In the Supreme Court of the State of California

ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES and PERSONAL INSURANCE FEDERATION OF CALIFORNIA *Plaintiffs and Respondents,* vs. **DAVE JONES in his capacity as Commissioner of the California Department of Insurance,** *Defendant and Appellant.*	Case No. S226529

Court of Appeal, Second Appellate Case No. B248622
Los Angeles County Superior Court Case No. BC463124
Honorable Gregory W. Alarcon, Judge

ANSWER BRIEF ON THE MERITS

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I.
INTRODUCTION

Respondents urge this Court to affirm the holdings of the courts below that the Insurance Commissioner exceeded his authority when he adopted a regulation dictating how insurers are to calculate and communicate estimates of replacement costs to insureds and applicants for insurance and declaring that any estimate communicated contrary to the dictates of the regulation is misleading as a matter of law, even when no one is misled by such communications. The effect of the regulation is to create a new unfair or deceptive insurance practice, expanding the list of unfair or deceptive acts or practices spelled out in the Unfair Insurance Practice Act and doing so contrary to the specific process detailed in that Act. (Insurance Code sections 790 and following.)

A regulation to be valid has to be within the scope of the authority conferred by the Legislature, consistent and not in conflict with the statute, and reasonably necessary. Government Code sections 11342.1 and 11342.2. This Court has noted in numerous cases that courts in judging the validity of a regulation should look first to determine whether the regulation is authorized by, consistent and not in conflict with the statute. (Citation) No need exists to determine whether the rule-making record contains substantial evidence supporting an agency's finding that a regulations is "reasonably necessary" if it lacks authority, is inconsistent or in conflict with the statute. Accordingly, Respondents, two insurance trade associations, limited their challenge on behalf of their members to the legal validity of the replacement-cost regulation. Title 10 CCR § 2695.183.

With respect to the issue before the Court, did the Legislature intend for the Commissioner to declare by regulation that new acts are misleading as a matter of law, it should be noted that the UIPA is unique. In that law, the Legislature specifically reserves to itself the authority to "define" new unfair practices. It only authorizes the Commissioner to "determine" other practices to be unfair, pursuant to an order for a show cause hearing. The UIPA does not authorize the Commissioner to expand the statutory definitions of unfair practices by regulation.

The regulation does declare new acts to be misleading. Conduct that is entirely consistent with the statute – the truthful, accurate communication of replacement cost estimates – would be classified as misleading under the regulation if the communication is made without following the detailed dictates of the regulation's singularly, prescribed methodology.

Determining that the Legislature does not intend for the Commissioner to declare new acts to be misleading, unfair, or deceptive is further evidenced by the legislative response to underinsurance complaints resulting from past wildfire losses. The Legislature has called for greater disclosure to consumers of homeowner insurance, more training of licensees, and even authorized the Commissioner to adopt standards for appraisers to estimate replacement costs. However, it has never conferred authority on the Commissioner to impose standards for estimating replacement costs on insurance licensees.

Despite the fact that Respondents have based their challenge only on the legal issue of authority and consistency and have not raised necessity as an issue, the

Commissioner in his opening brief sets out at length the factual rationale for adopting the replacement-cost estimate regulation. He cites complaints submitted by claimants who lost their homes in wildfires in the last two decades. While stories of inadequate insurance may exert an emotional tug, they have no relevance in determining whether the Legislature authorized the Commissioner to dictate a single methodology for calculating and communicating replacement cost estimates to consumers.

In addition, we ask the Court to take note of the following with respect to the litany of complaints cited by the Commissioner from the rule-making record:

1. They are just that – complaints. The rule-making record contains no evidence that any of the complaints were investigated and found to be justified.
2. The record contains no evidence explaining why the Department has not initiated any action against agents who are alleged to have made these misleading statements.
3. While insurers offer assistance, it is up to the homeowner to determine how much insurance to buy, that is, to set policy limits. *Everett v. State Farm (2008) 162 Cal.App.4th 649.*
4. A number of factors can also explain why some homeowners complain about being underinsured:
    a. Substantial time has elapsed between the time the homeowner set policy limits and when the loss occurred, and during that time, inflation drove up the cost of construction, and the homeowner did not regularly increase the coverage amount.

b. The homeowner added on or made other improvements to the house and did not increase policy limits.

5. A significant reason for underinsurance complaints following wildfires is "demand surge." In fact, the Commissioner recognized demand surge and defined it in a version of the regulation. The regulation provided that "demand surge" is "a phenomenon characterized by a substantial increase in the cost of construction due to unusually high demand for contractors, building supplies, and construction labor. Demand surge typically occurs after a disaster, such as a wildfire, earthquake, or other natural disaster, in which large numbers of structures are destroyed within a specific geographic area." AR 1169[1] The Commissioner struck that provision from the final version of the regulation.

6. The Commissioner's brief seeks to create the impression that the Legislature's response to underinsurance has failed, so he needs to step in with the regulation. In fact, the Commissioner issued a press release in November 2009 relating to the 2007 wildfires, stating "that the Department received only 70 complaints related to underinsurance stemming from the nearly 40,000 claims." AR 1254

II.
STATEMENT OF FACTS

On April 2, 2010, the Commissioner noticed his proposal to adopt a series of regulations ostensibly to address complaints by homeowners that they were underinsured

[1] Citations to the Administrative Record are to AR and the page number.

after suffering a total loss resulting from catastrophe wildfires. (AR, 1101.)[2] The noticed regulations were as follows:

1. Section 2188.65, Broker-Agent Training on Estimating Replacement Value, was proposed to be added. (AR, 1071- 1073.)

2. Section 2190.2, Required Records, was proposed to be amended. (AR, 1074.)

3. Section 2190.3, Records by File, was proposed to be amended. (AR, 1075.)

4. Section 2695.180, Valuation of Homes-Definitions, was proposed to be added. (AR, 1076.)

5. Section 2695.181, Standards for Real Estate Appraisers, was proposed to be added. (AR, 1076.)

6. Section 2695.182, Documentation of Person Making Estimate, was proposed to be added. (AR, 1077.)

7. Section 2695.183, Standards for Estimates of Replacement Value, was proposed to be added. (AR, 1077-1079.) This is the portion of the regulation that the Associations challenged and that was invalidated by the courts below.

