

# In the Supreme Court of the State of California

**ASSOCIATION OF CALIFORNIA  
INSURANCE COMPANIES and  
PERSONAL INSURANCE  
FEDERATION OF CALIFORNIA,**

**Plaintiffs and Respondents,**

**v.**

**DAVE JONES, in his capacity as the  
Commissioner of the California  
Department of Insurance,**

**Defendant and Appellant.**

Case No. S226529

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

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## ISSUES PRESENTED

As stated in the petition for review, this case presents the following issue: “Did the Commissioner act within his statutory authority in promulgating regulations designed to prevent insurers from providing homeowners purchasing or renewing insurance policies with ‘replacement cost’ estimates that the Commissioner reasonably concluded would be incomplete and potentially misleading?”

More specifically, the Court’s order granting review directs the parties to address “whether the Commissioner has the statutory authority to promulgate 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 California Code of Regulations is a ‘misleading’ statement with respect to the business of insurance. (Cal. Code of Regs., tit. 10, § 2695.183, subd. (j).)”

## INTRODUCTION

Catastrophic wildfires, which put lives at risk and destroy thousands of homes, are a recurring problem in California. So too is the problem of unanticipated underinsurance. Over the past two decades, after every major wildfire, lawmakers and the Commissioner have been inundated with complaints. Post-fire, homeowners tell a familiar story. They reasonably relied on the expertise of their insurers to provide them with estimates for what it would cost to rebuild their homes—often their single most valuable asset—and used those estimates to select coverage limits. After the loss, however, they discovered that the estimates did not include necessary expenses, such as the cost to replace the foundation, or take into account the features and circumstances of their homes that substantially affect the cost of rebuilding. These homeowners learned too late that their



“replacement cost” policies were insufficient to allow them to replace their homes.

Together, the Legislature and the Commissioner have worked to understand the problem of unintended underinsurance and taken various steps to remedy it. The Legislature has, for example, mandated that insurers provide customers with standardized disclosures that define the available types of replacement cost insurance, warn of the risks of underinsurance, and encourage homeowners to obtain current estimates of the cost to rebuild. (Ins. Code, §§ 10101, 10102.)<sup>1</sup> And, relevant to this case, the Commissioner promulgated California Code of Regulations, title 10, section 2695.183—the replacement cost regulation—exercising his authority “as conditions warrant” to “promulgate reasonable rules and regulations, and amendments and additions thereto, as are necessary to administer” Article 6.5 of the Insurance Code, the Unfair Insurance Practices Act (§§ 790-790.15). (§ 790.10.)

The Commissioner’s replacement cost regulation is designed to prevent homeowners from being misled into underinsuring their homes by incomplete estimates that fail to consider all the costs reasonably expected to be incurred in rebuilding. The regulation requires the insurer to consider and include a list of minimum costs and factors, such as demolition and debris removal, type of foundation, and geographic location; base the estimate on what it will actually cost to rebuild; and take steps annually to

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<sup>1</sup> All statutory references are to the Insurance Code unless otherwise noted. As used in this brief, “insurer” has the same meaning as “licensee” in section 2695.180, subdivision (b) of title 10 of the California Code of Regulations—specifically, any person or entity holding a license or certificate of authority issued by the Department of Insurance, a broker-agent, or any other entity for whom the Commissioner’s consent is required before transacting business in the State of California or with California residents.

ensure that estimating tools reflect current conditions. (Cal. Code Regs., tit. 10 (Regs.), § 2695.183, subds. (a)-(e).) The regulation further provides that failing to follow these steps in providing an estimate of replacement cost constitutes a misleading statement, which is a violation of the Unfair Insurance Practices Act. (Regs., § 2695.183, subd. (j); see § 790.03, subd. (b) [prohibiting, among other things, “any statement . . . 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”].) The regulation thus helps to ensure that when homeowners request replacement cost estimates to inform their insurance decisions—as the standardized disclosures encourage them to do—the information they receive from insurers is complete and not misleading.

The court of appeal struck down the replacement cost regulation, concluding that the Commissioner had exceeded his statutory authority in promulgating it, and that the existence of the Commissioner’s other statutory powers, such as his power to institute enforcement proceedings, limits his rulemaking powers in this area. (Opinion (Opn.) 23-25.) In so doing, the court failed to properly apply the rules of statutory construction and to give effect to the Legislature’s intent that the Commissioner, exercising his expert judgment, should have broad, quasi-legislative rulemaking authority to act without delay or the need for specific legislative direction to protect consumers, create a level and well-defined playing field for the insurance industry, and fill the statute’s gaps. This Court should reverse the court of appeal’s decision, confirm the Commissioner’s broad rulemaking authority, and uphold the replacement cost regulation.

## BACKGROUND

### I. THE INSURANCE CODE AND THE COMMISSIONER

“All insurance in this State is governed by the provisions of [the Insurance Code].” (§ 41.) In addition to its general provisions (§§ 1-48), the Insurance Code consists of five divisions setting out general rules governing insurance (Division 1, §§ 100-1879.8) and addressing classes of insurance, including residential property insurance (Division 2, §§ 1880-12880.5); the powers and duties of the Commissioner (Division 3, §§ 12900-13813); affordable housing entities’ pooling of self-insured claims or losses (Division 4, §§ 13900-13907); and insurance adjusters (Division 5, §§ 14000-16032). As set out generally in Division 3, “[t]he commissioner shall perform all duties imposed upon him or her by the provisions of this code and other laws regulating the business of insurance in this state, and shall enforce the execution of those provisions and laws.” (§ 12921, subd. (a).)

Among the Commissioner’s duties is the responsibility to ensure that the purposes of the code’s Unfair Insurances Practices Act, Division 1, Part 2, chapter 1, article 6.5, sections 790-790.15, are carried out. (See §§ 790.04, 790.05, 790.06, 790.10.) Enacted in 1959, the Unfair Practices Act codified certain provisions of the Uniform Fair Trade Practices Model Act developed by the National Association of Insurance Commissioners following Congress’s enactment of the McCarran-Ferguson Act (15 U.S.C. § 1011 et seq.). (§ 790.) The McCarran-Ferguson Act declared the business of insurance to be a subject of state regulation and exempted state law enacted for the purpose of insurance regulation from federal preemption. (15 U.S.C. §§ 1011, 1012; see *U.S. Dept. of Treasury v. Fabe* (1993) 508 U.S. 491, 499-500 [discussing history of McCarran-Ferguson Act].) The Model Act closely paralleled the Federal Trade Commission

Act (15 U.S.C. § 41 et seq.) to avoid potential federal preemption of state regulation of unfair or deceptive insurance trade practices. (Snyder, *"Preserving" Civil RICO: How the Model Unfair Trade Practices Act Affects RICO's Private Right of Action under the McCarran-Ferguson Act* (2011) 86 Notre Dame L.Rev. 1767, 1777.) The purpose of the Unfair Insurance Practices Act is to "regulate trade practices in the business of insurance in accordance with the intent of Congress as expressed in the [McCarran-Ferguson Act], 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." (§ 790.)

Section 790.03 defines and prohibits certain acts "as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance." For example, it specifically prohibits "[m]aking any false entry in any book, report, or statement of any insurer with intent to deceive any agent or examiner lawfully appointed to examine into its condition or into any of its affairs . . . ." (§ 790.03, subd. (e).) More broadly, section 790.03 also prohibits

making or disseminating . . . 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.

(§ 790.03, subd. (b).)

