You have studied correlations, primecations, combinations, logarithms, and all the tools by which you are able to make scientific comparisons?

A. And this is not a—

Q. No, Sir.

A. —scientific comparison.

Q. But you don't even have to be an actuary to know that there is a direct relation between the safeness of a driver and the number of accidents he has, as a general rule?

A. Well, that is not even necessary. As Judge Catterall said, some people may just be lucky. But—

page 582 } Q. But over a three year period with three hundred thousand people involved, luck will—you don't keep your luck, you don't ordinarily roll fifteen sevens in succession, do you?

A. I was only—

Philipp K. Stern

Q. You were only joking with Judge Catterall. I think it is a joke too, but let's get back to the question.

A. It has been explained to you that the experience in Territory 2 for the last three years on the average was better than expected at the time the last rates were established.

Q. And it has been sufficient to establish a significant trend, hasn't it, in Norfolk?

A. I would not call it a "trend". I would call it a "change".

Q. A "change"?

A. We don't know what it will do.

page 583 } Q. Well, let me return to my question because I want an answer to it. Don't you agree that there is a direct relation to the safeness of the drivers in an area as large as Norfolk and the number of accidents that occur?

A. Probably, yes.

Q. All right, Sir. Now, did you examine the Statewide record of Norfolk for the years 1960, 1961 and 1962, when you were looking this over?

A. Your question is did I examine the Statewide record of the drivers?

Q. Of Norfolk, the relation of the Norfolk drivers for the years 1960, 1961 and 1962, when you decided that you were going to come here and ask this Commission to take away from the insurance companies of the United States hundreds of thousands of dollars, that is, an eleven per cent decrease on the average rate of all the fifty some thousand drivers in Norfolk, fifty-one thousand drivers? Didn't you

page 584 } look at a greater period than just 1963, 1964 and 1965? Didn't you look at 1960, 1961 and 1962?

A. We looked at 1960, 1961 and 1962.

Q. And didn't that show you—

A. And the revised rates when that experience was used. That experience was faded out of the picture.

Q. You reviewed and looked at—

A. We looked at 1960, 1961 and 1962 at the time that experience was used. It was probably in the 1964 rate revision.

Q. Probably, but didn't it show that we were improving over the 1957, 1958 and 1959 period?

A. I don't know that.

Q. And you are satisfied to ask for a rate reduction based on 1963, 1964 and 1965?

A. That is correct.

Q. All right, Sir. Now, when was the whole Norfolk ter-

ritory uprated as compared to the other ter-
page 585 } ritories in the State?

A. Is your question what was the change the last time the rates were revised?

Q. I want to know when.

Commissioner Dillon: When it was put in Territory Two.

Senator Howell: When Territory Two was put in the most expensive category in the State to buy insurance.

A. Well, you can determine that by looking over some of these—

Q. Do you know? I don't want to look over them. I've got something else to do.

A. No, I don't have that information with me.

Q. You don't have it with you? Can you get it?

A. No. It is not relevant to this rate filing.

Q. All right, Sir. Well, now, when we get to other areas of Virginia, for example, let's take the City of
page 586 } Richmond. You originally put them in a category that was some six dollars less for the average rate for the driver in Norfolk?

A. That's what it says here, yes.

Q. All right, Sir. Now, why, what determines our basic rate, the one that goes back to the beginning here? In other words, when did you decide on to upcharge Norfolk and make it pay more, notwithstanding your decreases, to make us pay more than any other territory?

A. At the time the experience indicated that Norfolk rates had to go up.

Q. All right, Sir.

A. I happen to have an exhibit here, it's probably substantially right, when we used accident years 1961 through 1963. That was the revision that they became effective January 1, 1966.

At that time Norfolk probably received a reduction on bodily injury and an increase in property damage.

Q. All right, Sir. In these territories, what determines whether you are in Territory Two or Territory
page 587 } Ten?

A. Where your car is garaged.

Q. Why should Newport News have a present rate of forty-five dollars as compared to Norfolk's of sixty-one dollars?

A. Past experience.

Q. Meaning that we had more accidents in the past than Newport News?

A. Yes.

Q. Do you know that as a matter of fact or you are just assuming it?

Commissioner Dillon: Well, more dollars were paid out.

A. More dollars were paid out.

Senator Howell:

Q. Sir?

A. More dollars were paid out.

Q. All right, Sir. Now, what I want to know is why can you not now, why after three years, when Norfolk has had an experience that entitles us to an eleven per cent average decrease in our premiums, why after three years would it not be fair for this Commission to order that the

page 588 } Norfolk drivers be put in Territory Ten?

A. Because it doesn't fit into Territory Ten.

Q. But for the past three years our premium payout has been eight per cent better than Newport News, and we are just across the river connected by a tunnel?

A. No; no, that is not correct. You are misreading the figures.

Q. There's something wrong.

A. The loss ratio has been eight percentage points better than the loss ratio for the territory which is identified here as Nine, Ten and Eleven; but the loss ratio reflects the rates charged at the present time.

So you can't deduct from the difference of the loss ratio what the loss cost is in the territory.

Q. Well, does the territory—

A. They are not relative.

page 589 } Q. Is it fair to compare the territorial rate level change?

A. No, it is not because the territorial rate level change, again, is relative to what exists now.

Q. Well, when did the National Bureau last make a call or run or whatever you want to call it to determine the safeness of the drivers and the lack of accidents of the drivers in Norfolk as compared to Newport News for the purpose of putting Norfolk into the Territory Ten classification which is the classification Newport News has?

A. It's right here.

Philipp K. Stern

Q. I ask you the last time. Would you be willing—

A. The last time this was compiled, which was the official call compiled in 1966.

Q. Would you be willing to recommend that this Commission put Norfolk in the same territory as Newport News?

A. Certainly not. It doesn't fit into that ter-
page 590 } ritory?

Q. And why doesn't it fit, in view of our three years' experience?

A. Because after going through this rate revision, you will find that the rate in Nine, Ten and Eleven still will be eight dollars lower than for Norfolk on a ten/twenty basis.

So Norfolk experience, Norfolk loss cost is no where near the loss cost for these three combined territories.

Q. That is merely because sometime before three years ago you put us in such a high category?

A. That is not the case. It has nothing to do with it.

Senator Howell: At this point we are going to leave that question, and we ask this Commission to determine or to require the Bureau to see if now Norfolk is not deserving

after the three years' experience demonstrated
page 591 } by this eleven per cent—you weren't disagreeing
with me, were you, Commissioner Dillon, because I haven't finished?

Commissioner Dillon: With him?

Senator Howell: No, with me. I thought—

Commissioner Dillon: No, I'm not—

Senator Howell: I saw you shaking your head in the negative.

Commissioner Dillon: No. I just looked down at this, but I think he has explained why, hasn't he?

Senator Howell: No, Sir. He merely explained that some time when there was not an adversary proceeding they put us in a high risk, high rate premium classification.

Commissioner Dillon: But didn't he say that, even with these improvements, you still have a worse record than Newport News?

Senator Howell: No.

Commissioner Dillon: Isn't that your testi-
page 592 } mony?

Senator Howell: No, he hasn't said that.

A. I said that.

Commissioner Dillon: Yes, he did.

Philipp K. Stern

Mr. Moncure: Even after they have given you credit for such good behavior.

Commissioner Dillon: He says you are still not as good as Newport News.

Senator Howell: Even though we are entitled to an eleven per cent decrease, and Newport News is only entitled to a three per cent decrease?

Commissioner Dillon: Well, that is how our rates stand.

Senator Howell: Can you tell me why relatively speaking if Newport News is as safe as we are, why shouldn't they be entitled to an eleven per cent decrease in their average premium?

A. Because their rates are already lower.

page 593 } Commissioner Dillon: Yes, they were much lower.

Senator Howell: Do you understand that, Commissioner?

Commissioner Dillon: I think so, yes.

Senator Howell: Well, I'm—

Commissioner Dillon: Maybe I'm all wet, but I think I understand it.

Senator Howell: Well, all I'm asking you is to ask this Insurance Commission, which I don't believe ever checked on these figures, I want them to check these as to why, and write a letter to me as well as the Commission, as to why Norfolk is not now entitled to go into Territory Ten, because they got us up so high to start with, and no matter how safe we are, we wind up eight dollars higher than Newport News.

Commissioner Dillon: But you are still not as safe as Newport News, according to him.

page 594 } Senator Howell: Sir?

Commissioner Dillon: I said, according to Mr. Stern, you are still not as safe as Newport News.

Senator Howell: I know, but I don't think—

Q. When was the last time you made an analysis of the accident ratio in Norfolk per person as compared to Newport News, yourself or your staff, and, if so, are the figures in the bag?

A. In this revision and in the prior revision. Every revision we have used the territory experience.

Q. Have you done it?

A. Of course.

Q. All right, Sir. And have you interviewed the number of accidents occurring in Norfolk as related per car to the number of accidents occurring in Newport News?

Philipp K. Stern

A. Did I interview?

Q. Did you investigate?

page 595 } A. Yes, we have those figures, surely?

Q. Do you have them with you?

A. Yes.

Q. Let's see them. Are they in the bag?

A. It is probably in the exhibits which we filed with the Department. They are not in the bag any more.

Q. Are they an exhibit in the file? Are they an exhibit attached to the filing?

A. Senator Howell, these exhibits are the same exhibits that Counsel Elliott invited you to inspect, after they were filed with the Department of Insurance, and they have been available since April and May.

Q. But you didn't furnish an extra copy to send to Norfolk, and I had to take a day off and drive all the way up here to look at them. Was that right, Sir? You only gave him one copy?

Q. All right, Sir. We are going on to another question. You apparently can't—

page 596 } Commissioner Dillon: I think this would be a good time to adjourn until 9:30. Does that suit everybody?

Senator Howell: No, Sir. I think I can finish with Mr. Stern in about fifteen minutes if you think you could last until four-thirty, I would—

Commissioner Dillon: It is getting rather gruelling, but—

Senator Howell: It may get even more gruelling, if Your Honor please.

Commissioner Dillon: I couldn't last that long.

Senator Howell: Well, let me say that any time the Commission wants to leave—because, frankly, I feel the Commission has made up its mind. I want to get this evidence into the record.

Commissioner Dillon: Well, you know more than I know.

page 597 } Senator Howell: Well, I may, but I have the definite feeling that Judge Catterall certainly made up his mind. I think Judge Hooker has not, and I don't know how you have, Judge Dillon.

But any time—we are tendering this for the record—any time you all want to leave, we will just put it in because, frankly, I feel that this is important. It may not be important before this Commission, but I believe I could finish up in about fifteen minutes.

Philipp K. Stern

Commissioner Dillon: Can you hold fifteen minutes, Mrs. Wootton?

Reporter: I will try.

Commissioner Catterall: But Mr. Moss wants to cross examine.

Mr. Moss: I haven't had a single bite of the apple yet.

Commissioner Dillon: I know it. We've got to go on until tomorrow because you are certainly going to put your witness on the stand, aren't you?

Senator Howell: It might be possible I wouldn't
page 598 } come back, and that would save you all a whole lot.

Commissioner Catterall: Oh, oh, if you will promise not to come back.

Senator Howell: I am only suggesting, Judge Catterall. I am holding it out right now.

Mr. Shadoan: Judge Catterall, if you would go on until 6:30, I would promise not to come back.

Senator Howell: If you all want to quit, I mean—

Commissioner Dillon: Well, I was just thinking about Mrs. Wootton.

Senator Howell: May we go on with this Dictaphone belt? Mrs. Wootton doesn't have to take this down.

Commissioner Dillon: No, we can't do that.

Senator Howell: Why?

Commissioner Dillon: There is so much arguing back and forth, it is hard to get it.

page } 599 Senator Howell: Well, we don't want to harm this lady in any way.

Commissioner Dillon: No, but you go ahead for fifteen minutes if you can.

Commissioner Catterall: And don't ask the same question twice.

Senator Howell: If I can get a satisfactory answer, I won't, Judge.

Commissioner Catterall: Well, let's see if they can end.

Senator Howell: Judge, I am hoping to get one friendly question because I know you've got a very trustworthy mind, and if I can get one friendly question from you by the end of the day, I promise you I won't come back.

Commissioner Catterall: I have been very helpful to you. I have been trying to save you a lot of time.

Senator Howell: It has been hard to discern that fact.

page 600 } Commissioner Catterall: I clarified some of your questions so the witness could give you a clear answer.

Senator Howell: All right, Sir.

Q. Now, have you ever been called upon to give management advice or give advice to management in a failing business?

A. No.

Q. You never have?

A. No.

Q. Have you ever taken a course in economics?

A. Yes.

Q. You have?

A. Yes.

Q. Well, would you agree that it is a general principle that in a losing business that management should find a way to cut costs?

A. That may cure it some times; it may make it worse at other times.

Q. All right, Sir. Now, do you feel that in view of the fact —the Travelers Insurance Company is one of
page 601 } your subscribing companies, isn't it? One of your subscribing companies?

A. The Travelers in Virginia, yes.

Q. And from time to time you look at its insurance expense exhibits, don't you?

A. I don't.

Q. You never looked at it?

A. Not of individual companies, no.

Q. All right, Sir. But you do know that Travelers contends it is losing money on its automobile policies, don't you; or are they making money?

A. No, I do not.

Q. They are making money?

A. I don't know.

Q. You don't know one way or the other?

A. I don't know what they claim.

Q. Well, you are asking for a rate increase on behalf of Travelers, aren't you?

A. I am asking for a rate increase on behalf of all National Bureau members—

Q. Including Travelers?

page 602 } A. That's right, it is including Travelers.

Philipp K. Stern

Q. You don't have the slightest idea whether they are losing money or making money?

A. There is no need to investigate individual companies.

Q. Right.

A. Because these are the aggregates here.

Q. Profit and loss has nothing to do with rate-making processes. It is strictly an actuarial matter?

A. Past profit and loss has nothing to do with the process of rate-making rates.

Q. Well, in 1966, in view of the fact that Travelers spent five million dollars on travel and travel items, would you suggest that before they would be entitled to a rate increase that they ought to reduce that to two million dollars for travel?

A. No.

page 603 } Q. Do most of your subscribing companies lose money on every policy they write?

A. I wouldn't know that.

Q. You don't have the slightest idea?

A. Why are you asking questions, do they lose money on every policy they write?

Q. On an average do your automobile insurance companies?

A. There is no such thing, every policy they write on an average. Either you would say "average" or "every insurance policy." The two concepts are—

Q. These expense exhibits have segregated the expenses to casualty lines? It does not include the life insurance and the fire insurance?

A. It does not include life insurance.

Q. Now, my question is, on an average, every one of your subscribing companies in the past has been losing money?

A. No.

page 604 } A. No.

Q. No?

A. Again, you are talking about on an average every one of the insurance companies.

Q. Well, are most of them losing money?

A. I believe most of them do.

Q. All right, Sir. Now, would you agree that for most of the companies, the fewer policies they sell the less money they lose?

A. It adds up to that, yes.

Q. So now would you suggest that in view of the fact that the fewer policies they write, the less they will lose, that it would be well to eliminate travel, and stop traveling around looking for new policyholders?

A. No, that has nothing to do with that.

Q. Well, why in the world would they have to advertise? Isn't that for the purpose—I think it was conceded—

page 605 } Judge Dillon says the only reason you advertise is for additional business. Is he correct in that observation?

A. Well, yes, that is correct.

Q. All right, Sir. Well, now, if the less they sell, the less money they will lose, why would you not recommend that we cut out, for example, this is just one small company here, for advertising, two million, over two million dollars? Can you see any economic advantage to the policyholders that they spent two million dollars to produce new business when they are going to go deeper in the hole and have to charge more and more to each policyholder for every new policy they write?

A. This is quite a conglomeration of statements and questions, Senator. I'm sorry.

Q. Well, can you answer one *one* of them?

page 606 } A. Let me try them one by one.

First, a company does not go out of business just because it faces adversity. There is always the eternal hope that things may turn better.

Secondly, this is a competitive business. Companies try to write the kind of business that will ultimately produce a profit.

I think that's a proper answer.

Senator Howell: That's all I have.

Commissioner Dillon: Are you finished?

Senator Howell: Yes, I'm through.

Commissioner Dillon: You more than kept your promise.

Senator Howell: I tried to help out in this hearing.

Commissioner Dillon: Can you finish?

Mr. Moss: I might be able to. Are we coming back tomorrow?

Mr. Shadoan: May I address the Commission?

Commissioner Dillon: Yes.

page 607 } Mr. Shadoan: I understand that Mr. Moncure has been furnished with a copy of the written testimony of Mr. Maddrea, but I have not—

Mr. Moncure: Indeed I have not.

Mr. Shadoan: Well, all right.

Mr. Moncure: I beg your pardon. I have been wondering what's in it.

Mr. Shadoan: I asked the question. I did not make a statement.

Mr. Moncure: I thought you said that I had received it.

Commissioner Dillon: No, we did not require it.

Mr. Shadoan: Well, then, in any event, he will probably want to cross examine Mr. Maddrea.

Commissioner Dillon: I imagine he would.

Commissioner Catterall: Well, give it to him tonight.

Mr. Shadoan: If somebody has a copy, I would request that Mr. Moncure get a copy of it.

page 608 } Note: Copy handed Mr. Moncure.

Commissioner Dillon: Mr. Moss, could you come back in the morning?

Mr. Moss: Gentlemen, I am not as loquacious as my friends, and I don't think I am going to be quite as long. If you will give me about ten minutes, I am *going* to ask two or three questions, and I think I can wind it up.

Commissioner Dillon: You are not going to be here tomorrow?

Mr. Moss: Not if I can finish up now.

Commissioner Dillon: All right.

CROSS EXAMINATION

By Mr. Moss

Q. Mr. Stern, as you may be aware, I am not quite as familiar with these problems as my colleagues are; but I am concerned about two things: Number One, something that Commissioner Dillon said earlier with reference to the recent hearing which was in the future on the excess coverages.

page 609 } Now, first of all, how many companies are in your Bureau? I think you said earlier. How many do you represent? Roughly, you don't have to give the exact figure.

Q. I think there are about forty members here.

Commissioner Catterall: It's more than that.

Commissioner Dillon: Sixty some, isn't it?

A. Sixty?

Commissioner Dillon: I'm just, that's my impression.

A. I did not count them.

Commissioner Dillon: Members, and then there are about a hundred and some members and subscribers.

Mr. Moncure: And they write forty per cent of the business written in Virginia, I believe.

Mr. Moss: That was my understanding also.

page 610 } Q. Of those companies do you know of a single company that at the present time finds itself in any serious financial condition?

A. No.

Q. None of them; is that true?

A. That is correct.

Q. And isn't it true that of those same companies that you represent that, with that exception, they are all making a profit, a considerable profit, on the excess coverage policies that they are writing; is that not true?

A. I couldn't confirm or deny that. We have not yet studied the complete interest of experience,—

Q. Well, have you studied—

A. —at the present time.

Q. Excuse me. Have you studied any of them at this point?

A. Oh, yes. We made a review about four or five years ago. At that time it appeared the companies were

page 611 } just about breaking even from the figures in this coverage.

Q. You have made no studies since that time?

A. No, we did not.

Q. Well, if it appears from your studies that they were making an excess, and the Commission required, would you not then or would not a decrease in the policy amounts or the rates be in line?

A. If the experience indicates a decrease, rates will be decreased just as they are now going to be decreased in Norfolk for the basic limits coverage, yes.

Q. When do you anticipate the hearing, if you had such an anticipation, that you could make at this time, on this question of the excess coverage?

A. I can't predict about that. I testified today that preparing such a study will be a substantial undertaking, it will take a lot of work, and I said I am optimistic if I hope to finish this study in four months.

page 612 } Commissioner Catterall: Don't you do it every five years on the average?

A. We do it approximately every five years, but we have had computer problems and other problems. Also in many States the required limits were changed in the last few years, which makes it more difficult to complete aggregates and get enough insurance.

Mr. Moss

Q. Don't you in all fairness anticipate that your companies are making a profit over and above the allowed amount for the excess coverage which they are now writing?

A. No, I really don't.

Q. You have no idea?

A. Well, we have looked at some figures, and none of those figures showed that there was any excess. We have looked at those figures and we have not found that there was any redundancy.

Q. But that was four years ago?

page 613 } A. That is right. Now, for example, we have to submit some figures to one State that makes its own rates.

Q. Well, I understood you to testify previous to this time —if I am in error correct me—that the companies were making a considerable amount on the excess coverage.