The ostensible justification for the regulation is that some homeowners complained that their insurance was inadequate to rebuild after a total loss caused by widespread wildfires. (AR, 1081.) No complaints are in the Administrative Record that underinsurance resulted from a single loss, that is, one occurring outside catastrophic wildfire losses.

Responding to the Notice, Respondents submitted comments to the Commissioner, highlighting the Commissioner's lack of authority to define new unfair business practices or to regulate homeowners insurance as section 2695.183 does. (AR, 1185-1196, 1204-1207.) They also submitted comments recommending changes in the language for other

[2] The citations to the Administrative Rulemaking file will be cited as AR and the page number.

sections in the proposed regulations, however, they limited the challenge to the Commissioner's authority to adopt section 2695.183. Numerous other parties submitted comments as well. (AR, 1165-1233.)

On October 27, 2010, the Commissioner issued a Notice of Changed Text and Additions to the rulemaking file. (AR, 1258-1262.) The Commissioner did not make changes in the regulation to address Respondents' concern about the lack of authority to adopt section 2695.183. (AR, 1269-1273.)

Respondents submitted additional comments to the revised regulation, raising once again, among other issues, that the Commissioner lacks authority to adopt the regulations. (AR, 1239-1247 and 1253-1257.)

The Commissioner did not address his lack of authority in the final version of the regulations, (AR, 12-15.) and he adopted the regulations on November 16, 2010. (AR, 5.)

In adopting the regulations, the Commissioner prepared a Final Statement of Reasons in which he responded to comments submitted by interested parties. (AR, 1388-1542.) Repeatedly, he admits that the purpose of the regulation is not to assure "accurate" estimates of replacement costs. (AR, 1436, 1466, 1471, and 1473.)

The regulations became effective on June 27, 2011. (AR, 2.)

III.
STATEMENT OF THE CASE

This case turns on pure legal issues. Does the Commissioner lack authority under the UIPA to adopt a regulation that defines a new unfair practice by dictating how insurance licensees are to calculate and communicate estimates of replacement cost to

insurers and applicants for insurance? The Commissioner asserts that he has authority under section 790.10 in that he is specifically implementing the provisions of section 790.03(b). Respondents disagree, and the courts below also rejected the Commissioner's assertion.

A. Unfair Insurances Practices Act.

The Unfair Insurance Practices Act ("UIPA") begins with section 790. That section provides, "The purpose of this article is to regulate trade practices in the business of insurance . . . by defining, or providing for the determination of all such practices in this State which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined." It is important to note that section 790 refers to unfair acts or practices as "defined" or "determined."

Section 790.03 provides, "The following are hereby defined as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance." Hence, the unfair acts or practices referred to in section 790 as those "defined" are those acts and practices listed by the Legislature in section 790.03.

The Legislature, in subdivision (b), section 790.03, defines as an unfair act or practice, "Making or disseminating or causing to be made or disseminated before the public in this state, in any newspaper or other publication, or any advertising device, or by public outcry or proclamation, or in any other manner or means whatsoever, any statement containing any assertion, representation, or statement with respect to the business of insurance or with respect to any person in the conduct of his or her insurance business,

which is untrue, deceptive, or misleading, and which is known, or which by the exercise of reasonable care should be known, to be untrue, deceptive, or misleading." This is the provision of law that the Commissioner asserts he is implementing by the adoption of section 2695.183.

What then was intended by the provision in section 790 referring to unfair acts or practices to be "determined?" The answer to that question is found in section 790.06.

> "Whenever the commissioner shall have reason to believe that any person engaged in the business of insurance is engaging in this state in any method of competition or in any act or practice in the conduct of the business that is not defined in section 790.03, and that the method is unfair or that the act or practice is unfair or deceptive . . he or she may issue and serve upon that person an order to show cause . . . for the purpose of **determining** whether the alleged methods, acts or practices or any of them should be declared to be unfair or deceptive within the meaning of this article." (Emphasis added.)

The Commissioner did not follow the procedure provided by the Legislature in section 790.06. Instead, he cited section 790.10 as providing authority to adopt the challenged regulation. That section provides that, "[t]he commissioner shall, from time to time as conditions warrant, after notice and public hearing, promulgate reasonable rules and regulations, and amendments and additions thereto, as are necessary to **administer** this article." (Emphasis added.) Administering, however, is significantly less authority than the Commissioner assumed, defining new unfair acts.

The structure of the statutory authority is clear. The Legislature has reserved to itself the authority to define unfair business practices. If the Commissioner believes other specific practices to be unfair, the statute dictates the Commissioner must follow the

procedures set forth in section 790.06 to challenge those practices. Otherwise, the Commissioner merely has authority to administer the law as defined by the Legislature. The Commissioner cannot declare new acts to be unfair practices; that role is exclusively retained by the Legislature. The Commissioner cannot determine new unfair practices by regulation; he can do so only pursuant to section 790.06.

B. <u>The Regulation</u>.

Section 2695.183, the regulation under review, imposes on homeowner insurers a single, detailed method for estimating the replacement cost of a house. It provides: "No licensee shall communicate an estimate of replacement cost to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis, unless the requirements and standards set forth in subdivisions (a) through (e) below are met.":

Subdivision (a) of section 2695.183 provides as follows:

> "(a) The estimate of replacement cost shall include the expenses that would reasonably be incurred to rebuild the insured structure(s) in its entirety, including at least the following:
>
> (1) Cost of labor, building materials and supplies;
>
> (2) Overhead and profit;
>
> (3) Cost of demolition and debris removal;
>
> (4) Cost of permits and architect's plans; and
>
> (5) Consideration of components and features of the insured structure, including at least the following:
>
> (A) Type of foundation;

(B) Type of frame;

(C) Roofing materials and type of roof;

(D) Siding materials and type of siding;

(E) Whether the structure is located on a slope;

(F) The square footage of the living space;

(G) Geographic location of property;

(H) Number of stories and any nonstandard wall heights;

(I) Materials used in, and generic types of, interior features and finishes, such as, where applicable, the type of heating and air conditioning system, walls, flooring, ceiling, fireplaces, kitchen and bath(s);

(J) Age of the structure or the year it was built; and

(K) Size and type of attached garage."