The Unfair Insurance Practices Act provides the Commissioner with certain investigative and enforcement tools. Section 790.04 empowers the Commissioner to examine and investigate the business affairs of any person to determine compliance with the Act. The Commissioner may bring

enforcement actions under section 790.05 against any person alleged to have engaged in a prohibited act or practice defined in section 790.03. Upon a determination that the person has engaged in prohibited conduct, the Commissioner may assess monetary penalties under section 790.035 and may enjoin the conduct. Further, section 790.06 permits the Commissioner to initiate an administrative proceeding against a person suspected of engaging in any act or practice that is unfair or deceptive, but is not defined in section 790.03. Section 790.06 provides that after an administrative hearing, if the Commissioner determines the act or practice is unfair or deceptive, he must issue a report so declaring. (§ 790.06, subd. (a).) Under section 790.06, the Commissioner cannot directly assess monetary penalties or order the conduct to cease as he can when proceeding under section 790.05. The Commissioner must instead apply to the superior court for an injunction. (§ 790.06, subd. (b).)

In addition, section 790.10 vests the Commissioner with quasi-legislative rulemaking authority.<sup>2</sup> Section 790.10 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.” In delegating rulemaking authority to the Commissioner, the Legislature intended for him to clarify and fill in the details of the broad provisions of the prohibited acts or practices defined in section 790.03, “for the benefit of the public without having to wait for the Legislature to

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<sup>2</sup> The Legislature commonly grants agencies both adjudicatory and rulemaking authority. (See, e.g., *Agricultural Labor Relations Bd. v. Superior Court* (1976) 16 Cal.3d 392, 399-400 [Board has enforcement powers under Labor Code, § 1160 et seq. and rulemaking authority under Labor Code, § 1144]; see also §§ 779.21-779.24 [granting Commissioner both adjudicatory and rulemaking authority with respect to credit life and disability insurance].)

act at a later date.” (Opn. 28-29, quoting Assem. Com. on Finance and Insurance, summary of Assem. Bill No. 1353 (1971 Reg. Sess.) p. 1.)

## **II. THE CHRONIC PROBLEM OF UNINTENDED UNDERINSURANCE**

The Legislature and the Commissioner have worked for over two decades to address the problem of unintended underinsurance.

The severity of the underinsurance problem first became evident after the 1991 Oakland hills fire, which destroyed more than 3,000 homes. Facing what had become essentially empty lots, homeowners turned to their insurers and were shocked to learn that their “replacement cost” policies were not sufficient to cover the actual cost of rebuilding. (Appellant’s Motion for Judicial Notice (MJN), Ex. A, pp. 2-3 [Assem. Com. on Insurance, Bill Analysis of Sen. Bill No. 1854 (1991-1992 Reg. Sess.) as amended Aug. 11, 1992].) Many homeowners complained that misleading sales and marketing tactics by insurers led them to believe they were adequately insured to completely rebuild following a catastrophic event, when in fact their coverage was substantially inadequate. (*Id.*, at p. 3; MJN, Ex. B, p. 5 [Sen. Rules Com., Off. of Sen. Floor Analyses, analysis of Sen. Bill No. 1854 (1991-1992 Reg. Sess.) as amended Aug. 11, 1992].)

In response, the Legislature added to Division 2 of the Insurance Code a set of new provisions referred to as the California Residential Property Insurance Disclosure Act (Disclosure Act). (§§ 10101-10107.) These new provisions required that insurers provide homeowners with a standard disclosure form that encouraged homeowners to read their policies, and provided certain general information related to property insurance, such as the meaning and types of “replacement cost coverage.” (Stats. 1992, ch. 1089, § 1.) The Disclosure Act was intended to ensure that homeowners were provided with “full and accurate information” to make informed decisions about coverage. (MJN, Ex. A, p. 2 [Assem. Com. on Insurance,

Bill Analysis of Sen. Bill No. 1854 (1991-1992 Reg. Sess.) as amended Aug. 11, 1992].)

The problem of homeowners finding themselves unexpectedly underinsured in the wake of catastrophic fires persisted, as evidenced by the complaints that followed the 2003 wildfires in southern California. (Rulemaking File (RF [volume]:[page]) IV:1081; V:1320-1322; VI:1431, 1524.) The disaster brought to light a related problem—that underinsurance could result from cost increases occurring between the time the home is destroyed and the time that rebuilding can commence. In response, the Legislature enacted section 2051.5, which was designed to provide homeowners adequate time to rebuild or repair and to account for the fact that the cost at the time of rebuilding may be higher than at the time of the actual loss. (MJN, Ex. C, pp. 9-13 [Sen. Com. on Insurance, Bill Analysis of Assem. Bill No. 2199 (2003-2004 Reg. Sess.) as amended May 17, 2004].) The Legislature also amended section 10103 of the Disclosure Act to require the declarations page of every policy to state that the limit of liability is based on an estimate of the cost to rebuild the insured home. (Stats. 2004, ch. 385, § 2; § 10103, subd. (a)(2).)

The Senate Banking, Finance and Insurance Committee also identified underinsurance as a significant, continuing problem. (MJN, Ex. D, pp. 16-17 [Sen. Banking, Finance and Insurance Com., Bill Analysis of Sen. Bill No. 2 (2005-2006 Reg. Sess.) as amended Mar. 29, 2005].) The Committee noted that homeowners' lack of knowledge about construction costs, and improperly trained insurance industry personnel estimating replacement costs, contributed to underinsurance. The Committee declared that it is "critical that initial policy limits be set accurately and updated regularly." (*Id.* at p. 176, original underscoring.) The Committee noted that the Commissioner (the Department of Insurance) had also held hearings "to educate the public and to determine if market conduct exams needed to be

commenced,” and that in these hearings, “underinsurance was a major issue.” (*Ibid.*)

The Senate Committee’s hearings led the Legislature in 2005 to enact section 1749.85, designed in part to educate those members of the industry who interact with homeowners “in proper methods of estimating the replacement value of structures, and of explaining various levels of coverage under a homeowners’ insurance policy.” (§ 1749.85, subd. (a).) The section required the Department of Insurance’s curriculum committee to make recommendations to the Commissioner on such methods by 2006. (*Ibid.*; see MJN, Ex. E, pp. 24-26 [Sen. Rules Com., Third Reading of Sen. Bill No. 2 (2005-2006 Reg. Sess.) as amended August 30, 2005].)<sup>3</sup>

In 2007 and 2008, large wildfires again struck the State. (See, e.g., RF V:1301-VI:1387 [news articles documenting fire].) Once again, the Commissioner received numerous complaints from affected homeowners who had realized too late that they were seriously underinsured. (See, e.g., RF II:276-292 [summary of insurer actions contributing to underinsurance in Lake Tahoe and San Diego regions].) For example, a Lake Tahoe resident affected by the 2007 Angora fire reported that she was shocked to learn that she was “grossly under-insured” on two residences. (RF II:432, 436.) She was “led to believe” by her agent that her level of insurance was “in the ballpark” when in fact one home was forty percent underinsured, and the other fifty percent underinsured. (RF II:432, 436.) Another fire victim relied on his agent’s expertise to estimate replacement costs, and the agent’s assurance that the limits would be adequate to rebuild his home, only to find out that the agent estimated the replacement cost based only on

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<sup>3</sup> Pursuant to section 1749.1, the Commissioner appoints a curriculum board to develop and recommend pre-licensing and continuing education courses of study for insurance licensees.



his prior experience with construction costs and neglected to include many necessary expenses. (RF II:460, 481, 484.) As a result of his reliance, the homeowner was almost fifty percent underinsured. (RF II:481.)