A. I did not say that.

Q. You did not say that?

A. No, Sir.

Q. Then perhaps I am in error. Well, let me ask you this question, Mr. Stern. If it turns up that you are in fact making a considerable profit on excess coverage, would then not a decrease in the rate be justified?

A. Yes.

Q. All right. And if this was not determined until, say perhaps six months to a year from now before you have another hearing before this Commission, would it not also be true that if this rate increase were granted that you are asking now, that the policyholders would have been done a

page 614 } damage which could not be remedied because of the fact that they had paid this excess amount over and what they should have paid during that same period of time?

A. No, there are many other offsetting influences.

Q. What are they?

A. I would like to call your attention to one exhibit which

is included in the material Mr. Moncure submitted, which shows our Statewide experience, the National Bureau companies' experience, for the latest three years, and that is actual experience, the collected earned premiums as the companies collected them and the incurred losses.

And that shows for bodily injury the loss ratio, the actual loss ratio, of all companies was eighty-one per cent, which is approximately eleven points more than is provided in the rates for losses loss adjustments, and for, I call it "contingencies," and it's no sense talking about profit, it's a fast and simple provision for contingencies.

page 615 } So this past experience has shown that on a total limits basis for all types of private passenger rates the companies actually received less money than the rate provided for losses and for contingencies. There is no question of any underwriting profit in the last three years. The loss ratio was eighty-one per cent. And by the way, on property damage the loss ratio was also eighty-one per cent.

So the experience has been pretty bad, and it will take a great deal of improvement in the experience to change that into an excessive underwriting profit.

Q. Are you saying then that the experience which you are talking about at the present time includes both the basic policy and the excess coverage?

A. That is the data I computed.

Q. Let me see if I understand you. Let me put it in my language, if I may.

For example, if a company such as Glens Falls, page 616 } which is one of your companies, naturally they sell, do they not, both the basic amount and the excess coverage?

A. Yes.

Q. You are saying then that if the basic amount is apples and the excess coverage is pears, they are losing money, if you owned a fruit stand and you were selling both apples and pears? Is that what you are saying?

A. Yes. We will put it that way, yes.

Q. Are you also saying that they are losing money because they are losing so much on the apples, even though they are making a profit on the pears; or are you saying they are losing money on the apples and the pears?

A. It could be either way.

Q. It could be even.

Philipp K. Stern

A. No. From the data which we have submitted we have seen that the excess portion in Virginia by itself was relatively good; so they lost more money on the other parts of the experience, that is true.

page 617 } Don't forget we have assigned risks which the companies have to insure, they have no choice, and they had the loss ratio of one hundred and one per cent. Now, you have to add to the apples and pears another category which will balance up.

Q. But doesn't all of the assigned risk come into the basic policy amount and not to the excess coverage?

A. Yes, but you never get enough premium from them, at least we haven't gotten enough premium, because our rate filing excludes assigned risk.

Q. Well, all right. Let me see if I am making, I'm understanding you now. I'm not trying to confuse you, and I know I couldn't. What I'm trying to get at, as I understand it, you are saying to this Commission today that you anticipate filing for an increase in your rates for excess coverage in the immediate future?

A. No, Sir, I do not.

Commissioner Dillon: No. I made the statement we were going to bring them in here and see if they weren't

page 618 } making too much money.

Mr. Moss

Q. Well, you have no factual knowledge at this time, based upon your investigation or any other knowledge, that will give you any indication as to whether or not you are making money on your excess coverage; is that what you are saying?

A. I don't have any final figures which would indicate at this time.

Q. That's not what I asked you. I'm not talking about final figures. Do you have any indication, based on any study that you have made at the present time?

A. I would have to say I do not have any.

Q. Well, why did you say final figures a while ago?

A. Well, we produced figures for one State because we were asked to, Virginia. It showed relatively good loss ratios. We were also asked to produce data for another

page 619 } State that makes its own rates. The loss ratios are horrible. They were in the seventies and eighties. I would not pay any attention to either one of these figures on a Statewide basis. I have explained before that we

have to look at that on a broad countrywide basis, and I don't know what the countrywide picture shows.

Q. But you do have some for Virginia that looks pretty good; isn't that what you are saying?

A. Yes.

Q. Which means in effect that you have been making more than what you should make on your excess coverage policies?

Mr. Redd: He should.

Mr. Moss: Well, he can answer the question, Mr. Redd.

A. Well, I could say "Yes", but if you look at the overall, we have missed a point that is marked by more than eleven percentage points.

Q. True; that's overall, but I am speaking now
page 620 } purely for the State of Virginia.

A. No, no, overall in Virginia, for basic limits coverage and excess limits *coverate* combined, for bodily injury including medical payments, our actual loss ratio for the latest three years has been eighty-one per cent, which is eleven points more than the total provision in the rates for losses and for contingencies, nothing left for profits.

Q. All right.

Commissioner Dillon: Does that include excess?

A. That does include excess.

Commissioner Dillon: Why can't you segregate it? If you've got the combined and you've got the figures on the basic limits, why can't you subtract one from the other, and tell what they are?

A. Yes, Sir, we did that in the figures we submitted to Mr. Elliott, and they were quoted here, but if you look at increased excess limits data on a State basis, you
page 621 } may go very wrong. I quoted our 1962 filing which showed very high loss ratios for Virginia, and we did not say at that time we had to increase the payments.

By the same reasoning looking at some relatively low loss ratios at this time in Virginia does not indicate that the tables should be reduced. We have to wait until we see the countrywide picture.

Commissioner Catterall: What is your premium volume on the excess premiums in Virginia per year?

A. Approximately two million dollars.

Commissioner Catterall: And *its* takes twenty million to be credible?

A. Yes, Sir; and on excess limits I would say it would take much more because you have a greater influence of chance.

Commissioner Catterall: One half-million dollar verdict will throw all the figures into a cocked hat.

A. Absolutely.

page 622 } Commissioner Catterall: And if you have one of those in Virginia, it would look as if you ought to have a forty per cent increase?

A. That is correct.

Mr. Moss: Thank you, Mr. Catterall. I appreciate that.

Commissioner Catterall: I was just trying to clear it up. You asked for information, and that's it.

Mr. Moss: Yes.

Commissioner Catterall: It's like these little country telephone companies. We fix the rate, and one sleet storm will change it from a twenty per cent profit to a twenty per cent loss. You just can't do it.

Mr. Moss: Well, you can only hear about twenty per cent of what is being said anyhow, so it's probably a pretty fair deal.

page 623 } Commissioner Catterall: Oh, oh; well, maybe that's all they ought to get.

Mr. Moss

Q. Let me ask you just one final question, Mr. Stern; if I can, I'll leave it because I'm tired too.

If, as the Commissioner has stated, that you have a hearing, say, within six months, on this question of excess coverage, and if it turned out that a substantial or any reduction was in line, and if you are granted an increase this time that you ask, within this next six months, how then can the driving motorist in this State *every* recoup his losses?

A. I think in all fairness you ought to look at the other side of the picture. The companies don't recoup their losses. On an eighty-one per cent loss ratio for every three years the companies cannot recoup their losses either.

page 624 } We have to take our rate-making in cycles as is necessary, and today Norfolk got a reduction at this time, and there is a necessary and expected and normal time lag. There was the same time lag when Norfolk needed increases, and the same applies to the review of any other part of our rate structure. There is a time lag, but in a long run or in a short run, the time lags tend to offset each other.

Philipp K. Stern

Q. In other words, what you are saying, as I understand the question, you answered with a question. Then there is no way this can be done? We just have to look at another side of the picture?

A. Yes, you have to realize that rate-making has to be based on past experience, and there always will be a time lag.

Q. Then in order to be absolutely fair, doesn't it seem proper to wait until we get the total picture as far as the excess coverage is concerned, along with the basic policy, and find out if one would not offset the other before you are granted another rate increase?

page 625 } A. No, Sir, I don't think it is a matter of fairness at all.

Q. If you tell that to the people who buy the insurance, they may have a different idea.

A. Yes. Now, the people may have forgotten, for example, in 1952 when the real inflation, the real heavy inflation, was affecting the insurance business, tables had to be increased by about forty or fifty per cent; and in Virginia they had to wait approximately four more years before the increase was put into effect.

There was a time lag, a long time lag, with evidence that rates had to be increased. This is a necessity that rate-making data have to be looked upon in retrospect, and you have a time lag, but in the long run as rates go up and down, there is equalizing justice.

page 626 } Q. How can it possibly be equalized if eventually you find in this particular situation that a decrease is in line after they have been paying for the next six months?

A. Well, for increased limits, the waves are somewhat longer between rate revisions, and the people of Virginia don't realize that between 1952, when increased limits tables were increased in all other States—

Q. All right. We will leave it at that.

Commissioner Dillon: In other words, what you are saying is that if you got a thirty day note in the bank, that thirty days will pass a whole lot faster than thirty days will pass if you've got money on a savings account; that's about it, I reckon.

A. No, I thought it was the same thing.

Philipp K. Stern

Mr. Moss

Q. In other words, you are saying it only hurts for a little while, Mr. Stern?

A. I did say that the use of past experience
page 627 } involves a time lag, and that in the long run the
time lag will be an offsetting influence, and while rates may be redundant for a while, because the facts are not known, the next time rates will be ample to report about an equal length of time.

Commissioner Catterall: If we had had this hearing a year ago, Norfolk would be getting the benefit of reduced rates for a whole year. With the regulatory lag, you admit that is water over the dam.

Mr. Moss: It is correct, Your Honor, yes.

Q. One final question, and I'm going to leave it. Isn't it true, Mr. * * * that there is not one single company that you represent that did not show a profit on overall business written within the last two or three years or any one particular year you want to pick?

A. I can't answer your question because I didn't examine any company's operations.

Q. Isn't it true of most of them then, in all
page 628 } honesty?

A. I don't know.

Q. You don't know whether they showed a profit or not?

A. I think overall operations of most companies have been in the black, but not for automobile insurance. They write all types of insurance.

Q. Well, again, it goes back to the theory that you sell saws, hammers, apples and pears. If you are losing more money on saws, you are entitled to raise apples, pears and hammers?

A. You are—

Commissioner Catterall: That means you are entitled to raise on saws.

Mr. Moss: That's not what he said.

Commissioner Dillon: He just wants to raise the rates on the line of insurance on which he is losing money. That's what he said.

Mr. Moss: That's all I have.

page 628-B } Commissioner Dillon: We will adjourn until 9:45 A. M. tomorrow morning, June 2, 1967.

page 629 } JUNE 2, 1967.
9:30 A. M.

The Commission resumes its session.

Commissioner Dillon: Mr. Shadoan, I believe you have some evidence you wish to put on.

Mr. Shadoan: I have a few questions I would like to ask Mr. Stern before he retires.

Commissioner Dillon: Where is Mr. Stern?

Mr. Moncure: He is here. I have one re-direct I will ask when he finishes.

Mr. Shadoan: If Mr. Moncure would like to go ahead with the re-direct before I cross-examine, it will be all right with me.

Mr. Moncure: No, I will wait until you finish. There may be something else I will have to ask him when you get through.

CROSS EXAMINATION

By Mr. Shadoan

Q. Mr. Stern, yesterday in your discussion about the expense of advertising with respect to rate in-
page 630 } creases, you made a statement that I would like to explore. You said to Mr. Sacks—"Who is to decide?" Am I correct that there is no regulatory agency that can tell you or your member companies not to spend policyholder's money for such advertising?

A. Mr. Shadoan, I believe I said—"Who decides what is moral". Didn't I say that.

Q. If you want we can strike my question. My real question is—isn't it a fact that the sole discretion as to how much you want to spend on such advertisement, and with what you say in them lies within the industry and not with any regulatory agency?

A. I don't think that is quite true. I don't want to get involved with any statement—

Commissioner Catterall: Isn't that a legal question? All you have to do is look at the statute.

Mr. Shadoan: I think it leads into one that has a direct bearing, if the Commission please.

page 631 } Mr. Moncure: Judge, I don't think these are fair questions. This Commision has stated—

Mr. Shadoan: I will withdraw the question.

Commissioner Dillon: He has withdrawn the question.

Commissioner Catterall: Isn't it a fact that the Federal Trade Commission can forbid any false advertising in the state?

Mr. Shadoan: I don't know whether that is correct or not.

Commissioner Catterall: I know they have enjoined the General Motors Acceptance Corporation from advertising four and a half for handling automobile financing.

Mr. Shadoan: Let me see if I can't get to the part that I think is relevant to this inquiry.

Q. The statute for rate-making and automobile liability insurance states, among other things, that the Commission shall consider any other relevant factor. If your page 632 } member companies should spend, hypothetically speaking, a million dollars on newspaper advertisements respecting this proposed rate increase before the hearing, do you agree that that would be a relevant factor for them to consider in terms of whether the rate increase was granted.

Mr. Moncure: Judge, we are approaching the same question from a different angle. As I understand the Commission's ruling, it comes out of the budgetary portion, not the—

Commissioner Catterall: I am going to object to his asking legal questions of a witness that has not qualified as a lawyer.

Mr. Moncure: Thank you for finishing the last part of my motion for me.

Commissioner Catterall: That is a purely legal question and this witness does not know anything about it.

Mr. Shadoan: He has qualified, Commissioner, with respect to past factors which is relevant to rate-making, and I am asking him whether it is the position of the Na- page 633 } tional Bureau that, no matter how much money you have spent in advertisement—

Commissioner Dillon: You may proceed. That is all right. That is not legal.

Mr. Shadoan: That is my question.

Q. That no matter how much money you have spent respecting advertisements as to rate proposals, that that is an irrelevant item in the making of rates?

A. The question as to the operations of a company, the

position of management and so on are subject to regulation by the state and an excessive expenditure for any kind of activity, including advertisement, would be subject to this kind of regulation and probably would be stopped.

Q. You understand, of course—

A. I understand your question.

Q. —That I am talking about a specific kind of advertisement, not all advertisements. I am talking about advertisements respecting rate proposals, and my question, I think you have answered affirmatively, that you would
page 634 } recognize that it is relevant the amount of money that is spent as to whether or not the rates should be granted in the aggregate?

A. I did not say that.

Q. Will you tell me what you did say, Mr. Stern?

A. I said that rate-making, or the rate-making formula, contains a provision for reasonable expenses. If any company should incur unreasonable expenses, that company would be subject to the regulations by the Insurance Department and it would be stopped immediately.

Q. Well, if we don't have the expenses, we don't know how much is spent, we can't say whether it is reasonable or not, can we?

A. The Insurance Department has the expenses. They know what they are.

Q. The Virginia Insurance Department has no idea of the amount of money each company spent, does it?

A. If the Virginia Bureau of Insurance, the Commissioner, should decide that this is relevant, he will send
page 635 } his examiners to the company's home office, or branch office, and get the information.

Q. But that is the only way he can get it, isn't it?

A. That is the most direct way to get it.

Q. And furthermore, he can't get it from the companies if it is being spent by the Bureaus out of the dues the company pays the Bureau, can he? He has to go to the Bureau direct for that, does he not?

A. No. He can find it out from the company as to the expenses, and the Bureaus are subject to examinations just as the trade associations are.

Q. The companies pay an assessment to the Bureaus for their dues, do they not?

A. Yes, they do.

Philipp K. Stern

Q. And they don't track those dues to see how much went expense for advertisement in a particular state of a particular kind, do they?

A. Did you say "they"?

page 636 } Q. Each company. I could not go to one of your member companies and ask how much of your dues went into Virginia advertisements respecting the Virginia rate proposals, could I?

A. You probably could.

Q. How would they know that?

A. They have bills.

Q. They pay the bills?

A. They pay the bills for the Association.

Q. Are those bills itemized as to what the Association is going to do with it?

A. Well, no, I take this back. I did not understand your question. They pay the bills for dues for the Association. The Association again is subject to examination. The National Bureau has had examiners in its office for the last eighteen months.

Q. Well, the relevance of this expenditure, as you have said, while it might not have been in the language I would have chosen, is whether the amount of money

page 637 } spent for this sort of thing is reasonable, and I think you will have to agree with me, will you not, that there is absolutely no data before this Commission with respect to the amount of such expenditures; isn't that right?

A. It is right because these expenditures do not enter into the expense data, which are the basis for this proposed revision?

Q. And isn't the Commission in a position where they can do one of two things. They can either take the discussion and your judgment that these were not unreasonable, or they can demand that the data be produced. These are the only alternatives available to it, isn't that true?

Mr. Moncure: Judge, he is asking for a legal conclusion.

Commissioner Catterall: There is a third alternative. What percentage of the premium goes to general overhead, administrative expense?

A. 5.5 per cent.

page 638 } Q. And how many different items does that have to cover?

Philipp K. Stern

A. Sir, it covers every item of expense that is not specifically allocated in Regulation 30 to a different expense function.

Q. Is one of those expense items is what they pay in dues to the general associations like the Bar Association?

A. I do not know what exactly but the amount is very small.

The assessment to the National Bureau, for example, is less than one tenth of one per cent, and it involves all of our activities, the statistical functions, the collection of statistics.

Q. So you have one tenth of one per cent available?

A. For everything.

Q. Is part of that one tenth of one per cent used for this promotional advertising?

A. No. That would probably go to a different trade association where the assessment dues are probably even lower.

page 639 } Q. You said "Other Associations"?

A. Yes.

Q. Is that outfit like the Bar Association or the Bankers Association?

A. Yes. Something like that.

Q. And that would be how much of a percentage of the premium?

A. I don't know what that association's assessments would be but they are minute.

Q. I am talking about this third alternative. If they spend more money than they can squeeze out of that assessment, who pays it?

Commissioner Dillon: It comes out of profits, I would imagine.

A. The company should.

Commissioner Catterall: That is the third alternative.

Mr. Moncure: They exceed their budget.

Mr. Shadoan: I would like to pursue that for just a moment. I am in complete accord with the questions but take a little different perspective.

page 640 } Mr. Shadoan

Q. What Judge Catterall has been asking you about are the regulatory allowances; is that not correct?

A. You may call it that. The expenses—

Q. Regulation 30, and the assumption of what a company's

expenses are going to be under Regulation 30; isn't that right

A. Regulation 30 does not establish a provision for expenses in the rate.

Q. What is it that says you are allowed one tenth of one percent for assessment to the bureaus and boards?

A. There is no specific authority that establishes the minimum or maximum or fixed amount for anything.

Q. Except the five point five assumption, that you are allowed five point five for general administrative expenses, I mean general expenses?

A. That is true.

Q. The way you spend that, the way you allocate it, there are no regulations as to the way that five point

page 641 } five is going to be broken down; is that right?

A. I don't think you mean what you say.

Q. I mean what I say. I am asking you a question and I mean what I say.

A. There are regulations that determine just what items go into the general administrative expenses, and by reverse reasoning, that gives you the break down.

Q. Is that Regulation 30, Sir?

A. I beg pardon.

Q. Is that Regulation 30?

A. Yes.

Q. It specifies the items that may go into it without specifying the proportionate size of the items; is that right?

A. It is a factual recording of actual expenses.

Q. Does Regulation 30 specify the items that shall be allocated to General Administrative Expenses?

page 642 } A. It does it by an open clause. Anything that is not specifically allocated to a different expense category is assigned to General Administration expenses.

Q. Now, if you will just follow me for the next two or three questions, we will finish this.

I am asking you not what you say the facts are. I am asking you to make an assumption, and what I am asking you is—let's assume for a moment that advertisements of the kind we are talking about became as large as one per cent of the five point five allowance for General Administrative Expense, that that in fact occurred, and let's assume further that the State Corporation Commission would find that amount to be an unreasonable allowance, and that, if that were the case, you shouldn't be given the five point five,—you

should be reduced say to four point five for General Administration, which would give you an extra per cent to throw into your loss experience. With those assumptions, is there any data before this Commission from
page 643 } which they can determine whether or not the advertisement for rate proposals had amounted to one per cent of that five point five allowance?

A. I answered your question before when I pointed out that the expenses of individual companies are subject to examination, and so are the facilities of the various trade associations, and the insurance departments know what the companies and the associations spend for the various items. They do not know right now how much they spent last year.

Q. You know that is not responsive to my question.

Commissioner Dillon: I don't think that is responsive. I think you ought to answer the question.

A. Well, I was coming to this point of saying that the Insurance Department cannot know what they spent last week because they review the expenses but not currently.

Mr. Shadoan: Mrs. Wootton, would you read the last part of my question back?