Subdivisions (b) through (e) provide as follows:

"(b) The estimate of replacement cost shall be based on an estimate of the cost to rebuild or replace the structure taking into account the cost to reconstruct the single property being evaluated, as compared to the cost to build multiple, or tract, dwellings.

(c) The estimate of replacement cost shall not be based upon the resale value of the land, or upon the amount or outstanding balance of any loan.

(d) The estimate of replacement cost shall not include a deduction for physical depreciation.

(e) The licensee shall no less frequently than annually take responsible steps to verify that the sources and methods used to generate the estimate of replacement cost are kept current to reflect changes in the costs of reconstruction and rebuilding, including changes in labor, building materials, and supplies, based upon the geographic location of the insured structure. The estimate of replacement cost shall be created using such reasonably current sources and methods."

The regulation continues in subdivision (g)(2) and makes explicit that an estimate, to be acceptable, has to be broken out in four parts. It provides as follows:

> "An estimate of replacement cost provided in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis must itemize the projected cost for each element specified in paragraphs (a)(1) through (4), and shall identify the assumptions made for each of the components and features listed in paragraphs (a)(5), of this Section 2695.183."

Subdivision (j) renders any estimate calculated or communicated differently than that required by the regulation to be misleading as a matter of law. In other words, such a communication is deemed to be an unfair business practice. It provides as follows:

> "To communicate an estimate of replacement value not comporting with subdivisions (a) through (e) of this Section 2695.183 to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis constitutes making a statement with respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be misleading, pursuant to Insurance Code section 790.03."

Section 2695.183 repeatedly uses the phrase "estimate of replacement cost." That phrase is defined in section 2695.180(e), adopted at the same time as section 2695.183 and reads as follows:

> "Estimate of replacement value" shall have the same meaning as 'estimate of replacement cost' and means any estimate, statement, calculation, approximation or opinion, whether expressed orally or in writing, regarding the projected replacement value of a particular structure or structures."

C. <u>Procedural History</u>.

Respondents filed their Complaint for Declaratory Judgment pursuant to Government Code section 11350 on June 8, 2011. They challenged the validity of section 2695.183 of the regulation on three grounds:

1. That the Commissioner defined, by this regulation, an unfair business practice beyond those set out in Insurance Code section 790.03, and in doing so, he has acted contrary to the exclusive process contained in section 790.06 for determining new unfair business practices.

2. That the regulation restricts insurers' underwriting of homeowner insurance, and the Commissioner has no authority to regulate homeowner insurance in this manner.

3. That the regulation specifically makes any communication about estimates of replacement cost unlawful unless the estimate is calculated and communicated in strict compliance with the detailed provisions of the regulation; thereby, infringing the Respondents member companies' First Amendment rights.

(AJ, 117.)

The trial consisted of the trial court's consideration of Respondents' opening memorandum (AJ, 91-212), the Commissioner's opposition (AJ, 200-232), Respondents' reply (AJ, 259-282.), and oral argument.

The court issued its statement of decision on March 25, 2013. (AJ, 292-297.) The court concluded that the Commissioner did not have the authority to adopt section 2695.183 of the regulation under the Unfair Insurances Practices Act. (AJ, 294.) The court stated, "By characterizing all estimates of replacement costs as misleading (save the one provided by 10 CCR §2695.183) Defendant in exercising its authority under Cal. Ins. Code §790.10, expands the meaning of something 'known' or which 'should be known' to be misleading beyond the parameters of §790.03(b)." (AJ, 295.)

The court continued, saying, "The limits of the authority granted by §790.03 are underscored by Cal. Ins. Code §790.06, which provides a special process which the commissioner can determine how acts not listed in §790.03 can be defined as unfair or deceptive." The court added, "To follow Defendant's interpretation of §790.03(b) would

be to obviate the need for §790.06, and statutes should be interpreted in such a way as to make them consistent with each other (citation omitted). Therefore, because 10 CCR §2695.183 improperly alters the scope of Cal. Ins. Code § 790.03(b), its adoption cannot be justified." (AJ, 295.)

The decision recognizes that reliable, non-misleading estimates can be provided in ways other than that mandated by the regulation. The court concludes that the effect of the regulation is to expand unfair practices under section 790.03, and that the Commissioner does not have authority to do that by regulation, but only pursuant to the order to show cause procedure in section 790.06.

The court granted Respondent's request for declaratory relief against the Commissioner stating, "Pursuant to Government Code section 11350, the regulation section 2695.183 is invalid [in] that the Commissioner exceeded his authority by attempting to define additional acts or practices as unfair or deceptive by regulation rather than by the procedure set out in section 790.06." (AJ, 296.)

The Commissioner noticed his appeal on May 9, 2013. (AJ, 318-320.) Oral argument was held in the Court of Appeal, Second District on March 18, 2015. The court of appeal released its opinion on April 8, 2015, upholding the trial court decision. It concluded that "the Commissioner did not have authority to add content and format requirements for replacement cost estimates in homeowner insurance to the list of practices set forth in section 790.03 under the guise of deeming nonconforming estimates misleading under section 790.03, subdivision (b)."

The Commissioner filed a Petition for Review on May 19, 2015. This Court granted review on July 15, 2015.