These stories are typical. The vast majority of the underinsurance complaints were from homeowners who believed they had sufficient coverage, but learned after a major fire that the replacement cost estimates that they relied on to set policy limits did not consider costs for such routine and necessary steps as replacing foundations, debris removal, demolition, overhead and profit, engineering reports and architect plans. (RF V:1173.) Many homeowners reported that they had relied on the expertise of their insurers, insurance agents and brokers to prepare the replacement cost estimates and had purchased policies with limits based on those estimates. (See, e.g., RF I:79-80, 124-125, 139, 217; II:351, 421, 503; III:584, 720-721, 822, 826; IV:961.) Further, some homeowners reported that when they had asked to confirm the sufficiency of their insurance coverage, their agents or brokers reassured them that their policy limits were sufficient to rebuild. (See, e.g., RF I:168, 200; II:436, 484; III:790-792; IV:872, 906.) Other homeowners asked to increase coverage, but were dissuaded by their agents from doing so based on assurances that their existing coverage was sufficient. (See, e.g., RF III:582, 831.) Some also reported that their insurers had failed properly to account for the particular characteristics of their homes, leading to underestimates. (See, e.g., RF I:55-56, 166-176, 190-210; III:582-583, 643, 672, 743, 810; IV:869, 904-915, 1024-1026.) In many cases, there was a lack of documentation establishing how the insurer determined the replacement cost estimate. (See RF II:276-292.) And these problems were widespread; in a June 2008 survey of homeowners conducted by a nonprofit consumer advocate group, 74% of the respondents stated that the limits were not sufficient to cover their post-fire costs of rebuilding. (RF IV:1059-1062 [United Policyholders' survey].)

Pursuant to his investigative authority under section 790.04 of the Unfair Practices Act, the Commissioner conducted examinations of four insurers that, together, account for fifty percent of the homeowners' insurance policies issued in California. (RF IV:1027-1030; see § 790.04 [examination power].) The resulting examination report determined that despite insurers' attempts to place the responsibility to select appropriate coverage limits on homeowners, homeowners in fact relied on insurers' estimates of replacement cost to determine the amount of coverage to buy, and, as a result of insurers' failure to include all reasonable and necessary expenses in their estimates, a large number of homeowners were underinsured. (RF IV:1030.)<sup>4</sup> The examination report concluded that "the insurers' processes and tools for estimating replacement cost are inadequate for formulating a realistic dwelling rebuilding cost" and their use "result[s] in insureds who believe they are adequately covered for the full reconstruction cost of their dwelling . . . ." (*Ibid.*)

In 2010, the Commissioner and the Legislature continued to work on the problem of underinsurance and its relationship to replacement cost estimates.

In April 2010, a bill was introduced in the California State Assembly to amend the Disclosure Act—Assembly Bill No. 2022 (2009-2010 Reg. Sess.). The amendments were designed to reflect changing market conditions and to "help homeowners in reviewing the adequacy of their insurance coverage in the event of a catastrophe such as a wildfire." (MJN,

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<sup>4</sup> As part of these examinations, Department of Insurance staff reviewed a total of 188 policies on which a loss had been claimed. (RF IV:1029.) The limitation of liability on the structure was lower than the cost to rebuild in 102 cases. (*Ibid.*) Factoring in any extended replacement cost coverage that applied, 72 cases were still be underinsured for the total loss. (*Ibid.*)

Ex. F, p. 29 [Sen. Banking, Finance and Insurance Com., Bill Analysis of Assem. Bill No. 2022 (2009-2010 Reg. Sess.) as amended May 11, 2010].) The amendments revised the standard disclosure form to highlight ways for homeowners to protect themselves against unintended underinsurance. (*Id.* at p. 28.) Among other things, the amended disclosure form alerts homeowners that “[t]he coverage limit on the dwelling structure should be high enough so you can rebuild your home if it is completely destroyed[,]” and encourages homeowners to obtain estimates of replacement cost from insurers. (§ 10102, original underscoring.) Assembly Bill No. 2022 became law on September 30, 2010.

At roughly the same time that Assembly Bill No. 2022 was introduced, the Commissioner proposed new regulations to address underinsurance. (RF IV:1101-1109.) The Commissioner’s Notice of Proposed Action observed that wildfires had destroyed “a high number of residential structures[,]” causing a substantial number of homeowners to turn to their insurers for help; only then did “they learn[ ] that the replacement value estimates made in setting coverage limits for their homes w[ere] too low, causing underinsurance issues to arise during efforts to rebuild or replace their residences.” (RF IV:1103.) The Commissioner explained that the proposed regulation would, among other things, “set out requirements applicable to replacement value and replacement cost estimates to create a more consistent, comprehensive and accurate replacement cost calculation . . . .” (RF IV:1101.)

The Commissioner conducted a public hearing, accepted and responded to public comments, made changes to the proposed regulation in response to comments, and issued a Final Statement of Reasons for the replacement cost regulation on November 17, 2010. (RF V:1111-1164, 1165-1257, 1258-1273.) The Office of Administrative Law approved the regulation pursuant to Government Code section 11349.3 on December 29,

2010. (RF I:2.)<sup>5</sup> On June 26, 2011, the replacement cost regulation became effective. (*Ibid.*)

## STATEMENT OF THE CASE

### I. THE REPLACEMENT COST REGULATION

The replacement cost regulation, California Code of Regulations, title 10, section 2695.183 provides in relevant part:

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) provides that "[t]he estimate of replacement cost shall include the expenses that would reasonably be incurred to rebuild the insured structure(s) in its entirety," and must include at least the following five items: cost of labor; overhead and profit; cost of demolition and debris removal; cost of permits and architect's plans; and "[c]onsideration of components and features of the insured structure[.]" (Regs., § 2695.183, subd. (a)(1)-(5).) Such components and features include eleven specific items relevant to a typical rebuild, which include type of foundation; type of frame; roofing and siding materials; size of living space; and the structure's geographic location. (Regs., § 2695.183, subd. (a)(5)(A)-(K).) These components reflect not only the Department of Insurance's expertise and experience, but also its extensive investigation and research into the costs of rebuilding and consideration of comments from the industry and other affected parties.

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<sup>5</sup> The specifics of the final replacement cost regulation are discussed in greater detail in the next section.

Subdivision (b) provides that the estimate must “tak[e] into account the cost to reconstruct the single property being evaluated, as compared to the cost to build multiple, or tract, dwellings”—meaning that it must not include discounts that might be available to developers but not to individual homeowners. Moreover, under subdivision (c), the estimate cannot be based on the resale value of the land, or on the amount or outstanding balance of any loan, and under subdivision (d), it “shall not include a deduction for physical depreciation.”

Subdivision (e) further provides that, at least annually, the insurer must “take reasonable 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[,]” and the estimate “shall be created using such reasonably current sources and methods.”

As the Commissioner noted in response to comments, the purpose of the regulation is to ensure that “if a licensee communicates an estimate of replacement cost, the estimate must be complete and contain all the components that a reasonable consumer would assume to be part of a complete rebuild of the structure.” (RF VI:1419.) As evidenced by post-fire homeowner complaints, “[t]o do otherwise, creates consumer confusion and is misleading.” (*Ibid.*) The regulation is designed to “end any ambiguity” about “what components are included in making the [replacement cost] estimate.” (RF VI:1430.)

Consistent with the Commissioner’s view of the need for and purpose of the regulation, the regulation provides that if an insurer communicates an estimate of replacement costs that does not comport with subdivisions (a) through (e), this “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.” (Regs., § 2695.183, subd. (j).)