NOTE: The question is as follows:

page 644 } Q. (Continued) "With those assumptions, is there any data before this Commission from which they can determine whether or not the advertisement for rate proposals had amounted to one per cent of that five point five allowance?"

A. Do you mean what amount of money is included in the assessment for advertising?

Commissioner Catterall: No, no. The question is—is there on that table right in front of you the number of millions of dollars that are spent by the insurance Association on advertising, and you can surely answer that "Yes" or "No".

A. Obviously, the answer is no.

Mr. Shadoan: I agree, but it took me a long time to get it.

Commissioner Dillon: I think the Commission agrees.

Mr. Shadoan: Now yesterday when we were discussing the trend factor, I asked you some questions about the
page 645 } use of a frequency factor in developing trends, and if I understood your testimony correctly,

it was that you were unfamiliar with such an actuarial technique except for the criticism that had occurred in this testimony?

A. I think your question was specifically that you were referring to the State Farm, did I know what that Company does, and I said "No, I do not."

Q. Well now, are you familiar with the technique that uses frequency of claims as a factor in determining trends?

A. Oh, I know that there is such a technique. It was used in 1946 and 1948 when we had no other statistics available.

Q. State Farm is the largest liability insurance company in the world; isn't it?

A. Yes.

Q. I want to show you, how shall we mark these exhibits?

Commissioner Dillon: They will be received as Exhibits 33 and 34.

page 646 } Commissioner Catterall: Do they use this sort of data for basic rates or for classification groups?

Mr. Shadoan: Are you asking me or the witness?

Chairman Catterall: I am asking the witness. We have had exhibits where it was shown that people over sixty five have more accidents than others. In the statewide rates I am talking about.

Mr. Shadoan: I am talking about trends, average trends.

Q. You are familiar with the fact that this is a technique that is used in developing your overall bodily injury trend factor, aren't you?

A. I do not know what is the specific technique of State Farm. I doubt if it could be used.

Q. Do I understand you correctly that, after the Kentucky Commissioner rejected your trend factor, you have made no study to determine whether or not this would be a good technique to use or interpose in place of the rejected formula?

page 647 } A. I understand that we did not, but I did not handle the Kentucky case.

Mr. Shadoan: I did not ask you about the Kentucky case. Will you read the question, Mrs. Wootton.

NOTE: Question is as follows:

Philipp K. Stern

Q. "Do I understand you correctly that, after the Kentucky Commissioner rejected your trend factor, you have made no study to determine whether or not this would be a good technique to use or interpose in place of the rejected formula?"

A. I had no reason to do that because we are aware of the possibility of using claim frequency technique and have rejected it as inapplicable.

Q. One of these exhibits which has been marked Exhibit 33, gives a graph representation of the State Farm trend factor as developed for Maryland, the Maryland hearings. You see the graph and then they show a straight line. The straight broken line is the trend line, isn't it?

page 648 } A. Yes. It appears to be.

Q. If you were going to make such a graph showing the claims and that sort of thing, and you used your line of best fit, and you developed a trend, the purpose would be to develop a trend like that; isn't that right?

A. Yes.

Q. That exhibit which you produced upon my demand, Exhibit 11, that does not show a trend line at all, does it?

A. It did not intend to do that.

Q. I agree. I am not asking you what you intended to do. I have my ideas about that. What I am asking you is whether or not this shows these trend lines?

A. It is a factual presentation but does nothing as to the trend line.

Q. Now, with respect to the B.I. trend, we had reference earlier as to the hearing that was held in February of this year before the Arkansas Commission. You used a B. I. trend, indicating an upward adjustment in Ar-

page 649 } kansas of five thousand dollars bodily injury, didn't you?

A. Yes, we did.

Q. And the coverage there is ten-twenty, isn't it?

A. Yes.

Q. And you used a B. I. trend factor to adjust the data upward in Maryland in 1965, where the limits are fifteen thirty and you used the basic five thousand dollars; didn't you?

A. I don't know the specific data for the Maryland case.

Q. I showed you the exhibit yesterday. I will show it to you again.

Philipp K. Stern

A. Yes, you did. That is correct, yes.

Q. Have you ever used in the last three years before any department a B. I. trend which indicated a downward trend, a downward adjustment?

A. I believe there was a revision in North Carolina which reflected a downward adjustment.

Q. And did you use it?

A. It was used, yes.

page 650 } Q. When was that hearing?

A. I don't remember the exact date.

Q. Give me the year please.

A. I believe it was last year. It was used by the Commissioner. I should not mention North Carolina at all because we do not file rates in North Carolina.

Q. What I asked you was when did you find a downward adjustment of your trend factor sufficiently reliable that you used it in a rate filing?

A. We did not. On the other hand—

Q. I said when.

A. I said we did not.

Q. Never?

A. No. We also have rejected an upward trend factor right here in this State in the 1965 rate case, which was decided by this Commission on November 15th, 1965, we had a situation similar to the one at this time on bodily injury. We made the statement that the bodily injury average paid claim cost did not indicate a true trend up or down.

page 651 } If we had produced the kind of exhibit you asked me on yesterday to present, I believe that is Exhibit No. 11, we would have obtained a trend factor of one point zero four six or an upward adjustment of four point six per cent.

Q. May I see the exhibit?

A. I have it in my work folder. It is in the files of the Bureau of Insurance.

Q. I would like to see it.

A. You can look at my work folder.

NOTE: Folder handed Mr. Shadoan.

Q. Now, this says, this has a proposed factor adjusted of one point zero eight six, in Exhibit B—right?

A. No. There is a unity underneath.

Q. Oh, I'm sorry. You've got "Unity". I was looking at the P. D.

A. The indicated factor was one point zero four six. The proposed factor was one point zero zero zero.

Philipp K. Stern

Q. All right. Did you file such an exhibit in
page 652 } that filing?
A. Not in the filing. It is supplementary information, just as we did this year.
Q. But in this year what you filed was the underlying data, not the computation; isn't that right?
A. That is correct, and I believe it is the same thing as last time.
Q. Now, let me ask you a couple of questions about that.
Somebody said yesterday that there is no actuary on the Virginia staff. Is that correct?
A. If you define "Actuary" as someone who is a member of an actuarial society, the answer is "Correct".
Q. I haven't been given an answer. I am asking you if there is one.
A. There are many actuaries who are not members of a professional organization, and they are very capable, and I have the greatest respect for Mr. Hazelwood and Mr. Redd as Actuaries.
page 653 } Q. Are they Actuaries?
A. Yes. I would consider them Actuaries, yes.
Q. In other words, you are saying they are qualified, while not being members of the Actuarial Society; isn't that right?
A. Yes, Sir.
Q. That's what you are saying?
A. Yes, Sir.
Q. Now, can you explain why—
A. As a matter of fact, I would like to see them become members of the Academy of Actuaries which was recently formed. I hope they will become members.
Q. I do too.

Commissioner Catterall: Don't do that. We will have to raise their salaries.

Mr. Shadoan
Q. Can you tell me why in response to Mr. Hazelwood's letter, you submitted underlying data without the
page 654 } actuarial computations to the line of best fit, and showing what the factor was?
A. There are two good reasons for that:
One, Mr. Hazelwood knows, he is knowledgeable, and he can read the figures and understand.
Secondly, our trend line is designed to produce a line of

best fit. If by examination you determine that the line would not be a best fit, it would be misleading to calculate such a line.

Q. You had calculated it.

Mr. Moncure: Let him finish, please, Sir.

Mr. Shadoan: I'm sorry.

Mr. Shadoan

Q. Who is it going to mislead, this analyst, this expert that understands? Who are you going to mislead?

page 655 } Commissioner Dillon: Well, if you are trying to prove the incompetency of our staff, we think they are competent.

Mr. Shadoan: I am not trying to prove they are incompetent at all.

Q. I am going into why, when you had, isn't it a fact that *that* you had the trend factor computed, you had it computed because it has been presented in here as Exhibit No. 11?

A. I had it computed because I expected you would ask for it.

Q. But you didn't present it in response to Mr. Hazelwood's request, did you?

A. Mr. Hazelwood did not ask for it. He asked for the underlying data for bodily injury which lead to the conclusion that the factor should be unity

Q. May I see your exhibit No. 11, please?

While he is digging out Exhibit No. 11, may I ask you whether it isn't a fact that last year, in October of 1966, in Maine that has coverage of ten and twenty-five, you used

page 656 } a B. I. trend factor for showing an upward adjustment?

A. I don't quite understand your question. Are you asking whether we used a trend factor in Maine?

Q. Yes, to show an upward adjustment for B. I.?

A. I assume we did, but I don't have any rate filing in my memory.

Q. Exhibit No. 11 which you produced at my request was never submitted to the Insurance Department, it was never produced to anybody connected with Virginia before I demanded it yesterday; isn't that right?

A. That is correct. The underlying data was submitted.

Q. Yes.

A. At the request of the Department.

Q. And the underlying data does not show the data adjusted to the line of best fit, does it?

A. I don't know whether it does or not.

Q. That's Number 8, Exhibit No. 8.

page 657 } A. No, they don't.

Q. You don't have shown on what you submitted to the Department, you don't show the line of best fit, and you don't show the actuarial computations, do you?

A. That is correct, for the reasons I just explained before, that—

Q. Yes. Now—

A. —they do not lend themselves to fitting a straight line, which would present a best fit, it would be a misfit.

Q. And your computation indicated the average dollar change in paid claim cost, based upon a line of best fit, was a minus factor of seven point one twelve, (*sic*) is that right?

A. I assume you are reading from the exhibit. I don't remember.

Q. Your computation, when made on this exhibit that you didn't have to submit because it was self-evident, shows an average dollar change in paid claim cost based upon the line of best fit of minus seven point one two; right?

page 658 } A. That's what it shows, yes.

Q. And does it also show an average dollar change in paid claim cost in a thirty-four month period of a minus twenty point one five dollars?

A. That's what this calculation shows.

Q. And does it also show an average change in paid claim cost in a thirty-four month period expressed as per cent of a minus two point one per cent?

A. That's what it does.

Q. And then, finally, because you believe that these figures are not actuarially reliable, you use a factor of unity; is that right?

A. By the same reasoning as we did in 1965, when we had a plus indication and a similar lack of consistency in the data and where we also used a unity trend factor.

Q. Now—

A. Consistent in the prior relation and in this relation.

page 659 } Q. What I want to ask you now is, if it is because it was a lack of consistency in the data, why was it in your letter to Mr. Hazelwood you didn't mention

that, but relied instead upon the increased coverage? Can you explain that?

A. Well, I think you are reading into my letter—I said it is our belief that the average paid claim cost does not clearly indicate the presence of a trend, and, therefore, a factor of unity was applied.

Q. But in your letter—

A. I pointed out that for the latest period it has risen sharply to nine hundred and fifty-three dollars, which is much more than twelve months earlier. We also believe, I said, that our self-imposed limitation to five thousand dollars is not realistic, and that's why I said why we think it is not realistic, because of the fifteen/thirty minimum requirement.

Q. Now, are you finished?

A. Yes.

page 660 } Q. The thing that troubles me is that the same coverage was in force in Maryland in 1965, and this did not prevent you from using a trend which showed an upward adjustment. Can you explain why that's so?

A. No, I cannot explain it. I can try to think of reasons why something should not give a clear picture. I cannot—

Q. I am relating to this explanation you have in your letter about that it's not realistic in light of the fifteen/thirty minimum; and yet it is realistic in Maryland where you have the same limits.

A. No, it is not realistic in Maryland. I wish we had our ten thousand dollar limitation for all States, where the limits are more than five/ten, and we are working on those data, and we will have them.

It is not only going to be for Virginia, it is going to be in all States where the financial responsibility limits require more than five/ten coverage.

page 661 } Q. Well, it was sufficiently realistic that you used it to increase the rates in Maryland in your application, wasn't it?

A. Yes.

Q. And it was sufficiently realistic in Maine where there was ten and twenty coverage, when you used it to show an upward trend, wasn't it?

A. Yes. I notice that you fail to understand the concept of the limitation.

A limitation for five thousand or ten thousand dollars is designed to exclude unusual concepts. If nothing unusual occurred, the data will be perfectly reasonable and blend themselves to interpretation. It is only if unusual conditions

existed that the lack of a realistic limitation would produce unrealistic data.

Q. Well, maybe I didn't understand what you just said, and if I didn't, I want to make sure; and if the Commission understands, then I will just drop it.

But it is not the concept with which I quarrel.
page 662 } I don't feel qualified to challenge the concept.

What I don't understand is why the concept is valid in one State under what, as far as I can tell, are exactly the same conditions that prevail here, but is not a valid concept here.

A. No, Sir, it is not the same conditions here. I will try it again in different words.

We limit the items that go into the calculation of our averages, in order to exclude unusual occurrences. For example, if you have a big claim in a State, let's say two hundred and fifty thousand dollars. Give a certain volume in that State, it may affect the average paid claim cost for that one quarter, if you take it unlimited, to the extent of a thousand dollars; and the average paid claim cost will be extremely high in that one quarter, and any other quarter compared to that one will be out of line, for this
page 663 } one quarter we are talking about. Therefore, you should have a limitation to include that. But if no unusual loss had occurred, and you did not have the limitation, your data would still be reasonable, and then you would say, "Why do you need a limitation? I don't need a limitation because nothing unusual happened. I have the limitation prepared to meet unforeseen or extraordinary situations."

If in Maryland, even though the limit is fifteen/thirty, if the average paid claim cost was reasonable, and they do not show any unusual fluctuations, then I would say that probably there was no unusual condition or no accumulation of unusual conditions, and it is realistic.

Q. Well, now, the average, if I am following you, and let's make sure that we are all together on this because I want to be sure, what you are saying is the fifteen/thirty minimum coverage may be a cause to render the trend factor unrealistic in Virginia when it is not in Maryland
page 664 } or in Maine, because in Virginia there were unusual losses in the last quarter which took you up past your five thousand dollar limitation; is that what you said?

Philipp K. Stern

A. Well, I think it would be exact more, say that when I look at the data and I see that there are unreasonable fluctuations, I look for a reason, and I say this is probably due to the fact that we are limiting the losses by too low a level in comparison with the high required limits.

Q. Now, the fluctuations that you turned out here, you said they had risen to nine hundred and fifty-three dollars average paid claim cost. As I understand what you are telling me, the principal thing is that the pulse, the average paid claim costs were having some rather dramatic fluctuations which you felt were sufficient that you couldn't get a trend; is that right?

A. Again, you are saying they were not sufficient to produce a trend.

page 665 } Q. A reliable trend. Obviously, you can get a trend, can't you?

A. To indicate a reliable trend. Oh, yes, you can because I gave you one, but it is not reliable.

Q. And the reason is because of the fluctuations; is that right?

A. That is correct. It is most unusual to see an average paid claim cost jump from nine hundred and sixteen dollars to nine hundred and fifty-three dollars by the addition of only one quarter; and that is why we rejected the trend factor.

A. It was upward, yes.

Q. And the trend factor still pointed downward, but because of the dramatic fluctuation upward, you decided not to use it at all; is that right?

Q. Now, this was a fluctuation upward—right?

A. Well, the answer is "Yes". You have to understand the mechanics in designing a line of best fit. Any one

page 666 } change will force the line to tilt in one direction or the other. If you have an unusual loss, it will cause it to tilt, up or down. That is what makes the line unrealistic; but if you have a relatively smooth movement in values from one quarter to the next, the adjustment to a straight line does no violence to the actual value; it will always be relatively close.

Q. Well, now, I am looking at what was marked as Exhibit M before the Maryland Commissioner in developing a trend factor for bodily injury paid claim costs, and I see the last quarter there had jumped from eight forty-six to eight eighty-nine. That's just about as dramatic as your nine sixteen to nine fifty-three, isn't it?

Commissioner Catterall: Did this witness say that he thought that the Maryland trend factor was a reliable trend factor or did he just throw it in as a make-weight because he had all that trouble with the Maryland Commissioner?

page 667 } Mr. Shadoan:
Q. Can you answer the question, Mr. Stern?

Commissioner Catterall: That's what this lawyer is trying to get you to admit.

Mr. Shadoan: No. On the contrary, it's not what I am trying to get him to admit.

Commissioner Catterall: Well, I—

Mr. Shadoan: No; what I'm trying to get him to show—I disagree completely with what you said. As a matter of fact, that was the first hearing that had ever been hurled in a hundred years in Maryland, and there was no reason to expect that there was going to be any more difficulty in Maryland than I expect here.

What I am trying to show is the fluctuation in average paid claim cost in Maryland was just as dramatic as they are here. The only difference was that the trend factor was upward, and it was used. That's what I'm trying
page 668 } to get him to admit.

Commissioner Catterall: Well, make him admit it. Then we can go on to something else.

Mr. Shadoan: Well, I'm trying to.

Commissioner Catterall: Go ahead and admit it; then we can go on.

A. I did not examine recently the data, and I couldn't do it right now here. I gave you the change in one quarter only as one example. The Virginia trend data fluctuate from quarter to quarter. They have fluctuated for a long time, and we know that in Virginia we have had this problem of a non-responsive average paid claim costs.

Mr. Shadoan

Q. Can you—

A. I don't know what all the data from Maryland indicate.

Q. Can you explain, Sir, why for four years there has been no reliable trend in Virginia when there was a reliable trend in Maine, Arkansas and Maryland?

page 669 } A. I tried to rationalize it with myself. Until we have better data, as I set forth in my letter to Mr. Hazelwood, until we have better data.—

Commissioner Catterall: We've got an impasse that is going on forever.

Mr. Shadoan: I'm through with him, Your Honor.

Commissioner Catterall: The point has been made, and I think we can draw our own conclusions.

Mr. Shadoan: All right.

Mr. Shadoan: I just tender this.

Commissioner Dillon: Exhibit No. 35 will be received.

Mr. Shadoan: Which shows the average paid claim costs in Maryland.

Mr. Shadoan: I'm all through with Mr. Stern.

Commissioner Dillon: Do you want to start up again now?

Mr. Moncure: He has answered my question.

page 670 } He has kept unity when it was up in Virginia, that's all.

Commissioner Dillon: You may stand aside.

Witness stood aside.

page 671 } Mr. Moncure: Mr. Smith, will you come around one minute?

RICHARD EARLE SMITH, a witness introduced on behalf of Applicant, being first duly sworn, testified as follows:

DIRECT EXAMINATION

By Mr. Moncure

Q. What is your occupation, Mr. Smith, name and occupation and age?

A. Richard Earle Smith; age, forty; Executive Secretary of Virginia Association of Insurance Agents.

Q. There seems to be some misunderstanding of what you may have told Senator Howell. I just want to clear it up. Will you state to the Commission what you told him about agents' commissions?

A. Yes. Senator Howell made a vicissitous and brief statement, apparently on my behalf, yesterday, which needs considerable clarification.

page 672 } During one of the recesses yesterday he asked me, in response to a remark that Delegate George Allen had made here about some agent's commissions, what the agents' commissions were in Virginia. I prefaced my remark to him by saying that agents' commissions were a matter of private contract between the agent and his com-

pany, and that these come about through a matter of negotiation between the agent and his company.

I then told him that the agents' commissions, so far as we knew, could be twelve per cent or it could be fifteen per cent. Unfortunately, this is where Senator Howell stopped. I said it also could be eighteen per cent or twenty-five or thirty per cent; that we had never made a survey, it was none of our business, and we had no idea what the agents' commissions were on any class of business.

Mr. Moncure: That's all, Sir. I just wanted to get it straight.

page 673 } Mr. Shadoan: I would like to ask him a question.

CROSS EXAMINATION

By Mr. Shadoan

Q. When you say it might be as high as twenty-five or thirty per cent, you are speaking in terms of theoretical possibilities, rather than applying any factual knowledge that would indicate that anybody in Virginia is getting that much; is that correct?

A. Absolutely. I have no factual knowledge about it whatsoever.

Q. As a matter of *act,* you would be kind of shocked to find out anybody in Virginia was getting twenty-five per cent, wouldn't you?

A. Not only I, but I suspect some of our agents would be shocked to know that.

Comissioner Dillon: You didn't mean to imply that there were agents getting as little as twelve per cent, did you?

page 674 } A. No, neither one way nor the other. I simply indicated to him that we did not know what the agents' commissions are.

Commissioner Dillon: Well, you were certainly misquoted in the Courtroom yesterday.

Chairman Hooker: As I understand, the twenty per cent that is the agent's allowance is not followed; do I get that correctly?