IV.
QUESTION PRESENTED

The question for the Court to address is whether the Legislature intended for the Insurance Commissioner to expand by regulation the list of business practices that constitute unfair methods of competition or unfair or deceptive acts or practices when (1) it has "defined" such acts in a statute, section 790.03, [3] containing ten subdivisions, one of which has sixteen paragraphs, and (2) it has provided in sections 790.06 a detailed process for the Commissioner to "determine" whether acts or practices not statutorily defined as unfair or deceptive should be declared to be unfair or deceptive within the meaning of this article. The Court has directed the parties to address also whether the Legislature has authorized the Commissioner to adopt "a regulation specifying that the communication of a replacement cost estimate which omits one or more of the components in subdivisions (a)-(e) of section 2695.183 of Title 10 of the C.C.R. is a 'misleading' statement with respect to the business of insurance." The Court's question is a subset of the broader question set out above and the answer to both is the same – the Legislature provided in section 790.06 the process for the Commissioner to declare acts or practices not statutorily defined as unfair or deceptive to be "misleading" and, therefore, unfair or deceptive.

[3] All statutory citations are to the Insurance Code unless otherwise noted.

A A Court Exercises Its Independent Judgment In Determining The Validity Of A Regulation And Must Invalidate A Regulation That Alters, Amends, Or Enlarges The Statute.

This Court in reviewing the validity of the replacement - cost estimate regulation exercises its independent judgment. As it recently stated in *Western States Petroleum Assoc. v. Board of Equalization* (2013) 57 Cal.4th 401, "when an implementing regulation is challenged on the ground that it is 'in conflict with the statute' (Gov. Code, § 11342.2" or does not "lay within the law making authority delegated by the Legislature" (Citation omitted.) The issue of statutory construction is a question of law on which a court exercises independent judgment. (Citation omitted.) In determining whether an agency has incorrectly interpreted the statute it purports to implement, a court gives weight to the agency's construction (Citation omitted.) "How much weight … is 'situational, and greater weight may be appropriate when an agency has a 'comparative interpretive advantage over the courts' as when 'the legal text to be interpreted is technical, obscure, complex, open ended, or entwined with issues of fact, policy, and discretion.' Nevertheless, the proper interpretation of the statute is ultimately the court's responsibility." (Citation omitted.) *Western States*, supra, 57 Cal.4th, pp. 415-416.

"Administrative regulations that alter or amend the statute or enlarge or impair its scope are void and courts not only may, but it is their obligation to strike down such regulations (Citation omitted.)" *California Ass'n. of Psychology Providers v. Rank* (1990) 51 Cal.3d 1, p. 11. See also, *Association for Retarded Citizens v. Department of*

*Developmental Servi*ces (1985) 38 Cal.3d 384, p. 391; *Morris v. Williams* (1967) 67 Cal.2d 733, p. 748.

While the Commissioner invites this Court to apply a less rigorous standard of review, the invitation should be rejected. The Commissioner relies extensively on *Ford Dealers Association v. Department of Motor Vehicles* (1982) 32 Cal.3d 347. That case is of questionable authority. Its articulation of the standard of review has not been followed by this Court. In the *Ford Dealers* case, the Court said "the judicial function is limited to determining whether the regulation (1) is 'within the scope of [the] authority conferred (Citation omitted) and (2) is 'reasonably necessary to effectuate the purpose of the statute (Citation omitted).' Moreover, 'these issues do not present a matter for the independent judgment of an appellate tribunal; rather, both come to this court freighted with a strong presumption of regularity accorded administrative rules and regulations." *Ford Dealers Association*, supra, 32 Cal.3d 347, p. 355. And the Court added, "the courts will interfere only when the agency has clearly overstepped its statutory authority or violated a Constitutional mandate." (*Id.* 356).

The standard articulated in the *Ford Dealers* case was criticized by Professor Michael Asimov as being ambiguous, "It could mean that the court must accept a reasonable agency interpretation with which it disagrees, in which case it would diverge from the mainstream doctrine." The Scope of Judicial Review of Decisions of California Administrative Agencies 42 UCLA L. Rev. 457 (1995), p. 1201. He urged clarification of the standard of review in "the form of a Supreme Court opinion or a new judicial

review statute." Professor Asimov argues that the clarification should embrace the mainstream weak deference model and should suppress the inconsistent lines of case law. He goes on to say that the weak deference model should apply "absent evidence that the Legislature intended to delegate interpretive power to the agency. Furthermore, such evidence should be demonstrable; the court should not simply assume that the Legislature intended to delegate interpretive power, as has often occurred in the past." (*Id.* p. 1203)

The court did embrace the mainstream model in *Yamaha Corp. of America v. State Board of Equalization* (1998) 19 Cal.4th 1. Both the majority and concurring opinions sought to clarify the standard of review. *Yamaha*, of course, is the basis for this Court's opinion in *Western States Petroleum Association*, supra, 57 Cal.4th 401. There, this Court concluded, as noted at the outset of this section, that courts exercise independent judgment and only give weight to the agency's interpretation depending on the situation. Unfortunately, the Court has not clearly suppressed the other inconsistent line as reflected in the *Ford Dealers* decision. This Court is encouraged to do so and reject the *Ford Dealers* case as applicable precedent.

Professor Asimov also encouraged the Court to require demonstrable evidence of legislative intent before giving significant weight to the agency's interpretation. Again, that can be done in rejecting the portion of the *Ford Dealers* opinion where the Court states "an administrative agency is not limited to the exact provisions of a statute in adopting regulations to enforce its mandate. '[T]he absence of any specific [statutory] provisions regarding the regulation of [an issue] does not mean that such a regulation

exceeds statutory authority ….' (Citations omitted)" The DMV is authorized to "fill up the details" of the statutory scheme. (Citations omitted). That concept is a far cry from requiring demonstrable evidence of the Legislature's intent.