The regulation includes other requirements consistent with its purposes. For example, if the insurer will issue a replacement cost policy, then the replacement cost estimate must be itemized and in writing. (Regs., § 2695.183, subd. (g).) Further, the regulation imposes certain recordkeeping obligations on insurers. (Regs., § 2695.183, subd. (i).) Failure to comply with these other requirements is not, however, encompassed within subdivision (j)’s definition of misleading statement.

As set out in the Initial and Final Statement of Reasons and in his response to comments, the Commissioner’s considered view was that section 790.10, which empowers the Commissioner to issue regulations necessary to administer the Unfair Insurance Practices Act, authorized him to issue the replacement cost regulations. (See RF VI:1433-1434, 1471.)

## **II. INDUSTRY CHALLENGE AND LOWER COURT DECISIONS**

Two insurance trade associations, respondents Association of California Insurance Companies and Personal Insurance Federation of California, brought a declaratory relief action challenging the validity of the regulation. The trade associations argued that the Commissioner has no authority under sections 790.10 and 790.03, subdivision (b) to promulgate content and form requirements for replacement cost estimates. They alleged that the Commissioner is authorized only to administratively enforce against specific actors pursuant to section 790.06, which applies to unfair or deceptive acts not defined in 790.03.<sup>6</sup> Respondents did not,

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<sup>6</sup> The trade associations additionally contended that the regulation affects insurance underwriting and infringes on insurers’ right to free speech. Neither the trial court nor the court of appeal reached the merits of those two issues (see Opn. 18, 31), and they are not at issue in this appeal.

however, argue that the cost components identified in the regulation should not be considered in estimating replacement cost. (Opn. 8-15.)

The Commissioner responded that, under section 790.10, he could by regulation make definite and specific a particular type of misleading statement falling under the general prohibition in section 790.03, subdivision (b), and that section 790.06 does not supplant his rulemaking authority. (Opn. 15-16.) Following a bench trial, the trial court declared the regulation invalid. (Opn. 17-18.)

The court of appeal affirmed, concluding that the Legislature has not delegated to the Commissioner the authority to determine that incomplete replacement cost estimates are misleading as defined in § 790.03, subdivision (b). (Opn. 22.) Relying on the rule of *expressio unius est exclusio alterius*, the court of appeal inferred “that the absence of a provision regarding replacement cost estimates was a deliberate choice” by the Legislature. (Opn. 23.) It thus 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).” (*Ibid.*)

The court of appeal further stated that the Commissioner’s view of his rulemaking authority “proves too much” because, if it were correct, the replacement cost estimate regulation would be unnecessary, as the Commissioner could already bring an enforcement action based on any misleading estimate in a proceeding under section 790.05 (authorizing administrative enforcement against practices defined in section 790.03). The court also reasoned that this would render superfluous section 790.06, which authorizes the Commissioner to bring an action to prevent unfair practices that are not defined in section 790.03, because the Commissioner could always first promulgate a regulation to declare particular conduct

misleading and then use the more streamlined enforcement processes of section 790.05. (Opn. 24-25.) The appellate court distinguished *Ford Dealers Association v. Department of Motor Vehicles* (1982) 32 Cal.3d 347, where this Court upheld the exercise of agency rulemaking authority, on the theory that the underlying laws were different. (Opn. 26-28.)

The court of appeal acknowledged that the legislative history of section 790.10 appeared to support the Commissioner's view of his rulemaking authority. However, the court determined that the Legislature's subsequent addition of unfair claims settlement practices (section 790.03, subd. (h)), as well as statutes outside of the Act which mandate disclosures for homeowner insurance policies (sections 10101-10107), were inconsistent with the original legislative intent. (Opn. 28-29.) It thus 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)." (*Ibid.*)

This Court granted the Commissioner's petition for review on July 15, 2015.

### STANDARD OF REVIEW

A regulation is presumed valid, and the burden to prove otherwise is on the party seeking invalidation. (*Credit Ins. General Agents Assn. v. Payne* (1976) 16 Cal.3d 651, 657.) The replacement cost regulation is a quasi-legislative rule because it is "the substantive product of a delegated legislative power conferred on the agency." (See *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 8.) In reviewing a quasi-legislative rule, a court must determine whether in promulgating the rule, the agency acted within the bounds of its statutory mandate, and, if so, whether the regulation is reasonably necessary to effectuate the purpose of



the statute. (*Id.* at pp. 9-11.) Respondents did not challenge the reasonable necessity of the regulation in the trial court or the court of appeal. (Opn. 18, fn. 8.) (They had no basis to do so, given that the replacement cost regulation is a clear and reasonably necessary response to a well-documented and recurring problem. (See Background II., pp. 7-11, above.)) Review in this case therefore is limited to the question of whether the replacement cost regulation lies within the Commissioner's rulemaking authority.

In answering that question, courts give "great weight" to the construction of a statute by officials charged with its administration, though final responsibility for the interpretation of the law rests with the courts. (*Yamaha, supra*, 19 Cal.4th 1, 9; *id.* at p. 11, fn. 4.) The standard governing a challenge to the "fundamental legitimacy" of a quasi-legislative regulation is "respectful nondeference." (*Id.* at p. 11, fn. 4, quoting *Environmental Protection Information Center v. Department of Forestry & Fire Protection* (1996) 43 Cal.App.4th 1011, 1022.) "Where the Legislature has delegated to an administrative agency the responsibility to implement a statutory scheme through rules and regulations, the courts will interfere only where the agency has clearly overstepped its statutory authority or violated a constitutional mandate." (*Ford Dealers, supra*, 32 Cal.3d 347, 356.)

## ARGUMENT

In determining whether a regulation lies within an agency's rulemaking authority, a court's "fundamental task is to ascertain the Legislature's intent so as to effectuate the purpose of the statute." (*Smith v. Superior Court* (2006) 39 Cal.4th 77, 83.) Courts look first to the statutory language to ascertain its usual and ordinary meaning. (*Ibid.*) "If there is no ambiguity, then [courts] presume the lawmakers meant what they said, and

the plain meaning of the language governs.” (*Day v. City of Fontana* (2001) 25 Cal.4th 268, 272.)

Where the statute is ambiguous or reasonably susceptible to more than one interpretation, a court may look to a variety of extrinsic aids, including the object to be achieved, the evils to be remedied, the legislative history and public policy. (*Smith v. Superior Court, supra*, 39 Cal.4th at p. 83.) A court does not construe statutes in isolation, but reads them with reference to the entire statutory scheme and must “harmonize statutes, reconcile seeming inconsistencies in them, and construe them to give force and effect to all of their provisions.” (*Even Zohar Construction & Remodeling, Inc. v. Bellaire Townhouses, LLC* (2015) 61 Cal.4th 830, 837.) Ultimately, the Court “must select the construction that comports most closely with the apparent intent of the Legislature, with a view to promoting rather than defeating the general purpose of the statute, and avoid an interpretation that would lead to absurd consequences.” (*Smith v. Superior Court, supra*, 39 Cal.4th at p. 83.)

Properly considered, section 790.10 by its plain language authorizes the Commissioner to issue regulations administering section 790.03, subdivision (b), specifying for consumers and the insurance industry statements that are inherently misleading and—more specifically—to issue the particular replacement cost regulation challenged in this case. This conclusion is supported by the Unfair Insurance Practices Act’s legislative history, as the court of appeal itself recognized. It is fully consistent with other provisions of the Act, including those that confer adjudicative power on the Commissioner. And it is in no way at odds with, but in fact complements, the Legislature’s actions.