A. As I understand the allowance we have, Judge, it is nothing but a budgetary allowance which includes agents' commissions. There are many other items that go into this

budgetary allowance, not the least of which is the branch office operation of the companies, which can in many instances be a rather substantial sum of money. I have no idea that the companies actually live on this twenty per cent. I suspect it would be somewhat higher in most instances.

Chairman Hooker: You are talking about the agents' commissions now would be higher or the companies?

A. No, the entire budgetary allowance for pro-
page 675 } duction.

Chairman Hooker: I understand it, yes; I understand the production costs. What I'm talking about is that we gave an allowance here for the agents of twenty per cent several years ago.

Commissioner Dillon: No.

A. No, I think this Commission has said many, many times that the production costs allowance has nothing to with *per se* with the agents' commissions.

Chairman Hooker: Yes, but this twenty per cent?

A. Twenty per cent allowance for the production, whether it is paid by commissions or otherwise.

Commissioner Dillon: Expenses of the offices, and all.

Commissioner Catterall: Why did the agents go to all that trouble and expense of trying to appeal to the Court of Appeals?

A. That was the time when the commission allowance, as I recall, was reduced from twenty-five per cent to twenty per cent.

page 676 } Commissioner Dillon: They were afraid that the five per cent was coming out of their commissions, that's the reason.

Chairman Hooker: As I understand from your testimony, it wouldn't have affected your commissions, so I am just like Judge Catterall, I'm surprised that you had any interest in it.

A. Well, Your Honor, as I recall, there were some other considerations in that particular case. It was appealed, and found to be not a party in interest in that case.

Mr. Moncure: Do you have any further questions of Mr. Smith?

Mr. Shadoan: Will you indulge me for just a moment?

Commissioner Dillon: Yes.

Mr. Shadoan: I don't think I have any questions.

Commissioner Dillon: You may stand aside, Mr. Smith. Thank you for coming.

Witness stood aside.

page 677 } Mr. Moncure: The Applicant rests, Your Honors.

Commissioner Dillon: Do you have some evidence?

Mr. Shadoan: If the Commission please, I furnished yesterday a copy of the written testimony of Mr. Grayson Maddrea to Counsel for the Applicant. It has been previously submitted I believe, maybe perhaps not up to the Commission, but in any event this testimony on direct suffers from the same advantages and the same limitations as the testimony on direct of Mr. Stern, that is to say, that the areas of it which are obviously not consistent with your ruling in the opinion of May 17th.

Commissioner Dillon: Well, it could be—

Mr. Shadoan: I would like for it to be received—

Commissioner Dillon: We will receive it.

page 678 } Mr. Shadoan: And you will give it such weight in those irrelevant parts as you think you ought to.

Commissioner Dillon: We will do that.

Mr. Shadoan: Your Honors, I would like to mark that as Exhibit No. 36.

Mr. Moncure: Okay. Just to get the record clear, the receipt of it is, of course, in accordance with the ruling that those portions of it dealing with the cash—

Commissioner Dillon: We will only consider that part of his testimony that is consistent with our prior opinion.

Mr. Shadoan: That being the case, this ruling in which I am in accord, I am simply going to present Mr. Maddrea for cross examination.

Commissioner Dillon: Come around, Mr. Maddrea.

Commissioner Catterall: But only on the parts that are relevant.

page 679 } Commissioner Dillon: Yes. He, I don't imagine, would want to cross examine on any points that we have already decided.

Mr. Moncure: No, Sir, unless he has something of his own. You are just putting him on for cross examination?

Mr. Shadoan: I am giving him to you, Sir.

Mr. Moncure: I have no questions whatsoever. I would like to put Mr. Stern back for rebuttal for the two things that are important.

Commissioner Dillon: Well, let him be sworn in.

page 680 } T. GRAYSON MADDREA, a witness introduced on behalf of Interveners, being first duly sworn, testified as follows:

DIRECT EXAMINATION

By Mr. Shadoan

Q. Will you identify yourself, Mr. Maddrea?

A. My name is T. Grayson Maddrea. I am a Certified Public Accountant in Virginia. I live at 8035 Marilea Road, Richmond, Virginia.

Q. Can you tell us something about the positions that you have held in your profession, Sir?

A. I am a member of the American Institute of CPA's, the Virginia Society of CPA's, I have served on the Professional Ethics Committee, the Committee on Federal Taxation, and the Board of Advisers to the Journal of Accountancy of the American Institute of CPA's, I have served on the Board of Directors and several Committees of the Virginia Society of CPA's, and have been President of its Richmond
page 681 } Chapter. I have had articles published in the Journal of Accountancy, Journal of Taxation, two chapters in two books on accounting and tax matters.

Q. How long have you been engaged in a full-time way in the profession as a Certified Public Accountant?

A. Twenty-four years.

Mr. Shadoan: I have no further questions.
Mr. Moncure: I have no questions.
Commissioner Dillon: Mr. Elliott?
Mr. Elliott: I have no questions.

NOTE: Direct testimony of Witness, T. Grayson Maddrea, is as follows:

PURE PREMIUM TEST

On Exhibit A, Sheet 1, of the rate increase application of the National Bureau of Casualty Underwriters the earned number of cars is divided into the dollar amount of losses incurred, including loss adjustment expenses, for
page 682 } statutory limits. This produces an average dollar amount per car, called the pure premium. This average amount is compared with the average amount in the present rates and indicates an increase. This increase

represents the proposed increase in premium rates after applying a factor for property damage. Calculating the need for a premium increase by this method and applying a percentage increase to the premium dollar results in the theory that all other expenses of the Companies "tracks" the increase in the average claim costs. That is, if rates are increased five per cent, there is a corresponding increase of five per cent in claim costs, agents' commissions, taxes and general overhead. Exhibit A, Sheet 11, of the National Bureau of Casualty Underwriters filing shows the budgeted amount of each expense item in the premium dollar. General and administrative expenses are budgeted at five point five per cent of the premium dollar. The National Bureau of Casualty Underwriters has presented no support-
page 683 } ing data to show that general and administrative expenses have increased, yet if the flat percentage increase is granted such additional funds would automatically accrue.

COVERAGE IN EXCESS OF STATUTORY LIMITS

The filing application of the National Bureau of Casualty Underwriters is based solely on statutory limits of fifteen/thirty for bodily injury and five thousand dollars for property damage. The earned premium for limits in excess of statutory limits is not included nor the incurred losses applicable to such extended coverage.

In tabulating losses for rate making, each loss incurred up to the statutory limit is first charged against the earned premium from excess limits. For the accident years 1963, the statutory limits, is any part of it charged against earned premiuc from excess limits. For the accident years 1963, 1964 and 1965, this statistical procedure has resulted in showing profits on excess limits coverage substantially
page 684 } in excess of five per cent. Sheet I attached, furnished by the National Bureau of Casualty Underwriters shows the loss ratio to be:

Accident Year	Loss Ratio
1963	.533
1964	.372
1965	.521

T. Grayson Maddrea

even after converting these amounts to 1967 prices by use of a factor. If we add thirty point four per cent for expense loading to the above loss ratios and subtract the result from one hundred, the profit on excess limits becomes:

Accident Year	% Profit to Earned Premium
1963	16.3%
1964	32.4%
1965	17.5%

It is true that the dollar volume of premiums for excess coverage is approximately ten per cent of statutory
page 685 } coverage but it is believed that it should be considered in deciding the need for an increase in premium rates. Sheet 2 attached shows the profit on underwriting for 1965 for statutory coverage, excess limits coverage and combined, on bodily injury coverage.

FACTOR FOR INCREASE IN PAID CLAIM COST

On Exhibit A, Sheet 1, Line 7, of the filing application, the pure premium for property damage of fourteen dollars and four cents has been increased by sixteen point three per cent to sixteen dollars and thirty-three cents. This increase is explained on Exhibit A, Sheet 3, of the filing, and represents the per cent of increase in paid claim cost during the thirty-four month period ended 3-31-66. The procedure assumes that paid claim cost will continue to increase in the future as it has in the past.

Exhibit A, Sheet 3, covers average paid claim cost by quarter years from 6-30-63 to 3-31-66. During the period from 6-30-63 to 12-31-65, the federal government imposed an eight per cent excise tax on new automobile repair
page 686 } parts. A certain amount of every claim for property is composed of repair parts cost. On January 1, 1966, this eight per cent federal excise tax was repealed and will not be a factor in future claim cost. Only one quarter (3-31-66) year's average paid claim cost is included in Exhibit A, Sheet 3, since the repeal of the eight per cent tax. Attached is a letter dated May 16, 1967, from the United States Department of Labor and a copy of the automobile repair cost index, attached as Sheet 3. This

material shows that from December, 1965, to March, 1966, there was no change in the auto repair cost index. It also shows that from December, 1965, to March, 1967, the index increased from one hundred and thirteen point seven to one hundred and eighteen point one, or four point four points.

Furthermore, no information is included in the filing request as to claim frequency. If claim frequency decreased and dollar losses remained the same, the average paid claim cost would increase with no increase in total loss
page 687 } expense to the companies. The ratio of losses incurred to premiums earned could decrease (because of many other factors), as it did in Kentucky (see decision of Kentucky Commissioner, February 6, 1967, pages 16, 17, 18), yet the average paid claim cost increased. This witness found the same to be true in Arkansas for 1965 and 1964 accident years for both bodily injury and property damage.

Attached Sheet 4 shows the average paid claim cost for National Bureau of Casualty Underwriters companies furnished to this witness in August, 1966, for the twelve months periods 3-31-63, 3-31-64 and 3-31-65 for bodily injury increased one point four one per cent over this period and for property damage increased four point seven nine per cent. Sheet 5 shows the average incurred loss for the same period for bodily injury decreased two point five three per cent and for property damage, increased two point three seven per cent.

The trend factor used in the filing was, zero for
page 688 } bodily injury, and sixteen point three per cent for property damage.

It is submitted that the trend factor increasing the pure premium be eliminated.

INVESTMENT EARNINGS ON UNEARNED PREMIUMS

The companies collect premiums in advance from policyholders. These premiums, less agents' commissions, are added to the company's assets and made available for investment. Insurance company accounting provides that premiums be counted as earned only as protection is furnished. Unearned premiums are recorded on the books as a liability (before deducting acquisition cost)for return to a policyholder in case of cancellation of the policy by either party. During the period of the policy, the cash from the entire premium (less

commissions) is usually invested in assets yielding income or increment in value, or both. Approximately eighty-five per cent of total assets are invested at all times. If the company went out of business, all unearned premiums
page 689 } would have to be returned to policyholders. Unearned premium, therefore, is not company money, but policyholder money. It is not available to pay dividends to stockholders or for any other company purpose. This Commission has previously ruled on the principle that investment earnings on unearned premiums should arithmetically reduce rates to the extent of one-half of one per cent of earned premium. The filing application of National Bureau of Casualty Underwriters does not reflect this ruling.

Furthermore, it is submitted that investment earnings on unearned premiums is one point thirty per cent of earned premium as shown on Sheet 6. Sheet 7 shows the average investment return for 1965 on eight hundred and five stock companies admitted assets was four point four six per cent, net after investment expenses. It is believed that the investment earnings considered should include interest, dividends, realized capital gains and unrealized capital gains, since all of these items are reflectd in income reported in the annual statements. Furthermore, to eliminate capital gains from this income may influence investment policy fav-
page 690 } orably in this direction and away from fixed income investments, which may fluctuate less.

In calculating policyholders' equity in unearned premiums, expense loading and profits, or thirty-five per cent for expenses and profit has been eliminated from the amounts shown on Sheet 6.

INVESTMENT EARNINGS ON LOSS RESERVES

When an insurance company receives a loss claim it estimates the probable amount it will have to pay out. It then makes a bookkeeping entry deducting this estimated amount from its income (incurred losses) and adding it to a liability account known as a loss reserve. No payment is made at this time, but assets must be held available at all future periods to pay this claim. Amounts remain in the loss reserves as long as eight years, with about ninety-eight per cent being paid out at the end of five years. During all this time, the assets held against this reserve are being in-
page 691 } vested in income producing investments. None of these assets can be used to pay dividends to

stockholders, to build new offices, or for any company purpose except to pay claims. It is submitted that investment earnings on funds held against loss reserves should be arithmetically used to reduce premium rates. Sheet 8 attached shows such earnings to be two point one six per cent of earned premium.

The point has been made that loss reserves are created from a company's surplus, and not from premium income. The term "surplus" means the undisbursed profits of prior years. It is basically earnings from prior years retained in the business for increased activity. Without such retainage, the need for new capital would have to be satisfied by sale of additional shares of stock. Any company which utilizes accumulated surplus for current claim costs is courting bankruptcy.

Exhibit A, Sheet 11, of the filing application shows that in Virginia point six four six of each premium
page 692 } dollar is budgeted for losses and loss settlement expense, point three zero four for other expenses and point zero five for profit and contingencies. It is obvious that every item of cost, including losses, is expected to be recovered from premium income. No business would remain solvent long, if this were not true.

LOSS RATIO — CASH BASIS

Computing the loss ratio on the basis of premiums written/losses paid produces the actual amount of dollars paid out for losses, or the "cash flow" method. The difference between the loss ratio, on this method, and one hundred represents the portion of the total premium dollar retained by the companies for all other purposes, Sheet 9 attached shows this ratio for all companies writing in Virginia for the calendar years 1961-1965 or a five year average of fifty-seven point eight five per cent. The ratios do not include loss adjustment expense. The ratios were computed from
page 693 } the annual reports of the Virginia Insurance Commissioner. The ratios have decreased from a high of sixty point four two per cent in 1963 to a low of fifty-two point eight eight per cent in 1965. The ratio for 1966 was fifty-three point five per cent.

T. Grayson Maddrea

FEDERAL INCOME TAXES

The effective rate of federal income taxes to net income per books (from all sources) for 1965 for eight hundred and five stock fire and casualty companies was four point seven per cent as shown on Sheet 10 attached. The principle (*sic*) reasons for this favorable tax position are:

(a) Section 832(b) of the Internal Revenue Code taxes a stock casualty company on the same accounting method as is used in the annual reports to Insurance Commissioners. That is, income is included on the accrual basis, but expenses are deducted on the cash paid-out basis. On a rising
page 694 } premium market this method generally produces a loss which offsets other taxable income.

(b) Interest earned from tax exempt securities is exempt from tax.

(c) Dividends received by one corporation from another taxable domestic corporation is eighty-five per cent tax free.

(d) Realized long-term capital gains are taxed at a maximum rate of twenty-five per cent.

(e) Unrealized capital gains are not taxed.

If any consideration is given to the federal income tax, in this case, it is believed that the effective rate should be used and not the maximum rates.

PRESENT AND PROJECTED PROFIT ON UNDERWRITING ACTIVITIES

Sheet 11 attached, shows a computation of profit by using the "premiums earned/losses incurred" method
page 695 } plus investment earnings on unearned premium and loss reserves for bodily injury at present rates, to be four point eight eight per cent of earned premium. The last two columns on Sheet 11 show the projected profit if the rate increase is granted, to be eight point four nine per cent on the same basis.

Sheet 12 shows the computation for property damage on the same basis as Sheet 11. It shows present rates are yielding seven point two two per cent profit on earned premium and will yield eight point four four per cent if the proposed rate increase is granted and if property damage losses increase sixteen point three per cent.

It is the understanding of this witness that fire insurance

rates in Virginia are adjusted by using computations similar to those on Sheets 11 and 12, except that no investment earnings on loss reserves are included.

page 696 } The attached Sheet 13 is an article written by Mr. Frank Harwayne, Actuary for the New York State Insurance Department entitled "Insurance Risk, Investment and Profit". This article was submitted to the May 16, 1966, meeting of the Rates and Rating Organizations Subcommittee of the National Association of Insurance Commissioners, which accepted the article without action. On page 15 of this article Mr. Harwayne points out that

"These considerations lead to the result that net after tax income arising from premiums amounts to 11.3% for casualty (10.1% for fire) on account of premium. To this must be added the net return attributable to stockholders' funds which amounts to 6.3%. The grant total net after tax return on account of both policyholders' and stockholders' funds is 17.6% for casualty insurers (16.4% for fire insurers)."

Commissioner Dillon: You may stand aside.

Witness stood aside.

page 697 } Commissioner Dillon: Do you have any other evidence?

Mr. Shadoan: We have no further evidence.

Mr. Moncure: Your Honor, I would like to put Mr. Stern on just for two points he would like to comment on.

Commissioner Dillon: All right.

Mr. Moncure: Mr. Stern, will you come around, please, Sir?

page 698 } PHILIPP K. STERN, resuming the stand, testified as follows:

RE-DIRECT EXAMINATION

By Mr. Moncure:

Q. Mr. Stern, I believe last night you did have an opportunity to examine Mr. Maddrea's testimony, did you not, Sir?

A. Yes, I did.

Q. And I believe there are only two things involved that

are germane here, and that's the trend factor and the federal income. I would like for you to address yourself to those two wherein the actuarial soundness of those two theories is involved.

A. On Pages 2 and 3 of Mr. Maddrea's testimony, Mr. Maddrea refers to the relationship of trends in property damage and bodily injury, using incurred losses paid claim cost, and he has attached an exhibit to that.

His comments on bodily injury are—

page 699 } Mr. Shadoan: May I interrupt for just a moment? I would like to suggest this. It may not be possible, but it's going to be very difficult for me to follow and be able to object if I have an objection or otherwise do anything if this witness simply makes a speech about what he thinks about Mr. Maddrea's testimony. Now, if Mr. Moncure is able to ask questions and get answers, that means when he asks the question I could object if I don't like it, and I can follow testimony much better.

Commissioner Catterall: Why doesn't Mr. Moncure just read the part he wants to be commented on, and then we will all know what he is talking about?

Mr. Moncure: Judge, I think this is the one point on the exhibit that doesn't back up with the statistical date, and address yourself to that.

Mr. Shadoan: I would certainly agree. That would be much easier for me if he would do that.

page 700 } Commissioner Catterall: It would be much easier for us.

Mr. Shadoan: Yes.

Mr. Moncure

Q. In what way is the computation made upon which the statement on the bottom of Page 2 is based as to the trend factor put incorrect?

Mr. Shadoan: What statement are you talking about?

Mr. Moncure: I'm talking about the statement—

Commissioner Catterall: We want to hear the statement read aloud by somebody.

Mr. Moncure: All right, Sir.

On the top of Page 3—starting on Page 2, the statement is made:

Philipp K. Stern

"On Exhibit A, Sheet 1, line 7, of the filing application, the pure premium for property damage of $14.04"—

Mr. Shadoan: Wait a minute. I can't find it. That's on Page 2?

Mr. Moncure: At the bottom of page 2.

page 701 } Mr. Shadoan: Okay.

Mr. Moncure:

"has been increased by 16.3% to $16.33. This increase is explained on Exhibit A, Sheet 3, of the filing, and represents the per cent of increase in paid claim cost during the 34 month period ended 3-31-66. The procedure assumes that paid claim cost will continue to increase in the future as in the past."

Now, that's his statement; and he comes on down on Exhibit A and refers to the quarter by quarter, and makes the statement

"During the period * * * the federal government imposed an 8% excise tax * * *."

We went into all that yesterday. I am not concerned with that portion of it.

But we come to the top of Page No. 4, and this

page 702 } is the question that I want this witness to answer:

"Attached Sheet 4" (attached to Mr. Maddrea's testimony) "the average paid claim cost for National Bureau of Casualty Underwriters furnished to this witness in August, 1966," (that's Mr. Maddrea) "for the 12 months period 3-31 63, 3-31-64 and 3-31-65 for bodily injury increased 1.41% over this period and for property damage increased 4.79%. Sheet 5 shows" (that's Mr. Maddrea's exhibit) "the average incurred loss for the same period for bodily injury decreased 2.53% and for property damage, increased 2.37%. The trend factor used in the filing was, zero for bodily injury, and 16.3% for property damage."

Q. I want Mr. Stern to point out the inaccuracies of those exhibits 5 and 4 referred to in that statement.

Philipp K. Stern

Commissioner Catterall: Have you got some
page 703 } that we can look at so we can follow you.

Mr. Shadoan: We have some extra copies of Mr. Maddrea's testimony.

Mr. Maddrea: Here it is, Judge.

Commissioner Catterall: You are going to comment on—

Mr. Shadoan: I would inquire from Mr. Moncure or ask the Commission to inquire of Mr. Moncure to identify the exact page he is going to comment on.

Mr. Moncure: It is Page 4. I want him to comment on the statement, and what was furnished him by the National Bureau upon which he based his Exhibit Nos. 4 and 5.