As this Court said several decades ago, "The ultimate interpretation of a statute is an exercise of the judicial power." (Citations omitted.) The judicial power is conferred upon the courts by the Constitution and, in the absence of a constitutional provision, cannot be exercised by any other body. (Cal. Const., art. VI, sec. 1) (Other citations omitted.) *Bodinson Manufacturing Co. v. California Employment Commission* (1941) 17 Cal.2d 321, p. 326 More recently, this Court in *McClung v. Employment Development Department* (2004) 34 Cal.4th 467 repeated that principal, citing the Bodinson decision. There, this Court said, "Subject to constitutional constraints, the Legislature may enact legislation." (Citations omitted.) But the judicial branch *interprets* that legislation. "Ultimately, the interpretation of a statute is an exercise of the judicial power the Constitution assigns to the courts." *McClung*, supra, 34 Cal.4th 467, p. 472 In determining what the law is, the court's role is to "ascertain the intent of the drafters so as to effectuate the purpose of the law." *Esberg v. Union Oil Co.* (2002) 28 Cal.4th 262, p. 268.

The Legislature's intent in the UIPA is well articulated. The Legislature provided evidence demonstrating its intent that the Commissioner has authority to fill up the gaps, not by regulation, however, but by the specific procedure spelled out in section 790.06. It is by that procedure and only that procedure that the Commissioner may determine to

declare acts not defined as unfair or deceptive in section 790.03 to be unfair or deceptive acts or practices. The Legislature has evidenced its intent in the construction of the UIPA and has confirmed that intent in subsequent legislative enactments.

B. The Commissioner's Authority To Define New Acts As Unfair Business Practices is Limited to the Section 790.06 Process.

The UIPA is unique and the Legislature's intent becomes obvious by reviewing its structure and specific provisions. Section 790 of the UIPA states, "The purpose of this article is to regulate trade practices in the business of insurance . . . by **defining**, or **providing for the determination** of, all such practices in this State which constitute unfair methods of competition or unfair or deceptive acts or practices, and by prohibiting the trade practices so **defined** or **determined**." (Emphasis added.)

Hence, in the first section of the UIPA, the Legislature makes explicit that it has defined those acts or practices it considers to be unfair or deceptive. In addition, it makes explicit that it is "providing for the determination" of such other acts or practices that may be unfair or deceptive. The Legislature has limited the establishment of acts or practices as unfair or deceptive to only those two methods. The expression by the Legislature of those two methods excludes any other method of establishing acts or practices as unfair or deceptive. The expression of some things in a statute necessarily means the exclusion of other things not expressed. *Gikas v. Zolin* (1993) 6 Cal.4th 841, 852; *Sierra Club v. State Board of Forestry* (1994) 7 Cal.4th 1215, 1230.

Section 790.03 begins, "The following are **defined** as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance."

(Emphasis added.) Hence, as the Legislature stated in section 790, it is regulating the insurance industry by defining acts or practices as unfair or deceptive. It did not say that it was providing for the definition of such acts or practices. It did not delegate the responsibility or power to any other entity to define acts or practices as unfair or deceptive. It reserved that responsibility and power to itself, and it exercised that power in section 790.03. As a consequence, the totality of "defined" unfair or deceptive acts or practices is set out in section 790.03.

The Legislature did create a second method for establishing unfair or deceptive acts or practices. It provided for the determination of such acts or practices in section 790.06.

Section 790.06 provides,

> "Whenever the commissioner shall have reason to believe that any person engaged in the business of insurance is engaging in this state in any method of competition or in any act or practice in the conduct of the business that is not **defined** in Section 790.03, and that the method is unfair or that the act or practice is unfair or deceptive and that a proceeding by him or her in respect thereto would be in the interest of the public, he or she may issue and serve upon that person an order to show cause . . . for the purpose of **determining** whether the alleged methods, acts or practices or any of them should be declared to be unfair or deceptive within the meaning of this article." (Emphasis added.)

Section 790.06 is the method by which the Legislature authorized the Commissioner to establish new acts or practices as unfair or deceptive. Again, the explicit delegation of authority to establish new acts or practices through section 790.06 excludes the implication that the Commissioner may do so by regulation. (*Gikas*, *supra*, 6 Cal.4th at 852; *Sierra Club*, *supra*, 7 Cal.4th at 1230.)

Moreover, section 790.02 references the two methods. It provides that, "No person shall engage in this State in any trade practice which is defined in this article as, or determined pursuant to this article to be" unfair or deceptive.

In addition section 790.035 sets out the penalties to be imposed on an insurer who engages in "any unfair or deceptive act or practice defined in Section 790.03." Section 790.05 outlines the administrative procedure to be followed when the Commissioner believes that an insurer has engaged in any act defined as unfair or deceptive in section 790.03. Neither section refers to any acts or practices declared to be unfair or deceptive by regulation. Those two sections are explicit in referring to only those acts or practices defined in section 790.03.

The Commissioner argues that section 790.06 is simply an enforcement mechanism paralleling the enforcement procedure set out in section 790.05. The latter section is to be used to enforce the specific unfair practices defined in section 790.03. The former is to be used to enforce unfair practices that are not listed in section 790.03. (Appellant's Opening Brief, .)

What the Commissioner's argument fails to reveal is that before enforcement occurs under section 790.06, an act has to be **determined** first to be an unfair practice. Section 790.06 is explicit in this regard.

If the Commissioner believes an insurance licensee is engaging in an unfair act or practice not defined in section 790.03, the Commissioner may issue an order to show cause to determine whether the act or practice should be determined to be unfair. If the

alleged act or practice is found to be unfair, the Commissioner shall issue a written report declaring it to be so. (Section 790.06(b).)

If the report charges a violation and the act or practice has not been discontinued by the licensee, the Commissioner, through the Attorney General, may file a petition in court to enjoin the licensee from proceeding with the act or practice. (Section 790.06(b).) Evidence in addition to the record taken before the Commissioner may be considered by the court. The Commissioner may modify the findings as a result of the additional evidence. (Section 790.06(c).) If the court finds that the act or practice is unfair or deceptive it shall issue an order enjoining the licensee from continuing the act or practice. (Section 790.06(d).)