**I. SECTION 790.10 GRANTS TO THE COMMISSIONER BROAD AUTHORITY TO ISSUE REGULATIONS TO ADMINISTER THE UNFAIR INSURANCE PRACTICES ACT**

Section 790.10 provides in full 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” (Article 6.5, the Unfair Insurance Practices Act). (§ 790.10.) This provision does not limit the circumstances under which the Commissioner may issue regulations, or mandate the content of those regulations. Rather, it delegates quasi-legislative rulemaking authority to the Commissioner to issue substantive rules of general applicability. (See *Western States Petroleum Assn. v. Bd. of Equalization* (2013) 57 Cal.4th 401, 414 [holding in similar circumstances that agency’s regulation was issued pursuant to quasi-legislative power].)

The court of appeal appeared to give some credence to respondents’ argument that the Legislature’s change of the operative verb from “implement” to “administer” in the course of drafting section 790.10 is evidence that the Legislature intended to confer only a limited rulemaking role on the Commissioner. (See, e.g., Opn. 20, 27; Respondents’ Motion for Judicial Notice, 2 [Assem. Bill No. 1353 (1970-1971 Reg. Sess.) as amended on Jul. 9, 1971].) There is no basis for this inference. While the reason for the change in terminology is not specified in the legislative history, a reasonable explanation may be found in the language of the California Administrative Procedure Act (APA), Government Code section 11340 et seq. In 1971, and today, the APA defines a “regulation” to be “every rule, regulation, order, or standard of general application or the amendment, supplement, or revision of any [such] rule, regulation, order, or standard adopted by any state agency to implement, interpret, or make

specific the law enforced or administered by it, or to govern its procedure.” (Gov. Code, § 11342.600 [bracketed word added]; see Stats. 1957, ch. 916, p. 2124 [bracketed word in original].) As originally drafted, section 790.10 was arguably incomplete, mentioning only one of several reasons that an agency might engage in rulemaking—to implement the law it administers. Rather than adding the two other listed reasons for rulemaking—to “interpret or make specific” the law—the Legislature clarified that the Commissioner has the power to promulgate all reasonable rules and regulations, of whatever type and purpose, that the Commissioner determines are necessary to carry out his responsibility to “administer” the Unfair Insurance Practices Act. (§ 790.10.)

The language of section 790.10 is not unusual. As seen in a variety of statutes, the Legislature commonly uses “administer,” or a variant or synonym, to confer quasi-legislative rulemaking authority. (See, e.g., *Moore v. California State Bd. of Accountancy* (1992) 2 Cal.4th 999, 1010 [Bus. & Prof. Code, § 5010 authorizes Board of Accountancy to adopt rules for “administration” of Accountancy Act]; Ins. Code, § 10234 [authorizing Commissioner to adopt regulations as necessary “to administer” long-term care insurance]; Health & Safety Code, § 123280 [authorizing Department of Health Services to adopt regulations to “administer” nutrition program]; Veh. Code, § 34600 [authorizing DMV to adopt regulations “necessary to administer” the Motor Carriers of Property Permit Act].)

Accordingly, the only limitation on the Commissioner’s rulemaking authority under section 790.10 is that which applies to all quasi-legislative rulemaking: The regulation must be “consistent with and not in conflict with the statute and reasonably necessary to effectuate the purpose of the statute.” (Gov. Code, § 11342.1 [Administrative Procedure Act]; see also *California School Bds. Assn. v. State Bd. of Education* (2010) 191 Cal.App.4th 530, 544 [agency cannot promulgate regulations “that are

inconsistent with the governing statute, alter or amend the statute, or enlarge its scope”].)

## II. THE COMMISSIONER’S POWER TO ADMINISTER THE ACT INCLUDES THE POWER TO DEEM SPECIFIC PRACTICES TO BE INHERENTLY MISLEADING

This Court has consistently interpreted express delegations of quasi-legislative rulemaking authority broadly to include the authority to issue regulations that fill in the details and make specific the operation of a statutory scheme. (*Ford Dealers, supra*, 32 Cal.3d 347, 362-363; see also *Moore, supra*, 2 Cal.4th at pp. 1013-1014 [regulation prohibiting use of accountancy titles by unlicensed persons as misleading]; *Credit Ins. Gen. Agents Assn. v. Payne, supra*, 16 Cal.3d at p. 656 [regulation capping commissions paid to agents on sale of credit life and disability insurance]; *Ralphs Grocery Co. v. Reimel* (1968) 69 Cal.2d 172, 182-183 [regulations prohibiting discounts on wholesale price of beer].) The decision in *Ford Dealers* is particularly instructive, as the agency’s statutory authority, and the nature and purpose of its regulations, are substantially similar to those at issue in this case.

In *Ford Dealers*, automobile dealers challenged certain DMV regulations, asserting they were beyond the agency’s statutory powers. (*Ford Dealers, supra*, 32 Cal.3d at p. 354.) The challenged regulations were “designed to implement” a section in the Vehicle Code that broadly prohibits any licensed vehicle seller from making “a statement which is untrue or misleading and which is known, or which by the exercise of reasonable care should be known, to be untrue or misleading . . . .” (*Id.* at p. 356 & fn. 4; see Veh. Code, § 11713, subd. (a).)

The Court noted that the DMV is authorized by statute “to adopt rules and regulations ‘as may be necessary to carry out the provisions’ of the Vehicle Code.” (*Ford Dealers, supra*, 32 Cal.3d at p. 354, quoting Veh.

Code, § 1651.) The DMV is also charged with implementing and enforcing Vehicle Code section 11713, “which bars the dissemination of false or misleading statements to the public.” (*Id.* at p. 356.) Pursuant to these provisions, the DMV issued a set of regulations designed to prevent specific kinds of misleading statements. One regulation, for example, provides that if a franchise dealer will be reimbursed by the franchisor for expenses incurred in preparing a car for delivery, or for the delivery itself, the dealer cannot identify these things as charges in its communications to consumers. (See *id.* at p. 362; see also Cal. Code Regs., tit. 13, § 262.03 (former § 404.03).] And if the franchise dealer will not be reimbursed and intends to charge the consumer, the dealer must itemize those added charges and include them in the price advertised to consumers. (*Ibid.*)

The Court interpreted the DMV’s rulemaking authority in light of the purpose of section 11713, which the DMV is charged with administering. (*Ford Dealers, supra*, 32 Cal.3d at p. 356.) It noted that this section was enacted to “protect[ ] the purchaser from the various harms which can be visited upon him by an irresponsible or unscrupulous dealer.” (*Ford Dealers, supra*, 32 Cal.3d at p. 356, quoting *Merrill v. Department of Motor Vehicles* (1969) 71 Cal.2d 907, 920.) Recognizing the importance of protecting the public from these harms, the Court explained that section 11713 “must be liberally construed ‘to effectuate its object and purpose, and to suppress the mischief at which it is directed.’” (*Ibid.*, quoting *California State Restaurant Assn. v. Whitlow* (1976) 58 Cal.App.3d 340, 347.)