Commissioner Catterall: What page number?

Mr. Shadoan: In the bottom righthand corner it says 4 and 5 on the exhibit.

Commissioner Catterall: All right. I've got 4 and 5.

page 704 } Mr. Moncure: Has the Commission got the exhibits?

Commissioner Dillon: Go ahead. That's all right. We will listen to you.

Mr. Moncure: You don't have the exhibits?

Commissioner Dillon: I have them here, but I can't find them.

Commissioner Catterall: We have one copy, but there are three of us, and it would be lovely if we could have three copies of the exhibits.

NOTE: Exhibits handed Commissioners.

Mr. Shadoan: It says at the top of the page, I believe, "VIRGINIA AVERAGE AMOUNT PER PAID LOSS PRIVATE PASSENGER CARS".

Commissioner Dillon: That is 5?

Mr. Moncure: Yes, Sir, tied in with 4.

Mr. Shadoan: Now, that's the one that says "AVERAGE AMOUNT PER INCURRED LOSS", is it? That's No. 5?

page 705 } Mr. Moncure: You will have to ask him because I haven't one. You all only gave me one, and I have given that to Mr.—

A. Yes, yes.

Commissioner Dillon: Incurred losses.

A. Mr. Maddrea quotes on page 5 data which we submitted in the investigation case, specifically, at his request,

for he wanted to see a direct comparison of average claim cost on a paid and on an incurred basis, and that was in connection with a contention made at that time that the incurred losses are exaggerated.

With proper cautions we submitted an exhibit at that time, which was prepared out of the ordinary procedure in the Bureau, and it was explained to him at that time what we did. We had to take calandar year incurred losses and compare them with calendar year paid losses.

The proper way to locate incurred losses is on an accident year basis because only that way can you eliminate the changes in loss reserves which affect cases which

page 706 } have faded out of the current experience. We have readily available such comparison in the compilations of experience which are part of the information we submitted to the Bureau of Insurance, and which were entered in the record on yesterday by Mr. Moncure.

Mr. Moncure: The letter of May 9th, I believe, if you want a reference to it, Mr. Shadoan.

Mr. Shadoan: Yes.

Mr. Moncure: It's filed as Exhibit No. 24 or 25.

A. Comparing the calendar year incurred losses with the paid loss data which we use for a trend is a proper way of comparison.

On bodily injury, I don't think we have any disagreement. We stated that there is no significant trend, and Mr. Maddrea does not disagree. He states that our trend is zero.

On property damage, the accident year incurred average claim cost by our—for accident year—

page 707 } Mr. Shadoan: I'm going to object to the portion of the comment which characterizes Mr. Maddrea's statement as not disagreeing. That is not a fair comment upon the direct testimony as printed. It's a statement that that is the trend factor used by the NBCU, not that he agrees or disagrees with it.

Commissioner Dillon: We will amend it.

Commissioner Catterall: We will amend it. He neither agrees nor disagrees.

Mr. Moncure: "Disagrees", it doesn't make any difference.

Commissioner Dillon: He doesn't comment one way or the other.

A. On property damage the incurred average claim cost for 1963 in Virginia was a hundred and seventy-nine dollars; for 1964—

Commissioner Catterall: It's a hundred and sixty-nine on what I am looking at.

Mr. Moncure: Well, that's where the error is.

page 708 } We say it's different when calculated on the policy year.

Commissioner Catterall: I thought he was talking about this Number 5.

Commissioner Dillon: He is, but this is Mr. Maddrea's exhibit.

Commissioner Catterall: Oh, he is comparing Mr. Maddrea's testimony with this exhibit.

Commissioner Dillon: No, with his own exhibit. He is comparing this exhibit with his own exhibit.

Mr. Moncure: He says the exhibit is wrong because it is taken on the calendar year basis rather than the policy year—the accident year—which you remember this Commission ruled in its May 15th opinion.

Commissioner Catterall: Well, I'm looking at this exhibit.

Commissioner Dillon: He is disagreeing with this exhibit.

This is Mr. Maddrea's exhibit, and he says this

page 709 } exhibit is wrong.

Commissioner Catterall: Well, so I can follow the witness, let him point out what he is talking about. Are you talking about this one sixty-nine figure on this exhibit, and you say it should be one seventy-nine?

A. Yes, Sir. This one hundred and sixty-nine dollars is a twelve months calendar year period ending March 31, 1963, and it contains the paid losses for that period plus the outstanding losses at the end of the period, minus the outstanding at the beginning of the period.

Chairman Hooker: Now, what is your contention this figure should be?

Commissioner Dillon: One seventy-nine, I believe it is.

Mr. Moncure: It's one seventy-nine rather than the figure shown. That's inaccurate.

A. Let me make that very clear. I am saying

page 710 } that instead of using a calendar year incurred claim cost, you should use an accident year paid claim cost.

Commissioner Catterall: But the accident year could be a calendar year.

Chairman Hooker: You are not disagreeing with this; you are just disagreeing on the method?

Commissioner Dillon: He is disagreeing with the figures.

A. That is right.

Philipp K. Stern

Chairman Hooker: Not the figures, but on the years?

A. I assume Mr. Maddrea has quoted the figures correctly. I have no way of checking it, but I assume that he copied them correctly from my letter.

Commissioner Catterall: Couldn't an accident year be a calendar year?

A. An accident year covers the same period as a calendar year. The difference is that in our terminology

page 711 } calendar year experience is simply a recording of the transactions during the twelve months' period, which may involve transactions going back many years, where an insured had an accident many years ago, for example.

Commissioner Catterall: When you say "calendar year", you don't mean that you are talking about all the accidents that occurred during that year?

A. No, that would be the accident year.

Commissioner Catterall: I see; so when you say "calendar year", you mean a non-accident year?

A. Right.

Commissioner Catterall: I see.

Mr. Moncure

Q. In other words, it is a different method of computation from what you use on the accident year as against the calendar year?

A. I want to proceed by substituting for the figures shown on Sheet 5 for property damage, which are non-accident year data, the figures shown in the compilation of

page 712 } our experience for property damage, and, if I may quote these—the property damage incurred claim cost for accident year 1963 was a hundred and seventy-nine dollars; for 1964, one hundred and eighty-two dollars; and for 1965, two hundred and one dollars.

If we calculate from these figures an average annual change in average incurred claim cost for property damage liability, we find that the change is, in round figures, six per cent, approximately a twelve dollar increase per year.

That compares with the average paid claim cost annual increment, calculated in our filing, in round figures, of nine and a half dollars. The difference, of course, is due to the fact that in order to get a reliable average, we use many more points of time than just two points or two annual periods ended.

Commissioner Catterall: How many more?

Philipp K. Stern

A. We use twelve points of quarterly ended annual periods.

page 713 } Mr. Moncure: Exhibit A, Sheet 4, is the calculation in the Exhibit No. 7 of the filing.

A. But the comparison of the increment and average incurred claim cost which is what we use to predict the further movement of average claim cost certainly shows that our trend factor is conservative compared to the actual calendar year results.

Mr. Moncure

Q. Now, Sir, the statement of Mr. Maddrea on Page 7, the caption "FEDERAL INCOME TAXES". He makes the last statement there:

"If any consideration is given to the federal income tax, in this case, it is believed that the effective rate should be used and not the maximum rates."

What have you to say with respect to that statement?

Mr. Shadoan: Just a moment. Before he says anything, I'm going to object because he has testified pre-

page 714 } viously that he is neither an accountant nor a lawyer, that he has no familiarity with this, and he is not qualified to comment on a tax law at all.

Commissioner Dillon: I don't think we need a comment on it.

Mr. Moncure: Sir?

Commissioner Dillon: I don't think we need any comment on it.

Mr. Moncure: The Commission understands this is taken care of in its order I think, along with the factor of one-half of one per cent.

That's all I have, Gentlemen. I wanted to clarify that.

Commissioner Dillon: Do you have any questions?

Mr. Shadoan: Yes, I have a couple of questions, Mr. Commissioner.

RE-CROSS EXAMINATION

By Mr. Shadoan

page 715 } Q. Mr. Stern, I had some difficulty following the conclusions that you reached, and as I gleaned it from what you said, it was that the approach you use on an accident year is more conservative than the results that would be shown on a calendar year; is that right?

A. No, I did not say that.

Q. You didn't?

A. No.

Q. When you said it was more conservative, what was it; what contact are you talking about being more conservative?

A. I pointed to Sheet 3 of Exhibit A, which is Exhibit No. 7 in this case, on which we calculated from a period covering twelve points of time beginning with the year ended June 30, 1963, through the first quarter of 1966. From these data we calculated an annual increment of nine dollars and seventy-six cents in the claim cost; and we said we expect that to be continued—that to continue for a certain length of time.

If we look at calendar year incurred claim cost,
page 716 } we find that for substantially the same period,
1963 accident year through accident year 1965,
the annual increment in claim cost was actually twelve dollars and change.

And I said our assumption that the increment will continue at the rate of nine dollars and change is conservative in light of the twelve dollar increment, actual experience on an incurred basis.

Q. Well, perhaps I didn't make myself clear, but that's exactly what I tried to say, that's what I understood you to say.

Now, Mr. Maddrea's, the first of his computation, as far as I can determine it, is to compare the results of using incurred cost with paid cost; isn't that so?

A. He is using the data submitted for that purpose. He is now using them for a different purpose.

Q. Well, now, the computation that you have done in examining it, you haven't got any figures on an ac-
page 717 } cident year basis which would show incurred
losses, do you?

A. Of course.

Q. Oh, you do?

A. Incurred losses on an accident year basis are in our letter of May 9, 1967.

Q. Which letter is that?

A. Which is a combination of experience.

Q. On the quarterly?

A. No, not on the quarterly basis.

Q. Well, that's what you use here, isn't it, quarterly basis?

A. Well, the—

Philipp K. Stern

Q. I'm asking you if you've got the same data for incurred losses, so you can make a comparison with this?

A. No, you don't. You are not contemplating a rate-making procedure. It is—

Q. I'm not asking—look, I'm not trying to say that you should have it.

A. All right.

Q. I'm just saying you don't, do you?

page 718 } A. No, we do not.

Q. And the only way that you can make a comparison between incurred claims and paid claims is to do it on a calendar year basis because that's the only way that you've got the data; isn't that right?

A. It is your contention.

Q. I'm asking you a question.

A. The answer is "No".

Q. You do have it then? Obviously, you've got it—

A. Sir, you ask me—

Q. —on a full year basis here.

A. —to answer your question. The only way to compare incurred and paid losses is on a calendar year basis; and my answer was "No".

Q. No. Well, I didn't mean to ask you that. What I thought I had established, and maybe I was mistaken, that you do not have incurred loss data by quarter as you have paid loss data on Exhibit A, Sheet 3?

A. That is correct. We do not have—

page 719 } Q. And if you don't have the data—

Mr. Moncure: He is trying to say they don't use in rate-making, if you will let him get it out of his mouth.

Mr. Shadoan: He said that three times. I am not quarreling with the way he makes his rates.

Mr. Moncure: Well, the man said he doesn't prepare it for rate-making, and this is a rate filing, and I object to cutting him off before he makes his statement.

Mr. Shadoan: I apologize for cutting him off, and I hope it never happens again.

Commissioner Dillon: Your apology is accepted.

Mr. Shadoan

Q. Now, Mr. Stern, you don't have incurred loss data which is comparable to the paid loss data shown on Exhibit A, Sheet 3, do you?

A. No.

Q. And if somebody wanted to, whether you
page 720 } think it is appropriate or not, they can't make
the comparison because you can't give them the
data on this basis; isn't that right?
A. That is correct.
Q. All right.

Mr. Shadoan: I ask that this be marked as the next exhibit.
Commissioner Dillon: That will be received as Exhibit No. 36.

Mr. Shadoan
Q. While he is marking the exhibit, let me ask you if it is not true then, since we can't make the comparison, you can't say whether if the incurred loss data were compared with the paid loss data on a quarterly basis for the accident year that it would show any different result than that reached by Mr. Maddrea using calendar year data, can you?
A. No, I couldn't possibly answer your question. I would like to ask you to restate it.
Q. Let me try again.
You can't tell us that if we had the data on
page 721 } an accident year, rather than on the calendar
year, that it would show any different conclusion,
can you?
A. Of course, I can.
Q. I pointed out before that the incurred losses on a non-accident year data, you can't tell us that the conclusion from trend.
Q. I'm not asking that. I'm asking if you are making the comparison, Sir—see, we talking about making comparisons; that's what Mr. Maddrea did.
A. Comparisons?
Q. Between paid data and incurred data; and if you use the kind of comparison that Mr. Maddrea employed for accident year data, you can't tell us that the conclusion from that technique would be any different because he used accident year data rather than calendar year data?
A. I thought that's exactly what I did. I thought I showed
that if you used accident year data compiled
page 722 } under the official requirements for the statistical
recording in Virginia, under the statistical system required in Virginia, you are getting the results which

I quoted; and I explained that incurred loss data on a non-accident year basis are misleading.

Q. We understand that; but what I was hoping to establish—maybe I don't understand everything; but we've got four components. We have incurred data and loss and paid data on an accident year basis. We have incurred data and paid data on a calendar year basis. We have established a comparison on a calendar year basis which you feel is an inappropriate approach. We understand that you cannot make such a comparison on an accident year basis because you don't have the data for incurred losses on an aggregate year.

And my question is, since we don't have that and we can't make that comparison, we can't say that a comparison on that basis would show any different result. Am I wrong in that?

A. You are wrong because you are starting with

page 723 } the wrong premise. You say we don't have accident year incurred losses; and I am telling you the accident year incurred losses are in the record, they are right here.

Q. On a quarterly basis.

A. That you didn't say.

Q. That's what I'm saying now. I thought you understood that.

A. No, I did not understand that.

Q. Well, you don't have it on a quarterly basis?

A. No. Neither do we have Mr. Maddrea's non-accident year incurred losses on a quarterly basis.

Q. I'm going to show you what has been marked as Exhibit No. 36, which purports to be a letter dated August 19, 1966, to Mr. G. L. Hazelwood, Jr., Rate Analyst; and since it's signed by you, I want you to read it into the record, and I want to ask you some questions about it. I want you to read it aloud so Mrs. Wootton can hear it.

page 724 } "Dear Mr. Hazelwood:

"Under a separate letter we are sending you underwriting results on private passenger cars in Virginia based upon the experience of all companies reporting to the National Bureau for three 12-month periods ended March 31, 1963, 1964 and 1965; those data were compiled in response to your specific request of July 13, 1966.

"You will recall that Mr. Maddrea requested certain information from us in a letter dated April 27, 1966, which

was the subject of a conference in Richmond on July 8, 1966. During that conference, Mr. Maddrea explained that the purpose of his request was to obtain data from which he could make a comparison of average paid claim costs and average incurred claim costs. We explained to him that
page 725 } the data he had requested would not produce this information and proposed to find other means of compiling experience that would serve Mr. Maddrea's purpose. Mr. Maddrea expressed satisfaction with this approach.

"A short time later, in the course of developing methods to comply with your request the calendar year paid and incurred private passenger premiums and losses, we realized that we could obtain the information that Mr. Maddrea is seeking as a by-product of the data requested by you. Attached hereto in an exhibit showing paid losses and number of paid claims as well as incurred losses and number of incurred claims, and the respective average claim costs, for the three-year periods ended March 31, 1963, 1964 and 1965. These losses are exactly the same as those used in the
page 726 } exhibits, referred to at the beginning of this letter; in order to develop average claim costs, the losses and number of claims are exhibited separately for bodily injury and property damage.

"We are submitting this information as our response to Mr. Maddrea's request of April 27, 1966. In accordance with the understanding reached at our conference, we are sending a copy of this letter directly to Mr. Maddrea."

Q. Did you sign that letter?
A. Yes, I did.
Q. All right. Well, now, let me ask you some questions about it.

Mr. Shadoan: If the Commission please, I'm going to finish very shortly, but if you want to take a recess—
Commissioner Dillon: Let's take a five minute recess.
Commissioner Catterall: Let's make it ten minutes.

page 727 } 11:00 A.M. Commissioner Dillon: The Commission will recess ten minutes.

11:10 A.M. The Commission resumes its session.

Mr. Shadoan

Q. According to this letter that you wrote in August of last year, you understood Mr. Maddrea's purpose in requesting these data; is that correct?

Mr. Maddrea's purpose in requesting these data; is that correct?

A. Yes, I did. The purpose was—

Q. I'm not asking you what the purpose was. I am asking you if you understood it. If you will just answer my questions, we will finish up very quickly.

A. Yes.

Q. And you proposed to find other means to satisfy his purpose, that what he asked for wouldn't do it; isn't that right? Isn't that what you said in the letter, you proposed other means?

A. That's what I said, and I don't remember

page 728 } the details, of course.

Q. Okay. Then in this letter you tell Mr. Hazelwood that in the course of developing methods to comply with his request, you realized that you could obtain the information he was seeking as a by-product, and satisfy his purpose; isn't that right?

A. Right.

Q. And this data is the exhibit right here, attached to the letter; isn't that right?

A. Yes.

Q. Now, you show me something in that data that is in any way different from the data used by Mr. Maddrea in making his computation.

A. I think I said before that I assumed Mr. Maddrea copied my numbers correctly. That is not my objection to using them for the purpose he is using them here for.

Q. Well, we have established, have we not, that you knew his purpose, and you compiled this data to suit

page 729 } his purpose and gave it to him; haven't we established that?

A. The purpose at that time, yes.

Q. Let me see that letter. His purpose was to obtain data from which he could make a comparison of average paid claim cost with average incurred claim cost. That was his purpose, and that is what he has done; isn't that right?

A. No, he did not. Here he compares trends in average paid claim cost with trends based on incurred paid claim cost. There he wanted to compare absolute values of average—

In 1966 Mr. Maddrea made the contention that the com-

panies loss reserves are exaggerated and that their incurred claim cost are too high in comparison to the paid, and, therefore, he asked that we show him a comparison of absolute values; and that's what I tried to give him, to the best of my ability, at that time.

page 730 } Q. Well, let me ask you this, this one final question. Can't you say without making a computation that under the conditions that exist today the only difference that is going to exist between using paid and incurred is that the incurred is going to be more current and it is going to show a more increasing trend?

A. No.

Q. You can't say that?

A. No.

Q. Let me ask you this. The use of incurred data for the purposes of determining your loss experience is justified primarily because it's more current than paid data; is that not correct?

A. No.

Q. Well, your paid data includes accidents from prior years, that may have happened several years ago; isn't that right?

A. Yes.

Q. And the incurred data is related to the accidents which occurred in the year that you are *sttempting* to measure the experience?

page 731 } A. Yes.

Q. But when you get to make your trend, you start to make your trend, you use paid costs instead of incurred costs; isn't that right?

A. Yes.

Mr. Shadoan: I don't have anything further.

Commissioner Dillon: You may stand aside.

Witness stood aside.

page 732 } Commissioner Dillon: Is that all?

Mr. Moncure: We rest, permanently, I hope.

Mr. Shadoan: We haven't anything further.

Commissioner Dillon: Well, we enjoyed having you and Mr. Stallard with us in this hearing. I don't know whether Mr. Stern will say the same thing.

The Commission will take this matter under advisement. The Commission will rise.

page 733 }

* * * *

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

AT RICHMOND, JUNE 23, 1967

CASE NO. 18386

For a revision of automobile bodily injury and property damage liability insurance rates.

THIS PROCEEDING was heard on May 31 and June 1 and 2, 1967 and taken under advisement. The applicant was represented by M. Wallace Moncure, Jr., its counsel. The following parties intervened: Virginia State AFL-CIO by Beecher E. Stallard and George W. Shadoan, its counsel, C. Harrison Mann, Jr., Henery E. Howell, Jr., Stanley E. Sacks, Thomas W. Moss, Jr., George E. Allen, Jr., Clive L. DuVal II, and the Board of Supervisors of Arlington County by Charles E. Hammond. The Commission was represented by its counsel.

NOW, ON THIS DAY the Commission is of the opinion and finds:

(1) That the rates proposed in the filing for writing automobile liability insurance on private passenger automobiles for the Family Automobile Policy and the Basic Automobile Policy are excessive and should not be approved.