Then section 790.07 provides for penalties to be imposed on any person who "has violated a cease and desist order issued pursuant to Section 790.05 or a court order issued pursuant to Section 790.06". That section like other provisions in the UIPA recognizes two methods by which acts or practices may be declared to be unfair or deceptive—defined by the Legislature in section 790.03 and determined to be unfair by the Commissioner and confirmed by a court pursuant to section 790.06.

The Legislature has seen fit to erect a procedure that provides significant safeguards to the insurer that may be named in an order to show cause. The insurer has an opportunity in an administrative adjudicatory proceeding to offer evidence to demonstrate, for example, that the circumstances in which the act or practice was followed does not result in anyone being misled. The insurer can, if it chooses, abandon the act or practice, and the matter is resolved with no penalties. Moreover, even if the Commissioner

concludes that the act is unfair or deceptive and the insurer continues to engage in the act or practice, the insurer is not subject to an injunction until a court finds that the Commissioner's findings are supported by the weight of the evidence, not simply by substantial evidence, and no penalties attach unless the insurer violates the injunction.

Nothing in the adoption of section 790.10 indicates that the Legislature intended for the procedure with the substantial safeguards set out in section 790.06 to be overridden. Yet that is the effect by allowing the Commissioner to expand the list of unfair acts or practices in section 790.03 by regulation.

Moreover, had the Legislature intended for the Commissioner to be able to expand by regulation the list of unfair or deceptive acts or practices beyond those defined by the Legislature in section 790.03, it would have evidenced that intent elsewhere in the UIPA. For example, it would have added to the statement of purpose set out in section 790 by referencing acts or practices declared to be unfair or deceptive by regulation to those defined by the Legislature in section 790.03 and those determined by the Commissioner pursuant to section 790.06. It didn't.

Also, the Legislature would have expanded the prohibition in section 790.02 to include trade practices declared to be unfair or deceptive by regulation. It didn't. In addition, the Legislature would have provided for an enforcement procedure to determine whether an insurer has committed an act or practice declared to be unfair or deceptive by regulation as it has in sections 790.05 and 790.06 for acts or practices defined in section 790.03 and for those determined pursuant to section 790.06. It didn't. Finally, the Legislature would have provided for penalties to be imposed for committing an act or

practice declared by regulation to be unfair or deceptive as it has in sections 790.03 and 790.07 for those defined or determined to be unfair or deceptive. It didn't.

The section 790.06 mechanism is unique and makes inapplicable the cases cited by the Commissioner dealing with Proposition 103, life and disability insurance laws, or vehicle code provisions considered by the court in the *Ford Dealer* case. None of those cases involve a statutory structure where two exclusive mechanisms are identified as the way in which regulatory standards are established; one by the Legislature, and the second by the regulatory agency pursuant to an order to show cause procedure.

The provisions of the UIPA make explicit that the Commissioner has no authority to establish new acts or practices as unfair or deceptive pursuant to section 790.10.

C. The Legislative History Of Section 790.10 Demonstrates That The Legislature Did Not Intend To Permit The Commissioner To Define New Acts As Unfair By Regulation.

The Commissioner requests this Court to consider two documents relating to AB 1353, the bill that added section 790.10 to the UIPA in 1971. However, the materials included in the Commissioner's Request do not demonstrate that the Legislature granted authority to the Commissioner to define additional acts as unfair practices. Moreover, the one amendment made to AB 1353 demonstrates that the Legislature conferred narrow authority on the Commissioner. Further, the Department of Insurance's early implementation of section 790.10 evidences recognition that its authority was limited. Also, the Legislature in a subsequent bill made clear that it considers section 790.06 to be the method for the Commissioner to address acts that he considers to be unfair, but that are not defined in section 790.03.

The materials included in the Commissioner's Request include an enrolled bill report provided to the Governor by the Department of Finance. The telling part of that document is the description of the fiscal effect -- "One time $1500 hearing costs." In other words, the Department of Insurance, at that time part of Governor Reagan's Administration, contemplated conducting only one hearing to adopt regulations; regulations that it had apparently already conceptualized. No ongoing costs or subsequent costs were anticipated.

In fact, the Department did adopt regulations relating to advertising by insurers selling health insurance.[4] In 1974, the Department added sections 2536 through 2536.12 to Title 10 of the regulations. The following examples, while not exhaustive, illustrate the nature of the regulations that the Department contemplated in 1971:

- Section 2536.1 provides that advertisements should avoid deception and should be truthful and not misleading.
- Section 2536.2 prohibits omitting information or using words of phrases that have the effect of misleading customers. It also includes examples of the kind of statements that cannot be made unless they are true.
- Section 2536.4 requires testimonials to be genuine.
- Section 2536.7 prohibits unfair or incomplete comparisons about the policies, benefits, or insurers.

The regulations adopted by the Department in response to the authority granted by AB 1353 generally prohibit acts if those acts are untruthful, deceptive, or misleading. In other words, the regulations provide examples of acts that are prohibited by the UIPA,

[4] Health insurance of course is the line of insurance that the author identified as the target of AB 1353. (Appellant's RJN.)

using the language of section 790.03. The examples would be violations of the statute as well as of the regulations.

The 1974 regulations do not alter, amend, or enlarge section 790.03. They do not dictate how insurers shall advertise their health insurance products, declaring all other advertisements to be misleading as a matter of law.

The 1974 regulations are significant for two reasons. First, they are the regulations that were contemplated to be adopted under the authority of AB 1353. Second, they demonstrate that the Department interpreted section 790.10 as granting limited authority; it did not grant authority to define acts outside section 790.03 as unfair practices.