The Court held that the DMV’s regulations were “authorized by the broad statutory prohibition against false and misleading statements.” (*Ford Dealers, supra*, 32 Cal.3d at p. 362.) It explained that an agency “is not limited to the exact provisions of a statute in adopting regulations to enforce its mandate.” (*Ibid.*) Upholding the regulations, the Court

observed that “[t]he DMV is authorized to ‘fill up the details’ of the statutory scheme.” (*Ibid.*, quoting *Kugler v. Yocum* (1968) 69 Cal.2d 371, 376.) More specifically, “[a] regulation barring a specific class of misleading statements falls within the authority of the DMV under this statute.” (*Id.* at pp. 362-363.) “It is within the authority of the DMV to conclude that consumers confronted with an itemized charge for services performed on their automobile will assume that they are paying extra to purchase those specific services.” (*Id.* at p. 363.) Where that is not in fact the case, because the dealer has already been paid for the services, the DMV could reasonably conclude that such an itemized charge is “inherently misleading,” and could regulate to require correction. (*Ibid.*)

The circumstances of this case are similar in all relevant respects. The Commissioner is charged with issuing regulations to “administer” the Unfair Insurance Practices Act, just as the DMV is charged with “carrying out” the Vehicle Code. (§ 790.10.)<sup>7</sup> The provisions that each agency is charged with administering include a prohibition, applicable to those in a regulated industry, against making misleading statements to consumers. (§ 790.03, subd. (b).) The Commissioner, like the DMV, concluded that consumers would reasonably assume certain things to be true—in this case, that replacement cost estimates provided to them by their insurers would include all expenses generally necessary to rebuild. (See, e.g., RF VI:1419 [Final Statement of Reasons, Response to Comments].) The Commissioner, like the DMV, could properly conclude that a communication that fails to

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<sup>7</sup> “Carry out” is a synonym of “administer.” (Webster’s Collegiate Thesaurus (1976) p. 16; see also *Morris v. Williams* (1967) 67 Cal.2d 733, 741 [citing statute conferring authority on agency to issue regulations “carrying out” statute as evidence that agency is authorized to “administer” program].) The court of appeal’s rejection of cases where the relevant statute employs “carry out” rather than “administer” is thus without merit. (See Opn. 27.)

correct reasonable, but mistaken, consumer assumptions is inherently misleading, and then exercise his authority to require by regulation that the industry take specific action to ensure that consumers are not misled. (See RF VI:1413-1414, 1433-1434 [Final Statement of Reasons, Response to Comments, citing §§ 790.10 and 790.3, subd. (b) as source of authority].) This view of the Commissioner's rulemaking authority is reasonable and fully consistent with the public protection purpose of the Act. (See *Mejia v. Reed* (2003) 31 Cal.4th 657, 663, quoting *Dyna-Med, Inc. v. Fair Employment & Housing Com.* (1987) 43 Cal.3d 1379, 1387 [where uncertainty exists, consideration should be given to the public policy consequences that would flow from particular interpretation].)

The fact that the contents of a replacement cost estimate that does not comply with the specific requirements in subdivisions (a) through (e) of the replacement cost rule might not technically be "false" does not call into question the Commissioner's authority to determine that a non-compliant, and thus incomplete, estimate is inherently misleading and in violation of section 790.03, subdivision (b). This Court has long interpreted similar statutes prohibiting misleading statements, such as the Unfair Competition Law (Business and Professions Code section 17500), to encompass not only an affirmatively false statement, but also a statement that, "although true, is either actually misleading or which has a capacity, likelihood or tendency to deceive or confuse the public." (*Kasky v. Nike, Inc.* (2002) 27 Cal.4th 939, 951, quoting *Leoni v. State Bar* (1985) 39 Cal.3d 609, 626.) Thus, "a statement is false or misleading if members of the public are likely to be deceived." (*Chern v. Bank of America* (1976) 15 Cal.3d 866, 876.) As the *Ford Dealers* case illustrates, statements that omit crucial information can be misleading. (*Supra*, 32 Cal.3d at pp. 363-364; see also *Day v. AT & T Corp.* (1998) 63 Cal.App.4th 325, 332-333.)



The record contains overwhelming evidence that, before the replacement cost regulation, large numbers of homeowners were misled into underinsuring their homes by estimates that omitted critical rebuild expenses. (See RF I:18-25; VI:1401-1403 [listing evidence that Commissioner relied on, including hearings, complaints, comments, surveys and news articles].) At the legislative hearings held after the 2003 Southern California fires, the Senate Banking, Finance and Insurance Committee observed that “[o]f all complaints heard in both hearings, none was more frequent nor so moving as the discussion of underinsurance.” (MJN, Ex. D, p. 16 [Sen. Banking, Finance and Insurance Com., Bill Analysis of Sen. Bill No. 2 (2005-2006 Reg. Sess.) as amended Mar. 29, 2005].) Many homeowners testified that they had relied on the estimates they were provided and believed they had sufficient insurance, only to discover that they were underinsured by hundreds of thousands of dollars. (*Ibid.*) The Committee noted that the problem of unintended underinsurance “spanned nearly every occupational group and type of person . . . .” (*Id.* at p. 17.) The industry’s use of estimation software offering consumers “quick quotes” contributed to the problem, as it failed to take into account all the relevant characteristics of the property. (*Ibid.*)

The Commissioner’s investigation similarly confirmed that unintended underinsurance was a widespread problem, and that the industry’s estimate practices were a significant contributing factor. (RF IV:1027-1030.) Common sense establishes that a homeowner who is comparison shopping for insurance could be attracted to a replacement cost policy that is based on an incomplete estimate of the costs to rebuild, because reducing the components covered will also reduce the premium. And some insurers will be tempted to leave out important rebuilding expenses in order to keep premium quotes low and increase their competitiveness. Further, a substantial number of homeowners, who are

not insurance experts, will fail to perceive that differences in premium quotes may reflect real differences in coverage, and thus may be misled into underinsuring. This is confirmed by the Commissioner's investigation, which revealed that most homeowners did not deliberately or knowingly underinsure their homes to save money. (See, e.g., RF I:79-80, 124, 168, 217; II:351-352, 432; III:583, 789, 826.) Rather, underinsurance often resulted because homeowners relied on the expertise of insurers, insurance agents and brokers to estimate replacement costs, and they trusted that the estimates communicated to them would be sufficient to allow them to completely rebuild. (See, e.g., RF I:79-80, 124-125, 139, 217; II:351, 421, 503; III:584, 720-723, 789, 822, 826; IV:961.) These homeowners used the estimates they were provided to set the policy limit, did not take independent steps to establish adequate coverage limits, and thus were misled into a state of substantial underinsurance. (RF IV:1030 [summary of Commissioner's market conduct examinations]; see, e.g. RF I:217, II:351-354, III:723, 789 [complaints from homeowners].)

The replacement cost regulation helps to ensure that insurers' communications concerning replacement cost estimates reflect homeowners' reasonable expectations and assumptions about these estimates, in order to reduce the number of homeowners who unwittingly find themselves, post-catastrophe, to be substantially underinsured. Indeed, respondents do not dispute that the costs and factors listed in subdivisions (a) through (e) of the regulation would generally be incurred in a rebuild and should be considered in estimating replacement cost. (See Opn. 8-15 [summarizing respondents' arguments].) The Commissioner thus acted squarely within his authority when he clarified by rule that replacement cost estimates omitting these undisputedly reasonable and expected cost components are inherently misleading and violate section 790.03, subdivision (b).

### **III. THE COURT OF APPEAL'S READING OF THE ACT TO LIMIT THE COMMISSIONER'S RULEMAKING AUTHORITY IS INCONSISTENT WITH LEGISLATIVE INTENT**

The court of appeal sought to distinguish *Ford Dealers* and other cases that have upheld agencies' exercise of their quasi-legislative powers based on asserted differences in the underlying statutes. The court reasoned that, notwithstanding the plain language of sections 790.10 and 790.03, subdivision (b), the larger statutory scheme establishes the Legislature's true intent to constrain the Commissioner's rulemaking powers. (See Opn. 21, 23.) That reasoning cannot survive examination.