(2) That in lieu of the rates filed by the applicant it should file rates for the Family Automobile Policy and the Basic Automobile Policy which will produce: (a) An increase of 4.0% in the statewide rate level for bodily injury liability with limits of coverage of $15,000/$30,000; (b) An increase of 16.7% in the statewide rate level for property damage liability with a limit of coverage of $5,000; and (c) An increase of 8.2% in the statewide rate level for bodily injury and property damage liability combined with limits of coverage of $15,000/$30,000 for bodily injury liability and $5,000 for property damage liability, and that such rates shall be based on the following expense and loss provisions in the rating formula by which the statewide rate level changes for

members and subscribers of the National Bureau of Casualty Underwriters are determined.

page 734

Item	*Provision*
General Administration	5.0%
Inspection and Bureau	1.2
Total Production Cost Allowance	20.0
Taxes, Licenses and Fees	3.7
Underwriting Profit and Contingencies	4.5
Total Service and Overhead	34.4
Expected Loss and Loss Adjustment Ratio	65.6
Grand Total	100.0

(3) That the proposal of the applicant to eliminate the discount on compact private passenger automobiles provided for in Rule 27 of the Virginia Exception Sheets to the manual of classifications, rules and rates, rating plans and modifications thereof for writing automobile bodily injury and property damage liability insurance and in Rule 8A of the Special Automobile Policy Manual should be denied for the reason that it produces rates for writing automobile liability insurance on compact private passenger automobiles which are excessive;

(4) That the premiums proposed for the Special Package automobiles should be based upon the expenses and losses decessive and should be disapproved;

(5) That in lieu thereof, the applicant should file premiums therefore based on the rates for bodily injury and property damage liability insurance on private passenger automobiles required to be filed by Paragraph (2) above calculated in the manner proposed in the filing; and

(6) That future revisions of premiums for writing the Special Package Automobile Policy on private passenger automobiles should be based upon the expenses and loss developed under that policy and should be calculated on a rating plan to be developed by the applicant for its members and subscribers.

IT IS THEREFORE ORDERED:

(1) That the applicant file rates in compliance with the foregoing findings of fact;

(2) That in future applications for revisions of premiums

for the Special Package Automobile Policy, the proposed premiums shall be based on the expenses and losses developed under that policy; and

(3) That the revisions of automobile bodily in-
page 735 } injury and property damage liability insurance rates and premiums set forth herein are approved for use in this State by the members and subscribers of the National Bureau of Casualty Underwriters on all new and renewal policies written on and after August 2, 1967 and to all policies written before August 2, 1967 which will become effective on or after October 1, 1967. No policies effective prior to August 2, 1967 shall be endorsed or cancelled and rewritten to take advantage of or to avoid said changes except at the request of the insured and at the customary short rate charges as of the date of such request, but in no event prior to August 2, 1967. Upon experience rated policies, however, the revised rates herein approved shall be applicable as of the experience rating date of all policies to which an experience rating modification which becomes effective on or after October 1, 1967 is to apply and may not be applied to such policies prior to the experience rating date. As respects any policy to which an experience rating modification applies which became effective prior to October 1, 1967, these changes may not be applied until the first experience rating date after October 1, 1967.

(4) That an attested copy hereof shall be sent to the applicant, 125 Maiden Lane, New York, New York 10038, and to Wallace Moncure, Jr., its counsel, Ross Building, Richmond, Virginia; to Beecher E. Stallard, Attorney at Law, Central National Bank Building, Richmond, Virginia; George W. Shadoan, Attorney at Law, 352 Hungerford Drive, Rockville, Maryland 20850; C. Harrison Mann, Jr., Attorney at Law, 815—15th Street, N.W., Washington, D.C. 20005; Henry E. Howell, Jr., Attorney at Law, 808 Maritime Tower, Norfolk, Virginia; Stanley E. Sacks, Attorney at Law, Virginia National Bank Building, Norfolk, Virginia; Thomas W. Moss, Jr., 1528 Maritime Tower, Norfolk, Virginia; George E. Allen, Jr., Attorney at Law, Box 6855, Richmond Virginia; Clive L. DuVal, II, 821—15th Street, N.W., Washington, D.C. 20005; Board of Supervisors of Arlington County, Attention: Charles E. Hammond, Courthouse, Arlington, Virginia 22201; and, to the Bureau of Insurance.

A True Copy

Teste:

WILLIAM C. YOUNG
Clerk of State Corporation Commission.

page 736 }

* * * * *

Opinion, CATTERALL, *Commissioner:*

The considerations involved in the making of automobile liability insurance rates were considered in the course of an investigation instituted by order of the Commission on January 25th, 1966, in Case No. 17680. The Commission's opinion in that case, dated May 15, 1967, is referred to as a part of this opinion.

Applying the principles of that opinion to the facts of this case, the Commission concludes that the premium volume expected to be produced by the rates filed on behalf of the National Bureau members and subscribers should be reduced by one percent. One half of one percent gives consideration to the fact that, because premiums are paid in advance, the companies have had the use of the money between the time when they receive it and the time when they earn it; and one half of one percent gives consideration to the fact that the companies' general overhead expenses do not increase at the same rate as the premium volume.

The proposal of the National Bureau to discontinue for compact cars the 10% reduction from manual rates is denied, because their loss ratios in Virginia do not support the proposal and are slightly lower than those of standard-size automobiles.

page 737 } The interveners object that the National Bureau has not submitted expense data limited to Virginia expenses only. The National Bureau submitted the nationwide expense data modified by those expenses specially applicable to Virginia. The administrative practice of the Commission has always been to use the nationwide data as modified for Virginia because it is the best data available. We are fixing uniform rates to be charged by the 146 insurance companies that are members of and subscribers to the National Bureau of Casualty Underwriters. If we were fixing separate rates for each of the 146 companies we would, of course, examine the expenses of each company separately, the way we do when we fix the rates of a public utility like a telephone or electric company. Here we authorize for all the companies uniform rates based on average losses and average expenses. Some companies will suffer more and some will suffer less than average losses. Some will have higher and some will have lower than the average expenses allowed in this case.

W decided in our May 15, 1967, opinion in Case No. 17680 to allow more competition among the companies than we have heretofore permitted. A company whose losses and expenses have been below the average will be permitted to charge lower rates to the maximum extent that the proposed lower rates will not endanger the company's solvency or liquidity. The average rates are set for the average companies and necessarily some companies will make higher and some will make lower profits on the same rates.

§38.1-241 of the Code requires that a rate-filing be accompanied by information that supports the filing and authorizes the Commission to require the companies to furnish whatever additional information is necessary. Whenever an application is filed for a change in rates the Commission's staff goes over the filing and calls on the companies for whatever supplemental information is needed. The application is not heard by the Commission until after the companies have produced the information demanded by the staff.

page 738 } In the present case the supplemental data were quite voluminous. §38.1-241 makes this supporting information a matter of public record. At the request of the interveners it has been included in the record in this case because of their announced intention to appeal.

The law necessarily requires the Commission to give due consideration to every relevant factor, and the first step is to decide what factors are relevant. In this case, for example, the Commission gave no consideration to the country-wide loss experience (which is always available in the expense exhibit filed annually with the Commission) because the Virginia loss experience is broad enough to serve as the basis for the Virginia rates. Due consideration resulted in the conclusion that no consideration should be given to the country-wide experience, on the ground that that experience was not the best available evidence.

The filing in this case involves only the adjustment of the basic rates and does not deal with rates for coverage in excess of the basic limits. A policyholder who desires excess protection pays an additional premium. Some companies issue coverage up to $500,000. The formula for computing the amount of extra charge for extra protection cannot be based on Virginia experience alone for the reason that a single $500,000 loss would distort the average loss for the accident year it occurred in. Hence, the only relevant basis for the formula is countrywide experience. Since the computation of the percentage increases for excess coverage can have no influence on the amounts charged for basic coverage, there can be no reason to postpone decision of a basic-rate case until

the formula for excess coverage has been reviewed. (The practice is to review the formula every five years or so.) The "regulatory lag" in this case has been longer than usual because of the desirability of completing the lengthy investigation of the rate-making process before hearing this case. That "regulatory lag," the evidence discloses, has cost the companies large sums of money.

page 739 } The interveners complained about the advertising practices of the companies. The cost of advertising designed to attract new business comes out of the 20% allowance for acquisition expenses. Advertising published in the hope of making people understand why insurance rates keep going up, so-called "institutional advertising," comes out of the allowance for general overhead expenses. Companies that spend more than those allowances have to pay the difference out of their 5% allowance for profits and contingencies. The contingencies that come out of the 5% are federal income taxes, losses in excess of the predicted losses, and expenses in excess of the expense allowances. The contingency of federal income taxes is one that cannot be escaped. The companies have some control over their expenses and less control over their losses. It is impossible to predict within one or two or three percentage points what next year's losses will be. The fact that we make adjustments as small as one half of a percentage point does not imply that we expect to come that close to a perfect prediction of the amount of revenue and the amount of profits that the rates will produce.

HOOKER, *Chairman,* and DILLON, *Commissioner,* concur.

page 740 } AT RICHMOND, MAY 15, 1967

COMMONWEALTH OF VIRGINIA

At the Relation of CASE NO. 17680

THE STATE CORPORATION COMMISSION

v.

THE AETNA CASUALTY AND SURETY COMPANY, ET AL.

OPINION BY THE COMMISSION:

THIS INVESTIGATION was instituted by the Commission on January 25, 1966. All insurance companies (approxi-

mately 275) licensed to write automobile liabilty insurance in the State were made parties by the order instituting the proceeding. Hearings were held on September 12 through 16 and December 12 and 13, 1966. At the conclusion of the hearing, all parties in interest were permitted to file briefs on or before March 15, 1967, later extended at the request of interveners Henry E. Howell, Jr., George E. Allen, Jr., Stanley E. Sacks and H. Lee Kanter to May 1, 1967. Briefs have been filed and considered by the Commission.

The following appeared at the hearing: National Bureau of Casualty Underwriters, by M. Wallace Moncure, its counsel; National Association of Independent Insurers, by Garland M. Harwood, Jr., and Arthur C. Mertz, its counsel; Virginia Association of Insurance Agents, Inc. and Jack Newman, by John W. Riely, their counsel; Automobile Club of Virginia and Tidewater Automobile Association, by Fielding L. Williams, their counsel; American Insurance Association, by J. Randolph Tucker, Jr., its counsel; Government Employees Insurance Company, by Warren Nigh, page 741 } its counsel; Virginia Farm Bureau Mutual Insurance Company and Early Settlers Insurance Company, by Alden E. Flory, their counsel; Nationwide Mutual Insurance Company, by J. Vaughan Gary, its counsel; Henry E. Howell, Jr., George E. Allen, Jr., Stanley E. Sacks, H. Lee Kanter and Melvin L. Stark, in proper person; Charles E. Hammond, on behalf of the Arlington County Board of Supervisors; American Mutual Insurance Company, Amalgamated Casualty Insurance Company, National Granges Mutual Insurance Company, Shelby Mutual Insurance Company, and Hardware Dealers Mutual Fire Insurance Company, by Alexander W. Neal, Jr., and Thomas N. Parker, Jr., their counsel, and the Commission by Norman S. Elliott, its counsel.

Messrs. Howell, Allen, Sacks and Kanter united in attacking the practices of the insurance companies and are for that reason referred to as *the* interveners. The other interveners presented a wide variety of views and recommendations.

As stated in the order, the investigation was to determine:

"(a) Whether the rates now in effect for writing automobile liability insurance on private passenger automobiles in this State are excessive or inadequate or unfairly discriminatory, and what changes, if any, should be made therein;

"(b) Whether the presently approved and currently effective manuals of classifications, rules and rates, rating plans and modifications thereof for writing automobile liability insurance in this State which have been filed by, or on behalf

of, the insurance companies licensed to write automobile liability insurance in this State produce rates and premiums for automobile liability insurance on private passenger automobiles which are excessive or inadequate or unfairly discriminatory and what, if any, changes should be made therein;

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"(c) Whether the provisions for cancellation by insurance companies of policies of automobile liability insurance on private passenger automobiles heretofore adopted and established by the Commission are adequate, fair and reasonable and what changes, if any, should be made therein;

"(d) Whether the rules and practices for the renewal, upon expiration, of policies of automobile liability insurance on private passenger automobiles used by the insurance companies, or any of them, which write automobile liability insurance on private passenger automobiles in this State are fair, reasonable and equitable to all parties in interest; and,

"(e) All other matters relevant to what are reasonable, adequate and non-discriminatory rates and premiums to be charged in this State by insurance companies for automobile liability insurance on private passenger automobiles and what are reasonable classifications, rules and rating plans which should be used and enforced in applying such rates and premiums."

The Commission interviewed a number of actuarial firms, and, after a thorough investigation of their qualifications, selected the firm of Woodward and Fondiller, Inc., consulting actuaries and insurance auditors of New York, New York, to assist in the conduct of the study. A public hearing on this investigation was originally set for May 2, 1966, but it was found impracticable to meet that date in view of the amount of data that had to be compiled. As a result, the public hearing was continued to the week of September 12, 1966. The hearing was not completed during that week and was resumed on December 12, 1966 and concluded the next day. At the conclusion of the hearing, counsel for the parties and the interveners were given until March 15, 1967 to file briefs with the Commission on the issues developed in the public hearing. That date was subsequently extended at the request of the interveners to May 1, 1967.

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Regulation of Rates

The regulation of automobile liability insurance rates in

Virginia is governed by Chapter 6 of Title 38.1 of the Code of Virginia. As stated in §38.1-218, the purpose of such regulation is "to promote the public welfare by regulating insurance rates to the end that they shall not be excessive, inadequate, or unfairly discriminatory, and to authorize and regulate co-operative action among insurers in rate making * * *. Nothing * * * is intended (1) to prohibit or discourage reasonable competition, or (2) to prohibit or encourage, except to the extent necessary to accomplish the purposes mentioned above, uniformity in insurance rates, rating systems and rating plans or practices."

Each company that writes automobile liability insurance in Virginia must file its rates with the Commission and have them approved before they may be used (Code-§38.1-241). An insurer may make its own filings, or it may satisfy the requirement of filing by becoming a member of, or a subscriber to, a licensed rating organization which makes such filings, and by authorizing the Commission to accept such filings on its behalf (Code-§38.1-242).

There are two licensed rating organizations for automobile liability insurance in Virginia: The National Bureau of Casualty Underwriters which had 146 members and subscribers doing business in Virginia and the Mu-
page 744 } tual Insurance Rating Bureau which had 49 members and subscribers doing business in Virginia at the time this investigation was instituted. The other automobile liability insurance companies licensed in this State do not belong to, and are not subscribers of, either of these Bureaus and make independent filings, usually by adopting with modifications as to the rate of premium the filings of the two rating bureaus. For many years, it has been the practice of these two rating organizations simultaneously to make filings with the Commission on behalf of their respective members and subscribers whenever an increase or decrease in rates for automobile liability insurance is indicated by the Virginia experience.

Compilation of Experience Data

The Commission, pursuant to the provisions of §38.1-261, has adopted rules and statistical plans adapted to liability insurance on private passenger automobiles which each insurer must use in recording and reporting its Virginia loss and countrywide expense experience in order that such experience may be made available at least annually in order to aid the Commission in determining whether such rates are excessive, inadequate or unfairly discriminatory and other-

wise comply with the standards set forth in §38.1-252. The National Bureau of Casualty Underwriters, the Mutual Insurance Rating Bureau, the National Association of Independent Insurers and the National Independent Statistical Service have been appointed by the Commission as its statistical agents to assist it in gathering such experience for automobile liability insurance and making compilations there-
page 745 } of. The National Bureau compiles statistics for 146 companies that write automobile liability insurance in this State, the Mutual Bureau for 49 companies, the National Association of Independent Insurers for 68 companies and the National Independent Statistical Service for 5 companies. These statistical agents represent approximately 40%, 10%, 49.5% and 0.5% respectively of the premiums written in Virginia on private passenger automobiles. The compilations made by the statistical agents of the Commission are available for use by all insurers licensed to write automobile liability insurance in this State.

The Mechanics of Ratemaking

§38.1-218 of the Code of Virginia declares that the end to be sought by governmental fixing of insurance rates is that "they shall not be excessive, inadequate, or unfairly discriminatory."

Rates are excessive if they are higher than need be, and inadequate if the business cannot be profitably carried on. The rates must produce gross revenue sufficient to cover losses, expenses and enough profit to induce investors to put up the necessary capital. After the revenue needs of the insurance companies have been ascertained, the bureau of the rates must be distributed as fairly as possible among the different classes of insured motorists.

The statistical agents collect the statistical data on which rates are based. To those organizations the insurance companies report the significant details of every claim
page 746 } arising under a policy, and each company furnishes annually a statement of the expenses of conducting its automobile liability insurance business during the previous year. The data are analyzed and submitted by the statistical agencies to the staff of the Commission. The staff goes over the filing with a fine-tooth comb looking for errors and omissions. It makes a list of the things it questions and calls in the people who made the filing to give them an opportunity to answer the objections. When the staff is satisfied that the information has been corrected and that the

filing is correct, the facts are submitted to the Commission. The function of the Commissioners is to apply the law to the facts.

The entire factual structure rests on the facts gathered by the statistical agencies. The statistics are voluminous and their accuracy depends on the accuracy of each of the hundreds or thousands of company employees who do the reporting. Although the Commission has never doubted the efficiency of this fact-gathering machinery, the importance of making sure that it is working properly is so great that the Commission employed a prominent firm of professional actuaries to check the process from beginning to end. Woodward and Fondiller, Inc., with their large staff, made a study that demonstrated that the statistics complied by the statistical agencies are reliable. The high cost of this survey ($39,200) resulted from the number of man-hours spent on it. A less thorough study would not have been worthwhile. We are glad that we had this study made, because we, as well as all other insurance rate-makers, have to depend on this method of collecting the material facts because no other method is physically possible.

page 747 } In order to find out how much money the companies are making or losing the statistics must all relate to the same "accident-year." The "latest available accident-year" is necessarily not the twelve month's period ending the day before the case is set for hearing; and this accounts for the frequently-heard complaint that the statistics are "not up-to-date." The processes of organizing the raw statistical data are time-consuming, and in all rate-making, whether for insurance companies or public utilities, there is a "regulatory lag" which, in times of rising prices, operates to the disadvantage of the regulated businesses.

The problem to be solved by insurance actuaries is to ascertain how much the companies pay out on the policies they issue. Let us suppose that for $365 the company sells a policy insuring me against loss for one year. The actuary perceives that for this insurance I have paid at the rate of $1 a day and treats it as if I handed the company a dollar bill every day. On the days when I have no accident the company earns a dollar. One day I have a bad accident and the injured party makes a claim. The company may be liable for a heavy loss if it turns out that jurors or insurance adjusters decide that I did not drive as carefully as they would have driven. It may be five years before the company knows what its loss, if any, will be, and we cannot wait five years for that datum to reach the computers, because we have to fix next year's rates now. The company's claim department, based on its long

experience, estimates as accurately as it can the probable amount of that loss.

page 748 } It follows that the underlying data on which rates are based contain many thousands of such estimates, some of which will turn out to be too high and some of which will turn out to be too low. Not only are insurance rates dependent on the accuracy of these estimates:—the solvency of the company depends on their accuracy. So long as the liabilities remain contingent the company has to have on hand assets sufficient to cover the probable liabilities. The law requires it to have those assets and the company will lose its license if it fails to have them. Some critics of the rate-making process say: "Suppose the managements of some of the companies were dishonest and intentionally over-estimated the probable contingent liabilities in order to argue for higher rates?" A dishonest management would not be tempted to exercise its dishonesty in that direction. If it exaggerates the loss estimates it has to increase the loss reserve. If it increases the loss reserve it has to decrease its dividends because it cannot legally pay dividends out of the reserve. If its assets are insufficient to cover the loss reserve it will lose its license unless it can raise additional capital and surplus. The only direction in which intelligent dishonesty could operate would be in the direction of underestimating losses.

The accuracy of these estimates made during the latest available accident year cannot be finally determined before the rate hearing because it takes about five years in the case of bodily-injury claims and three years in the case of property-damage claims before all the losses incurred in the accident year have been finally paid. It follows that the only way to *test* the accuracy of the current estimates (the estimates being made during the latest available ac-

page 749 } cident year) is to *ascertain* the accuracy of the estimates made by the claim departments during the preceding years. The initial estimate made when a claim is reported will be based on the evidence then available. As the claim department accumulates additional evidence it revises the estimates up or down. At the end of the year the revised estimates are substituted for the initial estimates in the computation of the reserve set up on the books to provide for the payment of incurred losses. By the end of five years nearly all valid bodily injury claims will have been paid and the accuracy of the estimates will be ascertained. By the end of three years nearly all the valid property damage claims will have been paid and the accuracy of those estimates will

be ascertained. If the aggregate final payments are less than the aggregate initial estimates we know that the claim departments of the insurance companies have tended to overestimate the amounts of the incurred losses. If, for example, the final payments turn out to be less than the initial estimates by 2.3%, it is reasonable to assume that the claim departments are still overestimating the current incurred losses by 2.3%, and we reduce the estimates made during the latest available accident year by 2.3%. The figure arrived at by this laborious but necessary process is the figure for "incurred losses" used in rate-making.