The Department's initial interpretation that section 790.10 provided narrow, limited authority is consistent with that of the Legislature as evidenced by the one amendment made to AB 1353 during the legislative process. The bill, when introduced, provided that the Commissioner had authority to adopt regulations to "implement" the UIPA. On July 9, 1971, AB 1353 was amended, replacing "implement" with "administer."[5] That change demonstrates that the Legislature recognized (1) that it had fully implemented the UIPA by defining unfair acts in section 790.03 and by providing for the Commissioner to determine practices to be unfair through the order-to-show-cause procedure in section 790.06, and (2) that the Commissioner need only administer the UIPA. In other words, with the amendment, the Legislature signaled its intent to

[5] Respondents ask the Court to take judicial notice of the July 9, 1971 version of AB 1353, reflecting the amendment.

authorize the Commissioner only to manage, that is, to apply section 790.03 to specific fact situations. "Administer" is defined as follows:

> "To have charge of; manage. To give or apply in a formal way: Administer the last rites. To apply as a remedy: Administer a sedative. To meet out; dispense: Administer justice. To manage or dispose of (a trust or estate) under a will or an official appointment. To impose, offer, or tender (an oath, for example). To manage as an administrator. To minister." (American Heritage Dict. (2d college ed. 1982) p. 79.)[6]

The Legislature's intent was further demonstrated in 2000 when the Legislature strengthened the section 790.06 process, confirming that section 790.06 is the mechanism for the Commissioner to determine acts not included in section 790.03 to be unfair practices. Senator Burton introduced SB 1500 "to require the Department of Insurance to explain why a . . . practice or act is believed to be unfair or deceptive." Bill Analysis, Senate Committee on Insurance (April 26, 2000).[7]

Section 790.06 provides that whenever the Commissioner believes that someone is engaging in any method of competition or in any act or practice not defined in section 790.03 that he considers to be unfair or deceptive, the Commissioner may issue an order to show cause to determine whether the method, act, or practice should be declared to be unfair or deceptive. SB 1500 added, "The order shall specify the reason why the method of competition is alleged to be unfair or the act or practice alleged to be unfair or deceptive."[8]

[6] Respondents ask the Court to take judicial notice of this definition of "administer."
[7] Respondents ask the Court to take judicial notice of the Bill Analysis, Senate Committee on Insurance.
[8] Respondents ask the Court to take judicial notice of the chaptered version of SB 1500.

The Bill Analysis prepared for the Senate Insurance Committee provides background information on SB 1500. It states, "Present law defines a set of unfair methods of competition and unfair deceptive acts or practices in the business of insurance. (Section 790.03 of the Insurance Code)." It continues, "This bill addresses the authority of the Insurance Commissioner when the Commissioner has reason to believe an unfair or deceptive practice has occurred that is not one specifically defined in Insurance Code Section 790.03. In that instance, the Commissioner may issue an order to show cause upon a person and shall contain a statement of the acts or practices alleged to be unfair or deceptive."

The SB 1500 Bill Analysis references only two methods for declaring acts or practices to be unfair or deceptive—those defined in section 790.03 and the order to show cause authority conferred on the Commissioner. It does not recognize that the Commissioner has any authority to declare acts to be unfair or deceptive by regulation.

The enactment of SB 1500 demonstrates that the Legislature, 29 years after the adoption of section 790.10, still intends for section 790.06 to be the method for the Commissioner to determine whether acts not included in section 790.03 are unfair practices. Section 790.10 is not an alternative method. Its adoption in 1971 did not render section 790.06 redundant. This conclusion is supported not only by SB 1500 but also by the documents included in the Commissioner's RJN.

D. The Legislature Has on Multiple Occasions Evidenced its Intent that the Commissioner Has No Authority to Dictate Standards for Replacement Cost Estimates Provided by Insurers

The Legislature has since the adoption of section 790.10 added new acts to the definition of unfair or deceptive acts or practices in section 790.03. For example, in 1972, the year immediately following the adoption of section 790.10, the Legislature added subdivision (h); in 1975, it added two more paragraphs under subdivision (h); in 1978, it added the second and third paragraphs under subdivision (f); and in 1983, it added the fourth paragraph under subdivision (f). The Legislature evidences its intent that it is responsible for defining acts to be unfair or deceptive and that the Commissioner lacks authority to make such declarations by regulation. (I'm checking the legislative history on these four instances to determine whether the Commissioner sponsored some or all of these bills.)

The Legislature in responding to complaints of underinsurance arising from losses caused by wildfires has mandated greater disclosures to insureds about their insurance, required more training for licensees, and authorized the Commissioner to impose standards for appraisers to estimate replacement costs.

In 1992 following the Oakland Hills fire the previous year, the Legislature enacted section 10101 and following. Those provisions required insurers to deliver to insureds a copy of the California Residential Property Insurance disclosure statement. That statement described the types of policies—actual cash value coverage, replacement cost coverage, extended replacement cost coverage, and guaranteed replacement cost coverage. It described building code upgrade coverage and urged insureds to read their policy carefully. (Section 10102.)

Section 10102 was substantially amended in 2010, the same year the Commissioner adopted the replace cost regulation. It added a number of provisions to the disclosure. Three that should be noted. One provision, headed AVOID BEING UNDERINSURED, explained that the insured could be out thousands of dollars if the home is insured for less than its replacement cost. The second provision, headed DEMAND SURGE, explained that construction cost can increase dramatically because of unusually high demand for contractors, building supplies, and construction labor following a widespread disaster. The third provision, headed CHANGES TO PROPERTY, advised that adding on, customizing kitchens and bathrooms, or remodeling your home may increase its replacement cost.

In 2005, the Legislature enacted section 1749.85 in an article entitled "Pre-licensing and Continuing Education." Subdivision (a) of that section refers to a curriculum committee making recommendations to the Commissioner about training for insurance producers "in proper methods of estimating the replacement value of structures and explaining various levels of coverage under a homeowners' insurance policy." It also authorizes the Commissioner to approve those courses.

Subdivision (b) of section 1749.85 provides that only an "insurer underwriter or actuary or other person identified by the insurer, or a licensed property broker-agent, casualty broker-agent, personal lines broker-agent, contractor, or architect may estimate replacement value of a structure or explain various levels of coverage under a

homeowners' insurance policy." However, in 2006 the Legislature adopted an amendment, adding subdivisions (c) and (d).