#### **A. The legislative history supports the Commissioner's authority**

The court of appeal observed that in addition to the general prohibition in section 790.03, subdivision (b) against “[m]aking or disseminating . . . any statement . . . 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[,]” the Legislature has also defined as unfair or deceptive a number of specific actions. These include, for example, making any “estimate . . . or statement misrepresenting the terms of any policy” (§ 790.03, subd. (a)); filing or making any “false statement of financial condition” (§ 790.03, subd. (d)); “[m]aking or permitting any unfair discrimination between individuals . . . in the rates charged for any contract of life insurance or of life annuity” (§ 790.03, subd. (f)(1)); and advertising insurance that the insurer does not sell (§ 790.036, subd. (a).) (See Opn. 22-23.) From this, the court concluded that the Legislature reserved to itself the power to make law specifying unfair and misleading practices, and that “the absence of a provision regarding replacement costs was a deliberate [legislative] choice.” (Opn. 23.)

This construction fails to account for the contemporaneous legislative history explaining the Legislature's purpose in enacting section 790.10, which the court acknowledged supports the Commissioner's view of the law. (See Opn. 29.) In the words of the Assembly Committee on Finance and Insurance, section 790.10 was designed to "give[ ] the Insurance Commissioner the authority to promulgate rules and regulations so that if the need therefor arises, he can, without delay, promulgate necessary rules making such practices definite and specific for the benefit of the public *without having to wait for the Legislature to act at a later date.*" (MJN, Ex. H, p. 33 [Assem. Com. on Finance and Insurance, summary of Assem. Bill No. 1353 (1971 Reg. Sess.), italics added].)<sup>8</sup> This history establishes that the Commissioner has the authority to issue rules to carry out the purposes of the Unfair Insurance Practices Act unless and until he is instructed otherwise by the Legislature. Indeed, when the Legislature desires to check or guide the Commissioner's broad rulemaking authority under section 790.10 concerning a particular issue, it does so expressly. For example, when the Commissioner was in the process of promulgating the Fair Claims Settlement Practices Regulations (Cal. Code Regs., tit. 10, § 2695.1 et seq.) to specify acts prohibited under section 790.03, subdivision (h), the Assembly Committee on Insurance expressed concern that the proposed regulations would treat all classes of insurance alike. (MJN, Ex. G, pp. 31-32 [Assem. Com. on Insurance, Hearing Analysis of Sen. Bill No. 812 (1990-1991 Reg. Sess.) as introduced Mar. 7, 1991].) Accordingly, the

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<sup>8</sup> In analyzing the revised section 790.10 prior to its enactment, the Legislative Counsel observed that the Commissioner's power to regulate is limited only in that it must meet the consistency requirement of the Administrative Procedure Act, then Government Code section 11374, and now Government Code section 11342.2. (MJN, Ex. I, pp. 34-37 [Legislative Counsel Opinion of Assem. Bill No. 1353 (Jul. 14, 1971)].)

Legislature enacted section 790.034 to require the Commissioner's claims settlement practices regulations to account for "practices by classes of insurers." (§ 790.034, subd. (a).)

The Assembly Committee's statement of purpose further suggests that both the Commissioner and the Legislature may make law to address a regulatory issue, acting in different and complementary ways, without calling the Commissioner's authority into question. This is exactly the pattern of joint lawmaking seen in the area of underinsurance, where the Legislature and the Commissioner have together over time worked to address a complicated and evolving problem. One important example, as noted, is that the Legislature amended the mandatory disclosure form that insurers must provide to their insured. That form, among other things, alerts homeowners to the problem of underinsurance, and encourages them "to obtain a current estimate of the cost to rebuild" from an "insurance agent, broker, or insurance company or an independent appraisal from a local contractor, architect, or real estate appraiser." (§ 10102.) The replacement cost regulation in turn ensures that when a homeowner heeds that advice and asks an insurer—or multiple insurers—for a replacement cost estimate, he or she will receive an estimate that is reasonably complete and consistent with the homeowner's assumptions, reducing the occurrence of unintended underinsurance.

**B. The Legislature's subsequent actions do not call the Commissioner's rulemaking authority into question**

The court of appeal further justified its narrow reading of the Commissioner's rulemaking authority by noting that the Legislature has passed laws related to prohibited acts and, more specifically, to replacement costs, and, in any of these statutes, "could have gone on to define the content and format of replacement cost estimates." (See *Opn. 29-31*, citing § 790.03, subd. (h) [enumerating specific unfair claims settlement

practices]; § 2051.5 [defining replacement costs], § 1749.85 [creating curriculum committee to make recommendations on training broker-agents on proper methods of estimating replacement value]; § 10101 [requiring standard written disclosures that include admonitions to consumers about adequate coverage].) The court “infer[red] that these omissions were deliberate” and concluded that the Commissioner could not “under the guise of ‘filling in the details,’ . . . do what the Legislature has chosen not to do.” (Opn. 31.)

There is no basis for this inference. Granted, subsequent legislation interpreting a statute can in some circumstances be helpful to a court in establishing the Legislature’s original intent. (See, e.g., *People ex rel. Lockyer v. R.J. Reynolds Tobacco Co.* (2005) 37 Cal.4th 707, 724.) But the statutes cited by the court of appeal are expressions of the Legislature’s own prerogatives and concerns related to claims settlement and replacement cost estimates and do not purport to interpret, much less limit, the Commissioner’s authority under § 790.10 to promulgate regulations administering § 790.03, subdivision (b). And, in any event, subsequent interpretive legislation “[cannot] change the meaning [of the earlier enactment,]” which remains controlling. (See *ibid.*, quoting *Russ Bldg. Partnership v. City and County of San Francisco* (1988) 44 Cal.3d 839, 852 [brackets in *R.J. Reynolds*].) The Legislature vested the Commissioner with quasi-legislative rulemaking authority in 1971 by enacting section 790.10 and has taken no subsequent action to divest the Commissioner of this authority.

Further, where, as in this case, a statute confers quasi-legislative authority on an agency, the absence of a fully comprehensive and detailed *statutory* solution to a problem cannot be read to constrict the agency’s ability to address the problem through regulation. (*Ralphs Grocery Co.*, *supra*, 69 Cal.2d at pp. 182-183 [fact that Legislature enacted statutes

governing quantity discounts on wine and milk did not prevent Department of Food and Agriculture from promulgating regulation addressing quantity discounts on beer]; see also *National Petroleum Refiners Assn. v. FTC* (D.C. Cir. 1937) 482 F.2d 672, 676 [rejecting argument that *expressio unius est exclusio alterius* requires inference that Legislature necessarily considered and rejected all possible alternatives to enacted statute]; see also Opn. 26 [acknowledging similarity of statutory structure at issue in *Ford Dealers*, where Vehicle Code’s broad prohibition against false and misleading statements was followed by detailed provisions prohibiting specific types of misleading statements]; Stats. 1978, ch. 797, p. 2563 [version of Veh. Code, § 11713 in effect in at time of *Ford Dealers* decision].) The Legislature’s limited treatment of issues related to replacement cost estimates does not mean that it determined that this area should otherwise be left unregulated, to the detriment of the public. Rather, the logical inference is that the Legislature elected “to defer to and rely upon the expertise of [the] administrative agenc[y]” to fill any regulatory gaps related to replacement cost estimates. (See *Credit Ins. General Agents Assn. v. Payne*, *supra*, 16 Cal.3d at p. 656 [upholding Commissioner’s authority to promulgate regulations with respect to credit life and disability insurance under section 779.21 as indicating legislative deference to the Commissioner’s expertise regarding insurance]; see also *Ralphs Grocery Co.*, *supra*, 69 Cal.2d at pp. 182-183.)