The two principal ingredients that go into an insurance premium are the so-called "pure premium" and the expenses incurred by the company in providing the coverage. The "pure premium" is the part of the premium that

page 750 } goes to pay losses. The "losses" here referred to include the costs of settling the claims through negotiation or litigation (called "loss adjustment expenses") but do not include payments made pursuant to the "medical payments clause" of a policy. (The "medical payments clause" payments are excluded because they have nothing to do with legal liability. The company promises to pay the hospital and doctors' bills up to a specified limit of anybody riding in the insured automobile at the time of the accident, regardless of who was legally liable for the damages caused by the accident. The amount of the premium for "medical payments" is based on the principles applicable to accident insurance and not on the principles applicable to liability insurance.) The average pure premium for basic limits for the latest available accident year is the amount of losses incurred during the year divided by the number of automobiles insured during the year. (An automobile insured for only two months during the year is counted as one-sixth of an automobile.)

The next step is to determine whether current losses are costing on the average more or less than the pure premium of the latest available accident year. The relevant data which reflect the average paid claim costs are complied for the twelve quarters ending with the data for the latest available quarter following the latest available accident year. For each of those quarters we divide the total amount of payments made on claims for bodily injury by the number of such claims, and we divide the total amount of payments made on claims for property damage by the number of such claims. Arranging the figures for each quarter on a graph

page 751 } shows whether the average payment per claim is increasing or decreasing and shows the rate of

increase or decrease. Applying that rate of increase or decrease to the pure premium developed from the latest available accident year indicates as accurately as anything can the amount of the present pure premium:—the average number of dollars per insured automobile that the companies will be required to pay for losses during the time the rates will be in effect. To distinguish that pure premium from the accident year pure premium, actuaries have coined the term "rate level pure premium", because that is the average pure premium that the rates *must* yield if the rates are to be neither too high nor too low. Having reached that point in the computation the remaining fact that needs to be known is whether the rates now being charged do yield the "rate level pure premium." The average pure premium that the rates *now* being charged would have yielded if they had been in force throughout the latest available accident year is called, for lack of a better name, the "underlying pure premium". The percentage difference between the rate level pure premium and the underlying pure premium is the percentage by which rates must be increased or decreased if they are to be adequate and not excessive. The reason this procedure *looks* complicated is because it *is* complicated. The procedure has been developed and refined over the years and no simpler procedure could produce as accurate a picture.

The expenses incurred by the companies in providing the services to the policyholders whose losses enter into the computation of the pure premium are calculated by reviewing the expense accounts of the insurance companies.

page 752 } This calculation determines the average percentage of each premium dollar needed to provide such services. The present average "expense loading" (which includes the margin for profit and contingencies) is 35.4% of the premium. This leaves 64.6% of the premium available for the payment of losses. The 64.6% is the expected loss ratio. If more than 64.6% of the premiums received for the coverage are paid out in satisfaction of claims covered by the policies the rates have been too low, and vice versa.

At this point it must be observed that if rates are increased after the 64.6% permissible loss ratio has been established, then the number of dollars dedicated to the 35.4% expense loading will be correspondingly increased. Mr. Lewis H. Roberts, the actuary in charge of the Woodward and Fondiller survey, points out that while both losses and expenses tend to increase, they do not increase at exactly the same rate. Of the 35.4% expense loading only 28.9 of the percentage points vary upwards or downwards *pari passu*

with premium volume, and the 6.5% loading for general expenses remains the same number of dollars regardless of fluctuations in losses. The general expenses do of course increase each year because the salaries of office workers increase each year. At page 53 of his report Mr. Roberts has demonstrated by an actuarial computation that the rate filing in Case No. 17357 contained an expense loading for general expenses that was too high, and that the effect of this lapse from complete scientific accuracy was to increase the rate level by less than four-tenths of one percent. Complete scientific accuracy is a worthy goal, but we

page 753 } will reserve judgment as to whether it is worth while to add this additional refinement to the rate-making process. Fixing rates for the future is an exercise in prognostication based on the experience of past events. The most conspicuous lesson of experience is that it is idle to imagine that predicted future losses will ever turn out to come within one percentage point of actual losses. Over the past ten years the officials charged with the duty of fixing automobile liability insurance rates have regularly predicted losses at least five percentage points lower than actual losses.

The computations that we have described up to this point answer only the question of what changes in the basic-limits rates will have to be made in order to enable the companies to carry on this line of the insurance business at a profit instead of at a loss. The calculations have concerned only the statewide level of basic premiums. The next problem is to distribute the burden of the rates as fairly as possible among the policyholders. This part of the process is based on statistical demonstration that various groups of motorists have more accidents than other groups. For example, it is clear that city people have more accidents than country people, that those who drive to work every day have more accidents than those who don't, that young boys have more accidents than older people. To decide what discriminations are fairly discriminatory within the meaning of the governing statute requires the application to the relevant statistical data of common sense and a sense of fairness.

He who takes out insurance elects to suffer an

page 754 } immediate and certain financial burden rather than run the risk of suffering a possible future and uncertain very much larger financial burden. The people whose houses do not burn down elect to pay the losses of those whose houses do burn down, and the careful motorists elect to share the burdens of the careless (or unlucky) motorists. Fire insurance rates on brick houses near a fire-engine station are cheaper than those on wooden houses in the

country. In all kinds of insurance the policyholders are grouped according to similarity of risks.

In the exercise of its judgment as to fair classifications, the State Corporation Commission has taken the position that the classifications should be as broad as is reasonably possible. We have, for example, kept the classifications based on territory to a minimum. We cannot avoid the obvious necessity of putting in a high-rated premium class unmarried men under 25. We have, however, resisted the suggested breaking down of that class into nine classes so that a boy of 16 will pay a higher rate than a boy of 17, and so on. And we have turned down such refinements as fixing a lower rate for a motorist who drove only 7,499 miles last year than for a motorist who drove 7,501 miles.

And we are not entirely satisfied that the "safe driver" plan is not an advertising gimmick rather than a workable plan for writing automobile liability insurance. The ostensible purpose of the plan is to encourage safe driving and to reward safe drivers by allowing them a discount from manual rates, but only about one-half of the insureds are
page 755 } under the plan while the other one-half are not.

Even when an insured is under the plan, and by reason of his unsafe driving has been assessed points, there is nothing to keep him from transferring his business to a company that does not use the plan and thereby avoid paying the penalties provided for unsafe driving. These two factors make the plan unworkable from a practical standpoint because it is practically impossible to keep the plan in balance so that the debits assessed against the unsafe drivers will offset the credits given the "safe drivers."

Decisions on territorial and driver classifications are under constant review because there is no system of such classifications that does not involve a large element of judgment in evaluating the significance of the statistical data and the fairness of the classifications.

Cash Accounting versus Accrual Accounting

Most individuals and a few small business firms keep their financial records on a cash basis. Their check books show the number of dollars that came in and the number of dollars that went out. All other American businesses keep their financial records on the accrual basis. The Internal Revenue Code permits all taxpayers except insurance companies to elect to compute their annual net income by either the cash or the accrual method. Insurance companies are required by 26

U. S. C. A. §832 to report their income from underwriting on the accrual method. §832(c) says:

"The term 'underwriting income' means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred."

page 756 } It cannot rationally be suggested that the Congress of the United States passed this Act under pressure from the insurance lobby for the purpose of permitting insurance companies to minimize their annual net income. The Act could not have been passed for that purpose because if §832(c) had not been passed the insurance companies, like all other companies, could have elected between the cash and the accrual basis. The only effect of the statute is to forbid insurance companies to use the cash basis.

The reason accrual accounting does and cash accounting does not give a true picture of profit and loss is that accrual accounting does and cash accounting does not relate all relevant data to the same accident year. The so-called "Maddrea Formula" treats all premiums received by the company during the calendar year as income for that year and all losses paid during the year as deductions from gross income for that year. But many of the losses paid during the year are made in the performance of contracts entered into during the preceding five years, and many of the policies written during the year insure against accidents that will occur during the following year, some of which will not be paid for until five years thereafter. The combination of these data, a large proportion of which are unrelated to the year whose profit or loss we are seeking to ascertain, is not helpful. The process would tell what the cash flow is but not what the profits or losses are.

page 757 } The attraction of the Maddrea Formula to its advocates is that it will always make the profits look bigger than they are. How much bigger they would appear to be we do not know. We declined to order the companies to go to the great expense of compiling data that had never been compiled before and that would be irrelevant if compiled. It is obvious that the data, if compiled, would make the net income look larger, for the reason that for as long as the population of the United States continues to increase the sum total of all premiums annually paid for automobile liability insurance will continue to increase. From now until the population begins to shrink and the number of insured automobiles begins to decline, the premiums paid each year will exceed the premiums earned during the year and

the losses paid during that year will be less than the losses incurred during that year. By thus inflating the figure for premiums and deflating the figure for losses, the Maddrea Formula gives a totally misleading picture of underwriting results. Naturally we cannot adopt it. It can only obscure the true picture of profit and loss. It would violate the statutory requirement that rates be adequate, and it would make it financially impossible for insurance companies to continue indefinitely to issue policies of automobile liability insurance in Virginia.

The proposal that insurance companies ought to switch from accrual accounting to cash accounting was first publicly advocated by T. Grayson Maddrea, a Richmond certified public accountant employed by the interveners to testify in support of their allegation that the automobile insurance companies are making exorbitant profits. The nature of the insurance business, consisting as it does of agreeing, in return for a premium paid in advance, to assume contingent future risks, is so different from the ordinary business of buying at wholesale and selling at retail, that a certified public accountant expert in one field might be unqualified in the other. There are, of course, many accounting questions with respect to which there are various schools of thought, but the question we are considering is not one of them. So far as we know, every actuary experienced in the field of insurance accounting is on the side of accrual accounting and Mr. Maddrea is in a minority of one. Therefore, we have given no weight to his testimony on this issue.

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Counsel for the National Association of Independent Insurers protest on page 7 of their brief:

"This Association wishes to reiterate the strong protest it made to the Commission (Transcript pages 1476, 1512) over not being permitted to cross-examine Mr. Maddrea."

By the time page 1476 of the hearings had been reached it had become apparent that the Maddrea Formula was not a possible basis for making automobile liability insurance rates. No amount of cross-examination could have made that fact any clearer than it then was.

The statement on page 6 of the interveners' brief that "premiums earned does not take into account the so-called 'equity in unearned premium reserves' which occurs because the acquisition expenses are written off on a cash basis when paid rather than pro-rated over the life of the policies acquired"

is incorrect in so far as rate making procedure is concerned.

As soon as policies are written, the companies are required by §38.1-171 of the Code to establish and "maintain reserves equal to the unearned portion of the *gross pre-*
page 759 } *miums* based on unexpired or unterminated risks and policies." (Emphasis supplied)

This section further provides "that no deductions may be made from the *gross premiums* in force except for original premiums cancelled on risks terminated or reduced before expiration." The reserve for unearned premiums according to this section must be "computed on the annual pro-rata fraction basis or at the option of the company, on the monthly pro-rata fraction basis."

When an agent writes a policy, the company must immediately place in its unearned premium reserve the full amount of the premium without any deduction for acquisition costs although it might not receive the cash for the policy from the agent for 60 or 90 days from the date it was written and although when it does receive the cash, the agent will have deducted his entire commission. From this reserve, the company takes down each month 1/12th of the gross premium and this 1/12th becomes earned premium. At the end of each month the company earns 1/12th of the acquisition costs because acquisition costs are a part of the gross premium. If the policy is cancelled by the company after it has been in effect for 6 months, the company will have earned one-half of the gross premium which includes one-half of the acquisition costs. It must refund to its insured one-half of the gross premium which includes one-half of the acquisition costs and will collect from its agent one-half of the acquisition costs, the full amount of which he deducted when he remitted the premium to the company.

page 760 } *Earnings on Loss Reserves*

In addition to his formula for making actual losses look like apparent profits, Mr. Maddrea argues that earnings derived by a company from the investment of its loss reserves ought to be subtracted from the premiums paid by policyholders. This argument has been favorably received by at least one rate-making official. In his ruling of February 6, 1967, the Commissioner of Insurance of Kentucky, approved the 21.6 percent rate increase requested by the National Bureau of Casualty Underwriters. In the course of his opinion, however, he announced that in future cases he would treat the unearned premium reserve and the loss reserve as if they were funds held in trust. Consistently with his trust fund

theory he said he would "study the possibility" of determining the income derived from the investment of "such funds."

The difficulty with the "trust fund" theory is that there is no fund. The legal obligation of an insurance company to pay back the balance of an unearned premium is the same kind of liability as the liability of a bank to pay back the balance of a demand deposit. In both cases the legal relationship is that of debtor and creditor. In neither case is there a settlor, a trustee, a trust *res* or a *cestui que* trust.

The conclusions that the trust-fund hypothesis leads to are illustrated by a statement of Frank Harwayne quoted on pages 20 and 21 of the brief filed by the interveners. He assumes that the stock market will go up 3.5% every
page 761 } year and he points out that *unrealized* capital gains are not subject to Federal income tax. Therefore, he concludes that the policyholders should receive the benefit of the untaxed capital gains derived from the investment of the company's reserves. His illustration does not explain what effect on insurance rates a thirty-point decline in the Dow-Jones averages ought logically to produce.

To make sure that an insurance company will be able to pay its debts as they mature it must set up on its books a reserve sufficient to cover unearned premiums. The reserve is in no sense a separate fund, separately held and separately invested. It is just another item on the liability side of the ledger.

The only theory on which it can be said that the policyholders ought to receive credit for the income derived from the unearned premium reserve is that, since the premium is paid in advance, the company should be charged something for the use of the money. Since the liability is a debt liability and not a trust liability, the actual earnings derived from the investment by the company of this imaginary "fund" are immaterial and not ascertainable. In considering this aspect of the rate-making process all that can be done is to recognize that it is just and reasonable to take into consideration the fact that the company will probably earn around 3% on the balances that would be due policyholders if their policies should be cancelled. We do not propose to change rates annually with the fluctuations of the money market. The theory recognizes that the company has the use of
page 762 } money repayable on demand. Nothing turns on what the company in fact does with the money. This theory would require the same result even if the actual earnings could be ascertained and were zero:—even if the premium payments of all policyholders were deposited in banks as demand deposits.

The explanation for the allowance of a reasonable figure for the benefit the company gets from premiums paid in advance has no application to the loss reserve. When a company commences business its paid-in surplus is available to pay initial losses. It must at all times have assets sufficient to meet its obligations. If its obligations are so great that its loss reserve is too small, it will have to issue more stock or go out of business. Nothing ever goes into the loss reserve except assets contributed by the stockholders to the company. No part of an *unearned* premium goes into the loss reserve:—it stays in the unearned premium reserve. The *earned* part of a premium has been earned and is added to earned surplus. The policyholders are no more entitled to share in the earnings from the investment of the loss reserve than they are to share in the earnings derived from the investment of the original capital and paid-in surplus. The loss reserve is simply an item on the liability side of the ledger that diminishes the company's net worth. The net worth of a stock corporation consists of its stated capital, its capital surplus and its earned surplus. Its earned surplus consists of its net earnings accumulated since it started business, less the amounts paid to stockholders as dividends. The Virginia Stock Corporation Act (§13.1-43) authorizes the directors to pay dividends only "out of the unreserved and unrestricted earned surplus of the corporation." The policyholders have no legal or equitable interest in the company's capital, its capital surplus or its earned surplus, the three items that make up its net worth.

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Underwriting Practices

A cause of many current complaints against the automobile liability insurance business is the manner in which some of the companies refuse to write certain policies. A man who is turned down for life insurance is not nearly so aggrieved as a man who is turned down for automobile liabilty insurance, because he is informed by the company's doctor and understands why he is considered an abnormal "risk." But every time a liability insurance company cancels a policy or refuses to issue a policy or to renew a policy it makes one more critic of the whole industry. His indignation is aggravated by the company's unwillingness to tell him why they do not want his business.

Insurance companies and banks are regulated by law but, unlike common carriers and public utilities, are not required to make contracts they do not wish to make. An insurance company can refuse for any or no reason to issue a policy

just as a bank can refuse for any or no reason to make a loan. In 1966 the General Assembly adopted §38.1-381.3 of the Code permitting cancellation without cause during the first 60 days and for cause "at any time thereafter for reasons stated in the policy", and §38.1-70.10 which requires the company, on demand, to "mail to the named insured a written explanation, giving the reason or reasons for its failure to renew the contract." When the named insured gets the written explanation he is apt to think that the explana-
page 764 } tion is unfair, unreasonable or untrue, and his irritation is greater than it was before.

Banks and insurance companies are in business to make money and want to do as much profitable business as possible. Every bank has its own standards for passing on applications for loans, and every insurance company has its own standards for passing on applications for policies. During the course of this hearing, the Commission required all companies writing automobile liability insurance in Virginia to file written statements of their standards for passing on applications for policies. Each company goes to great expense to collect information on which to base its standards and presumably hopes that the application of its standards (called in the jargon of the trade "underwriting policies") will enable it to do business at a profit. A company naturally does not want to disclose the results of its work to its competitors, and the Commission did not require the companies to make their underwriting policies public. The Commission has no more jurisdiction to force an insurance company to liberalize its underwriting policies than it has to force a bank to liberalize its lending policies. The written statements of underwriting policies were excluded from evidence on the ground that they are not material to any issue within the jurisdiction of the Commission.

An examination of the statements filed with the Commission but excluded from the evidence discloses the wide variety of reasons that might lead a company to refuse to enter into a contract of insurance. A brief survey of the various underwriting policies made by C. W. Harris, a retired Deputy Commissioner of Insurance, is filed herewith as an Appendix.

page 765 } A law forcing insurance companies to give a satisfactory reason for each refusal to write a policy would require the establishment of a tribunal to decide in every case of complaint whether the reason was proper. The State of Massachusetts has experimented in this field. Its statutes require every motorist to have in-

surance and require every company to issue a policy to every applicant unless it can prove that the applicant is not reasonably insurable. Every such controversy involves findings on disputed issues of fact and the application of a rule of reason to the facts found. The way the Massachusetts statute operates is described in the following quotation from an opinion of the Supreme Judicial Court of Massachusetts in 123 A. L. R. 139:

"When our legislature enacted the Compulsory Motor Vehicle Insurance Law, by which all persons registering motor vehicles are required to provide security for the payment of claims for damages arising from their operation on the public ways, it foresaw the necessity for providing at the same time a procedure under which individuals could compel companies engaging in the business to insure them in the absence of sound reasons for refusal. One of the conditions accepted by a company which enters this field is that it must surrender its own final judgment as to whether or not it will issue a policy and must submit that matter to the determination of the board and of the court on appeal. The board and the court are to approach each case from a broad viewpoint and to consider all pertinent facts. They should not encourage the companies in efforts to avoid assuming the less profitable types of risk, nor on the other hand should they encourage carelessness or laxity on the part of motor vehicle owners in allowing the risks to become greater than need be. Rules of law controlling liability in actions on ordinary insurance policies are not decisive in passing upon the reasonableness of a refusal to issue a policy under the act. Nor can a company limit the power of the board and the page 766 } court to determine whether a refusal is proper and reasonable under all the circumstances by insistence upon answers deemed by it to be satisfactory to such questions as it may see fit to include in an application blank. And it is plain that no company attempting to engage in this business can take the position that it will insure only pleasure vehicles or limit its operations to that part of the field in which there is the least risk and the most profit. The compulsory law contemplates, and its successful operation requires, that as to their obligations to issue policies all companies alike should abide by the orders of the board or of the court."

As a result of the Massachusetts experiment, automobile liability insurance rates in Massachusetts are several times as high as the national average. An insurance company can,

of course, be required, as a condition of its license, to issue policies to all applicants. Equally of course, no insurance company can be forced to offer to do business in Massachusetts. The extraordinarily high premium rates in Massachusetts are the price paid by all Massachusetts policyholders to induce companies to qualify to do business in that state. The other states have not elected to pay that price. We recommend that the Massachusetts plan be not adopted in Virginia.