Subdivision (c) provides that this section should not be construed to preclude licensed appraisers, contractors, and architects from estimating replacement value of a structure." However, subdivision (d) provides, "If the Department of Insurance, by adopting a regulation, establishes standards for the calculation of estimates of replacement value of a structure by **appraisers**, then on and after the effective date of the regulation a real estate appraiser's estimate of replacement value shall be calculated in accordance with the regulation." (Emphasis added.)

Section 1749.85 is significant to this matter for two reasons. First, the Legislature authorized the Department of Insurance to establish estimating standards for appraisers, but did not include in that grant of authority the imposition of standards on insurance licensees. The language of subdivision (b) indicates that the Legislature views licensees and those involved in the business of insurance to be capable of estimating replacement costs without regulatory constraints. It does so by exempting licensees from the ban imposed on others to estimate replacement costs.

Second, subdivision (b) also accepts that contractors and architects are competent to estimate replacement costs without regulatory constraints. Subdivision (c) confirms this by providing specifically that the prohibition in subdivision (b) does not apply to appraisers, contractors, and architects. Subdivision (d) then conditions estimates prepared by appraisers to those conducted in accordance with regulations adopted by the

Department of Insurance. These provisions demonstrate the Legislature's intent that estimates prepared by contractors and architects, as well as insurance licensees, are not to be subject to regulations adopted by the Department of Insurance.

By expressly subjecting appraisers to regulation by the Commissioner in a section that deals with architects, contractors, and insurance licensees, the Legislature evidences its intent that the Commissioner's authority is limited. Once again, the rule of statutory construction that the expression of one thing excludes others is applicable. (*Sierra Club*, *supra*, 7 Cal.4th at 1230; accord *Gikas, supra*, 6 Cal.4th at 852.) The Commissioner has no more authority to regulate the calculation and communication of replacement cost estimates by insurance licensees than he has to regulate estimates prepared and communicated by architects and contractors.

E. The Commissioner Has Unlawfully Defined New Acts As Unfair Or Deceptive By the Adoption of Regulatory Section 2695.183.

The Commissioner asserts that regulatory section 2695.183 does not create a new category of unfair or deceptive acts or practices that require compliance with section 790.06. He asserts that the regulation does nothing more than identify one variety of a statement that is untrue, deceptive or misleading. (Appellant's Opening Brief, .) Those assertions mischaracterize the effect of the regulation and ignore its specific provisions.

If the regulation simply prohibited a licensee from providing an estimate of replacement cost that is untrue, deceptive or misleading, the Commissioner's assertion might be acceptable, but then the regulation would be unnecessary. The truth of the matter is the regulation requires estimates to be calculated and communicated in accordance with a detailed scheme, far exceeding a prohibition on untruthful, deceptive or misleading statements.

Also, if the regulation were no broader than the statute, then a violation of the regulation would also be a violation of the statute. One might ask, what is the need of a regulation in that case; why wouldn't the Commissioner proceed against a licensee under the statute for making an untrue, deceptive or misleading statement concerning an estimate of replacement cost?

The way to test whether the Commissioner defined new acts or practices as unfair or deceptive in the regulation is to determine whether any circumstance exists when the same conduct is considered to be a violation of the regulation but is not a violation of the statute. If such a circumstance exists, the regulation creates a new unfair or deceptive act or practice contrary to section 790.06.

Assume that a homeowner obtains a commitment from a reputable contractor that the contractor will demolish the owner's structure and rebuild an exact duplicate, down to the bathroom flooring, for $250,000. A communication of that $250,000 estimate by an insurance licensee to that homeowner is not untruthful, deceptive or misleading, and would not constitute a violation of section 790.03.

However, the licensee violates the regulation by communicating the $250,000 estimate. For example, the licensee did not consider the components and features of the insured structure. Also, the licensee did not break out the estimate to provide separate costs for (1) labor, materials and supplies, (2) overhead and profit, (3) demolition and debris removal, and (4) permits and plans. If the licensee communicates the $250,000 estimate without describing each and every one of the following features, the foundation, frame, roof, siding, contour of the land, square footage, location, number of stories and wall heights, age of the structure, size and type of garage, and the materials used in the interior features and finishes, such as heating and air conditioning systems, walls, flooring, ceiling, fireplaces, kitchens and baths, the licensee violates the regulation but not the statute. If the licensee communicates the $250,000 estimate orally and does not provide it in writing, the licensee violates the regulation but not the statute.

These are but a few examples of conduct by a licensee that would violate the regulation but not the statute. These examples demonstrate that the regulation impermissibly defines acts or practices not prohibited by the statute to be unfair or deceptive.

The very language of the regulation, makes it clear that the Commissioner intended to define new acts or practices as unfair or deceptive. Subdivision (j) of the regulation provides, "To communicate an estimate of replacement value not comporting with subdivision (a) through (e) of this Section 2695.183 to an applicant or insured in connection with an application for or renewal of a homeowners' insurance policy that provides coverage on a replacement cost basis constitutes making a statement with respect to the business of insurance which is misleading and which by the exercise of reasonable care should be known to be misleading, pursuant to Insurance Code section 790.03."

The effect of subdivision (j) is that the Commissioner is adding to and expanding the list of prohibited acts or practices currently defined in section 790.03. He states explicitly that the failure to comport with the many requirements of the regulation is now defined as a violation of section 790.03.

The Commissioner mischaracterizes the regulation as nothing more than a requirement that an estimate should be complete. (Appellate's Opening Brief,.) The UIPA, itself, already requires that estimates be truthful, not deceptive and not misleading. The regulation goes much further than that, it mandates that insurance licensees calculate and communicate estimates in lockstep with the regulation, break out estimates into four separate components, characterize the many factors that may impact cost, provide it in writing.

The Commissioner attempted to justify the regulation by stating that the term "replacement cost" will now be "consistent among insurers." (AR, 1587.) Then he made the failure to provide all of the information required by the regulation and to act consistently with other insurers as deceptive or misleading acts or practices. That is far beyond the scope of section 790.03.