Variations and Deviations from Manual Rates

Heretofore the Commission has based the "manual rates" (so called because they are published in a handbook) on the loss experience of all companies writing automobile liability insurance in Virginia. Some companies that do not belong to a licensed rating bureau charge rates considerably below the manual rates because their expenses are lower than those of the members and subscribers of the National Bu-
page 767 } reau. To make certain that the rates are adequate to cover all prospective liabilities, we have permitted downward deviations only to the extent of demonstrated lower expenses, except in one instance where rates for the largest independent company have been approved based on its own loss and expense experience.

We propose to discontinue these practices and to base the manual rates of the National Bureau Company entirely on the expense and loss experience of its members and subscribers, and to permit the Mutual Insurance Rating Bureau to file separate rates for its members and subscribers. It will be incumbent on each non-bureau company to file rates on the basis of its own experience or, if its own experience is not broad enough, on the basis of such experience as the Commission finds to be sufficient to enable it to determine whether the proposed rates are excessive, inadequate or unfairly discriminatory.

As provided by Section 38.1-258(b), a company that is a member or subscriber of either the National or the Mutual Insurance Rating Bureau may apply for permission to file and use a uniform percentage deviation from the rates filed on its behalf by the bureau of which it is a member or subscriber. The application for each deviation must be supported by the data on which it is based, and will be approved by the Commission if it is found to be justified.

It has been our experience that many of the large independent companies have lower loss ratios and lower expenses.

Many of them are more selective in deciding which group of motorists is least likely to give rise to claims; and their expenses, especially their acquisition costs, are
page 768 } lower. They can afford to charge lower rates because they insure better risks at lower costs of doing business and they appeal to the better risks because they charge lower rates. The Bureau companies pay their agents higher commissions and appeal for business to people who cannot or do not want to obtain a policy from one of the big independent companies or who are convinced that the services rendered by a so-called "independent" agent are worth the difference in price. (The legal definition of an "agent" is a contractor who is *not* independent, and §38.1-292 of the Code of Virginia says the agent shall "be held to be the agent of the company which issued the insurance solicited or applied for, anything in the application or policy to the contrary notwithstanding.")

Accordingly there are in Virginia four widely different rate levels for automobile liability insurance charged by:

1. The big independent companies.
2. The Bureau Companies.
3. The assigned risk plan.
4. The substandard risk plan.

The fourth of these rate levels was authorized in 1964 by the enactment of §38.1-262.1 of the Code of Virginia. The substandard risk plan has been in effect only three years and the Commission has it under continuing study. About thirty-seven companies are presently issuing policies under this plan in Virginia.

The insurance business is highly competitive
page 769 } and is getting more so, a circumstance that prompted Mr. Roberts to suggest that maximum rates be not fixed in advance by law. Competition is based on differences of price and differences of service. No element of monopoly exists and §38.1-218 of the Code contemplates "reasonable competition." The reason the price of what the companies sell continues to rise is that the price of the things they have to pay for (everything from hospital bills to dented fenders) continues to rise. A prominent feature of the continuing legal education programs of bar associations consists of demonstrations by leading trial lawyers on how to win higher verdicts; and the legislature has been persuaded to steadily increase the permissible verdict for death by wrongful act:

$10,000 in 1920
15,000 in 1942
25,000 in 1952
30,000 in 1958
35,000 in 1962
50,000 in 1966

This statutory recognition of the need for larger verdicts merely recognizes the constantly declining purchasing power of the dollar. It takes more dollars to buy automobile liability insurance for the same reason that it takes more dollars to buy other necessities.

page 770 } APPENDIX

1008 South Center Street
Ashland, Virginia 23005
March 31, 1967

Mr. Norman S. Elliott, Counsel
State Corporation Commission
Blanton Building
Richmond, Virginia

Re: Case No. 17680

Dear Sir:

In compliance with the instructions contained in your letter of February 16th, I have reviewed the replies of the 270 insurance companies licensed to write automobile casualty insurance in this State and which conformed to the request of Commissioner T. Nelson Parker that each company furnish: "(1) The written underwriting principles used by the company in writing automobile liability insurance in this State on private passenger automobiles; and (2) Any writings which outline the policies of the company in renewing such policies of insurance."

One hundred and fifty-four companies enclosed with their replies underwriting "guides" which are used by their underwriters and agents in issuing automobile casualty insurance policies. They emphasize the fact that these are "guides" only and not inviolate underwriting rules. Thirty-seven companies replied that no written underwriting "guides" were used and that policies are issued entirely in accordance with the judgment of the underwriter concerning each risk. Fifty-six companies indicated that, although they

are licensed to write automobile casualty insurance in Virginia, they are not doing so. Five companies issue policies to substandard risks only. These have not been reviewed. Eighteen companies specialize in insuring specific classes of risk such as long haul trucking fleets, taxicabs, and commercial fleets.

Your letter requests that I note specifically which, if any, companies refuse to issue policies on private passenger automobiles on account of race, color, or creed and on persons 65 years of age or over.

The Motor Vehicle Safety Responsibility Act became effective on January 1, 1945. On December 2, 1944, the then Commissioner of Insurance, Honorable George A. Bowles, sent a circular letter to all companies licensed to write automobile casualty insurance in this State requesting page 771 } that an executive officer of each company pledge his organization to accept and consider applications without discrimination as to race, creed, or color. His action was taken on the advice of a committee of nine representatives of stock and nonstock carriers and the agents thereof designated by each group after a meeting of all carriers held, at my suggestion, in the Commission's Court Room on November 2, 1944. The greater majority of the companies complied with Mr. Bowles' request. I can truthfully state that, during the subsequent years of my administration of the Rate Section of the Bureau of Insurance, such discrimination was virtually nonexistent.

The only discrimination, if such it can be called, found in the "guides" furnished by the companies is an indication that many of them will not insure persons who cannot speak and understand the English language and, therefore, would make poor witnesses in the event of litigation.

Twenty-eight companies indicated from their underwriting "guides," a limitation on the acceptance of applications from senior citizens, as follows: 22 will accept no application from persons 65 years of age or older; 5 companies from persons 70 years of age or older; and 1 sets its age limit at 75 years and older. None of these companies were among the large premium-volume writers in Virginia and, in the aggregate, wrote approximately less than 5% of the premiums written during the calendar year 1965.

By far the greater majority of the companies have no "cut off" age for insuring policyholders who have reached 65 years of age and will continue insurance for them as long as they appear to be physically and mentally fit to operate an automobile. Five or six companies, including the one which insures me, require at age 70 a doctor's certificate to

be completed on their forms indicating the operator is physically and mentally fit. This does not seem to be an unreasonable requirement. Of the 154 companies furnishing "guides," those of only 5 companies state that they will not accept applications from persons whose policies have been cancelled or their applications declined by other companies.

Very few companies in their replies referred to renewals and these stated that once an application is accepted, the policies are renewed automatically unless, during the term of the policy, conditions develop which would have required the rejection of the original application. These restrictions generally do not apply to youthful drivers who became drivers but were not the principal operators of the insured automobiles.

It was surprising to find that only 15 companies placed restrictions on the acceptance of youthful drivers. page 772 } These restrictions were by no means all-embracive of that age group. Five companies would accept no driver under 18 years, 1 company no male driver under 21 years, 1 company no male driver under 22 years, 2 companies no unmarried male under 25 years, 4 companies no male or female driver under 21 years, 2 companies no male or female unmarried driver under 25 years.

Although the foregoing are definite exclusions of the acceptance of applications, statistics of the Division of Motor Vehicles and of insurance companies positively indicate that the youthful operator causes a disproportionate number of accidents in relation to the number of licensed operators. Therefore, it should not be assumed that any company will accept their applications freely. On the other hand, they receive careful scrutiny and frequently there are special requirements, such as that if he is the owner and principal operator, he must live with his parents and be subject to their control; not be a student taking the insured automobile more than 100 miles from his home; that the company insure all automobiles owned by the parents; be gainfully and steadily employed; married; and have an excellent reputation and driving record. Sports types of automobiles and convertibles owned by this type of operator are generally not acceptable, principally due to the passenger hazard, even though the applicant otherwise would be acceptable. "Souped up" automobiles and those with a ratio of weight to horse power of 10 to 1 or less and rebuilt automobiles owned and operated by this age group are generally declined.

Enlisted personnel in the Armed Forces are not looked upon with favor as desirable risks. However, the companies

generally will attempt to insure them except for the first three lowest grades but these usually will be accepted if married and living with their spouses or families near the base.

The underwriter must consider the following factors, among others, for all persons who will operate the automobile in approving or rejecting an application:

Operator's record
(a) Statutory violations
(b) Chargeable accidents
General reputation of applicant
Use of intoxicating liquors or drugs
Physical and mental condition
Age of driver
page 773 } Number of operators
Inspection report of commercial agency

Many of the "guides" contain a prohibited list of risks although, as stated above, virtually all of the companies emphasize that underwriting judgment finally determines their acceptance or rejection. The following are those most frequently listed:

Poor operator's record
Poor reputation and habits
Transit workers and persons with no fixed address
Persons engaged in illicit activities
Persons in contact with the underworld such as operators of juke boxes, vending machines, pool halls, and persons employed at night
Auto salesmen using owned cars as demonstrators
Autos ten years old or older
Sports and rebuilt autos and autos with a ratio of weight to horse power of 10 to 1 or less

It is a basic underwriting principle that there are good risks in poor classifications and poor risks in good classifications, and the acceptance or rejection of risks is determined by the individual underwriter. In the cases of youthful drivers and senior citizens and other borderline risks, the companies require more information to determine the application's acceptability than is the case with the average risk.

In recent years the agency force in Virginia has multiplied manyfold. An unfortunately large number of these agents are merely "commission grabbers" with no sense of responsibility to society or the individual. I am convinced that herein

lies the difficulty with many rejections due to the fact that these agents are unwilling to place themselves to the inconvenience of obtaining the additional information required by the companies in order to intelligently underwrite borderline risks and reject them offhand when frequently they would be acceptable to the insurance companies. This is especially true with the youthful driver. I have not found that to be the case with the old and established agents, who recognize their social responsibilities.

page 774 } Automobile casualty insurance has become social insurance. The insurance companies are met on one hand with the demand from the public for coverage and, on the other hand, by demands from stockholders that an underwriting profit be developed. The conditions under which these demands must be met are unfortunate for the companies in that the cost of settling claims is continually spiraling upwards and there are thousands of licensed operators who expect and demand insurance who should not be driving on the highways. If the State and the courts finally discharge their obligation to the public and remove these operators from the highways, what public dissatisfaction with the companies that exists will be greatly alleviated.

Whether or not the companies have filed "guides," the overall result of the conduct of the automobile casualty insurance business represents the aggregate of the underwriting judgments of all underwriters supervising Virginia business. Needless to say, this varies not only between companies but between underwriters for the same company. Therefore, the only possible result of reviewing the material is the formation of an opinion and, based upon these replies and my many years of critical observation of the insurance companies' operations, I believe that the automobile casualty insurance business has a genuine sense of public responsibility and is performing the best service possible to the public under trying circumstances.

I have no interest, direct or indirect, in any insurance company, general agency, or agency other than in dividends received under a policy issued by a mutual life insurance company.

Very truly yours,

C. W. Harris

page 774-A }

* * * * *

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

CASE NO. 18386

For a revision of automobile bodily injury and property damage liability insurance rates

ADDITIONAL ASSIGNMENTS OF ERROR

The Interveners, Henry E. Howell, Jr., Stanley E. Sacks, Thomas W. Moss, Jr., George E. Allen, Jr., Clive L. DuVal, II and C. Harrison Mann, Jr., hereby file additional assignments of error as follows:

12. The increases in rates for writing automobile liability insurance on private passenger automobiles in all areas of Virginia other than the Norfolk area, including those territories which embrace the County of Arlington, the County of Fairfax and the Cities of Fairfax and Falls Church, and the County of Henrico and the City of Richmond are arbitrary, unreasonable and unsupported by the evidence, and the Commission erred in granting such increases.

13. The Commission erroneously granted increases in the allowances for various categories of expenses incurred by the companies, including acquisition expenses, taxes, licenses and fees, without requiring the companies to present data showing that their expenses in each such category had in fact increased.

HENRY E. HOWELL, JR., Intervener
STANLEY E. SACKS, Intervener
THOMAS W. MOSS, JR., Intervener
GEORGE E. ALLEN, JR., Intervener
CLIVE L. DUVAL, II, Intervener
C. HARRISON MANN, JR., Intervener

By C. HARRISON MANN, JR.
Of Counsel

I certify that pursuant to Section 5:13, Rules of the Supreme Court of Appeals of Virginia, a copy of the above Additional [Notice of Appeal and] Assignments of Error

has been mailed this 11th day of August, 1967, to all counsel of record, to Norman Elliott, counsel for the State Corporation Commission, and to the Attorney General for the State of Virginia.

C. HARRISON MANN, JR.

Recd. 8-14-67—Card A. L. L.

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* * * * *

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

AT RICHMOND, JULY 17, 1967

CASE NO. 18386

For a revision of automobile bodily injury and property damage liability insurance rates.

The interveners, Henry E. Howell, Jr., Stanley E. Sacks, Thomas W. Moss, Jr., George E. Allen, Jr., Clive DuVal, II, and C. Harrison Mann, Jr., having filed due notice of appeal in this case,

IT IS ORDERED that all of the original exhibits filed with the evidence, numbered and described as follows, be certified and forwarded to the Clerk of the Supreme Court of Appeals of Virginia to be returned by him to the Commission with the mandate of that court:

Exhibits filed with the evidence:

1. Transcript, Case No. 17680 before State Corporation Commission. 3 Vol.
2. Opinion of Commission, Case No. 17680.
3. Assigned [this number not filed here—withdrawn in S.C.C.—H. G. T.] for policy of individual (superseded by stipulation of counsel.)
4. Experience of compact car versus standard size car risks showing total limits loss ratio for 1964 and 1965.
5. Compact cars—standard size cars, showing 1964 and 1965 experience for bodily injury and property damage.
6. Premiums and losses for 1964 and 1965 under special package policy.

7. Filing in this case. Pages 1 thru 24 of this record.

8. Proposed revision of automobile liability insurance rates (letter of April 21, 1967, to G. L. Hazelwood, Jr., from Philip K. Stern).

9. Trend factor for bodily injury including Maryland and countrywide experience. [Not heard on 8/1/67—H. G. T.]

10. Limits data, average paid claim costs, bodily injury.

11. Development of bodily injury factor to adjust accident year data for subsequent changes in claim costs.

12. Report of sub-committee on cost and profit factor study of casualty lines, dated April 17, 1952. Rejected.

page 776 } 13. Memorandum submitted by National Bureau of Casualty Underwriters to National Association of Insurance Commissioners in support of Uniform Profit Provision of 5%. Rejected.

14. Return of stockholders' equity from investment and underwriting income. Rejected.

15. Letter of May 22, 1967, and enclosures from Norman S. Elliott to Honorable Henry E. Howell, Jr., George E. Allen, Jr., and Stanley E. Sacks.

16. Letter of May 5, 1967, from State of Arkansas insurance department to George W. Shadoan, with copy of telegram.

17. Letter of May 4, 1967, from M. Wallace Moncure, Jr., to George E. Allen, Jr., with copy of brief filed with State Corporation Commission on May 1, 1967.

18. Underwriting loss for accident years ended June 30, 1963, and 1964 in Maryland; underwriting losses on automobile liability insurance in Maryland.

19. Report of rates by the rates and ratings organizations subcommittee of the property, casualty and surety insurance committee of the National Association of Insurance Commissioners.

20. Letter of January 6, 1966, from State of Maryland Insurance Commissioner to George W. Shadoan, Esq., enclosing opinion of Commissioner.

21. Opinion of Insurance Commissioner of Kentucky.

22. Annual report to shareholders of insurance company—adjusted earnings. Rejected.

23. Transcript from Case No. 17357 before State Corporation Commission of Virginia, pages 493 through 497, page 634 and 655.

24. Testimony of National Bureau witnesses before Maryland Insurance Commissioner December 17, 1965. Rejected.

25. Transcript references from Arkansas hearing of 1967. Rejected.

26. Letter and enclosure of May 16, 1967, from Arnold E. Chase to T. Grayson Maddrea.

27. Copy of letter of April 25, 1967, from T. Grayson Maddrea to Department of Labor.
28. Letter of May 5, 1967, and enclosures to G. L. Hazelwood, Jr., from Philip K. Stern.
29. Letter of May 9, 1967, and enclosures to G. L. Hazelwood, Jr., from Philip K. Stern.
30. Advertisement of April 25, 1967, in Richmond Times-Dispatch.
31. "How to get rich while losing money", article in Forbes, February 15, 1967.
page 777 } 32. Comparison of present and proposed family and basic automobile liability policy rates.
33. BIPD cost x frequency trend, State of Maryland.
34. BIPD trend factor derivation, State of Maryland.
35. Bodily injury average paid claim costs, Maryland and countrywide.
36. Letter of August 19, 1966, and enclosure to G. L. Hazelwood, Jr., from Philip K. Stern.

END

A True Copy

Teste:

WILLIAM C. YOUNG
Clerk of the State Corporation Commission

page 778 } COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

CERTIFICATE

Pursuant to an order entered herein on July 17, 1967, the original exhibits listed therein are hereby certified to the Supreme Court of Appeals of Virginia, to be returned by the Clerk thereof to this Commission with the mandate of that court.

It is further certified to the Supreme Court of Appeals of Virginia that the foregoing transcript of the record in this proceeding, with the original exhibits, contains all of the facts upon which the action appealed from was based, together with all of the evidence introduced before or considered by this Commission.

Witness the signature of H. Lester Hooker, Chairman of

the State Corporation Commission, under its seal and attested by its Clerk this 18th day of July, 1967, at Richmond, Virginia.

[SEAL]

H. LESTER HOOKER
Chairman

Attest:

WILLIAM C. YOUNG
Clerk

CERTIFICATE

I, William C. Young, Clerk of the State Corporation Commission, certify that within sixty days after the final order in this case the Interveners, Henry E. Howell, Jr., 808 Maritime Tower, Norfolk, Virginia, Stanley E. Sacks, Virginia National Bank Building, Norfolk, Virginia, Thomas W. Moss, Jr., 1528 Maritime Tower, Norfolk, Virginia, George E. Allen, Jr., Box 6855, Richmond, Virginia, Clive DuVal, II, 821 15th Street, N. W., Washington, D. C. 20005, and C. Harrison Mann, 815 15th Street, N. W., Washington, D. C. 20005, filed with me a notice of appeal therein which had been delivered to M. Wallace Moncure, Jr., Ross Building, Richmond, Virginia, opposing counsel, to Counsel for the State Corporation Commission and to the Attorney General of Virginia, pursuant to the provisions of §13 of Rule 5:1 of the Rules of Supreme Court of Appeals of Virginia.

Subscribed at Richmond, Virginia, July 18, 1967.

WILLIAM C. YOUNG
Clerk

page 779 } SUPPLEMENT TO
RECORD ON APPEAL IN CASE NO. 18386
BEFORE THE STATE CORPORATION
COMMISSION

SUPPLEMENTAL CERTIFICATE

I, William C. Young, Clerk of the State Corporation Commission, certify that within sixty days after the final order in Case No. 18386 before the State Corporation Commission and in addition to the Interveners listed in my certificate

therein dated July 18, 1967, which was a part of the transcript of the record transmitted to the Clerk of the Supreme Court of Appeals of Virginia, the following Intervener, Virginia State AFL-CIO, by counsel, George W. Shadoan, 352 Hungerford Drive, Rockville, Maryland, 20850, Beecher E. Stallard, Central National Bank Building, Richmond, Virginia, 23219, and George E. Allen, Jr., 1809 Staples Mill Road, Richmond, Virginia, 23230, has filed with me a notice of appeal therein which had been delivered to the persons listed in my certificate of July 18, 1967, and to Charles E. Hammond, Board of Supervisors, Arlington County, Arlington, Virginia, pursuant to the provisions of §13 of Rule 5:1 of the Rules of Supreme Court of Appeals of Virginia.

Subscribed to at Richmond, Virginia, the 17th day of August, 1967.

WILLIAM C. YOUNG
Clerk

* * * * *

A Copy—Teste:

Howard G. Turner, Clerk.

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