**C. The Act’s distinction between defined and undefined prohibited acts, and the existence of administrative enforcement tools, do not curtail the Commissioner’s rulemaking authority**

The court of appeal also relied on the Unfair Insurance Practices Act’s distinction in certain provisions between unfair or deceptive acts that are “defined” by the Legislature in section 790.03, and those that are not so defined, to hold that the Commissioner’s replacement cost regulations

exceeded his rulemaking powers. (Opn. 25.) For example, as the court noted, section 790.05 sets out the process for taking administrative enforcement action against practices defined in section 790.03, and section 790.06 sets out the process and additional requirements for taking enforcement action against practices not defined in section 790.03. (See Opn. 24-25.) The court inferred that only the Legislature can “define” acts that are prohibited by section 790.03, and thus the Commissioner overstepped his authority by issuing a rule clarifying and filling in specific types of misleading statements concerning “the business of insurance” that are prohibited by 790.03, subdivision (b). The fault in this reasoning is that all actions listed in 790.03, including those set out in subdivision (b), are by the statute’s terms “*defined* as unfair methods of competition and unfair and deceptive acts or practices in the business of insurance.” (§ 790.03, italics added.) The Commissioner here has not defined a new prohibited act, but has provided clarity about a prohibited act already defined in statute.

The court of appeal also erred in adopting a constrained view of the Commissioner’s rulemaking authority in light of his enforcement authority under sections 790.05 and 790.06. The court stated that if the Commissioner could already resort to enforcement under section 790.05 because incomplete replacement cost estimates violate section 790.03, subdivision (b), there would be no need for the replacement cost regulation. (Opn. 24.) This reasoning fails to account for the distinct benefits of adjudication and rulemaking and the relationship between them, however, and affords too little consideration to the Commissioner’s expert view of whether a regulatory, adjudicatory, or combined approach will best carry out the intent of the statutes he is charged with administering.

In certain circumstances, proceeding by adjudication may be preferable—for example, where problems are unforeseen, where the agency does not have sufficient experience to formulate a rule of general



application, or where the problem is so specialized “as to be impossible of capture within the boundaries of a general rule.” (*Securities and Exchange Com. v. Chenery Corp.* (1947) 332 U.S. 194, 202-203.) On the other hand, there are sound policy reasons to proceed through rulemaking in certain circumstances, particularly when an agency seeks to set out rules of general application. As the D.C. Circuit has observed, “[t]he function of filling in the interstices” of a complex statute “should be performed, as much as possible through [the] quasi-legislative promulgation of rules to be applied in the future.” (*National Petroleum Refiners, supra*, 482 F.2d 672, 682 (Skelly Wright, J.), quoting *Securities and Exchange Com. v. Chenery Corp., supra*, 332 U.S. at p. 202.) Rulemaking avoids any appearance of “unfairly focusing on a single defendant in a restricted proceeding when promulgating a new policy with industry-wide ramifications.” (*National Petroleum Refiners, supra*, 482 F.2d at p. 682.) Its procedures allow all affected parties to participate, and agencies have the benefit of that participation in formulating the final rule. (*San Diego Nursery Co. v. Agricultural Labor Relations Bd.* (1978) 100 Cal.App.3d 128, 142-143, quoting *NLRB v. Wyman-Gordon Co.* (1969) 394 U.S. 759, 777-779 (dis. opn. of Douglas, J.)) Rulemaking procedures “provide an agency about to embark on legal innovation with all relevant arguments and information . . . .” (*National Petroleum Refiners, supra*, 482 F.2d at p. 683.) And because regulations are published and designed to be accessible, they can in many instances provide greater notice to the public and guidance to the regulated entities than decisions resulting from adjudications. (See Bonfield, *State Administrative Policy Formulation and the Choice of Lawmaking Methodology* (1990) 42 Admin. L. Rev. 121, 125-126.) Moreover, proceeding by rule does not rule out adjudications. Where warranted, a mixed system of rulemaking and adjudication can result in more efficient and expeditious enforcement than adjudication alone,

leveling the playing field for those who comply with the rules, and preventing any windfall that might come to those who would delay or avoid compliance. (*National Petroleum Refiners, supra*, 482 F.2d at p. 690.)

Here, the Commissioner determined that promulgating a rule requiring completeness in replacement cost estimates would yield distinct benefits and advantages. The rulemaking process allowed input from all affected parties, including the regulated industry. The resulting replacement cost regulation proactively protects California homeowners, ensuring that they immediately receive the basic information they need to make sound insuring decisions and reducing the risk of future large-scale instances of unintended underinsurance. Further, the regulation provides clear notice to the industry of certain actions that the Commissioner has determined are misleading, fostering voluntary compliance and avoiding litigation. (See *National Petroleum Refiners, supra*, 482 F.2d at pp. 690-691 [industry compliance is more likely where expectations set out in rules, rather than being established in case-by-case adjudications].) And, if individual enforcement actions prove necessary, the regulation will narrow the issues by establishing that certain omissions can make a replacement cost estimate incomplete and misleading. (See *id.* at p. 690.)

Relying solely on enforcement actions, in contrast, would not adequately and efficiently address the widespread problem of underinsurance. The Commissioner would be forced to develop over time the necessary replacement cost estimate components, proceeding on a case-by-case basis through a series of enforcement actions. In the interim, some homeowners would continue to be provided with incomplete estimates. Members of the industry, too, would not have a clear set of standards to follow, and some insurers could potentially gain a market advantage by exploiting the uncertainty. Indeed, it is questionable whether the adjudicatory process could ever result in a set of required replacement cost

estimate components that are as clear and comprehensive as provided by the challenged regulation. The Unfair Insurance Practices Act should not be read to produce such an unreasonable result that contravenes the Act's very purposes.

The court of appeal also reasoned, erroneously, that recognizing the Commissioner's authority to clarify and fill out the details of misleading statements defined in section 790.03, subdivision (b), would render section 790.06 "superfluous." (Opn. 25.) According to the court, the Commissioner "would never have to resort to the procedures in section 790.06 regarding practices not 'defined' in [section] 790.03" because he could promulgate a regulation defining the conduct as misleading under section 790.03, subdivision (b), and then rely on the enforcement procedure in section 790.05. (See Opn. 25.) The conduct described in section 790.03, subdivision (b), however, does not encompass all of the conduct described in 790.06. Section 790.03, subdivision (b) applies to any untrue, deceptive, or misleading "statement" made to the public in certain defined ways, which the person or entity making the statement knows, or reasonably should know, is untrue, deceptive, or misleading. Section 790.06, in contrast, is not limited to "statements," but applies more broadly to any unfair or deceptive method of competition or any act or practice that is in fact unfair or deceptive—whether or not the actor recognizes, or should recognize, that it is unfair or deceptive. (§ 790.06, subd. (a).) Accordingly, even with a robust set of rules in place clarifying what is prohibited by section 790.03, subdivision (b), and even with the other specific acts defined in section 790.03, the Commissioner might well have occasion to rely on section 790.06 to put a stop to undefined prohibited acts. More fundamentally, even assuming the operation of sections 790.03 and 790.05 largely eliminates the Commissioner's need to rely on section 790.06, "the presence of arguably unnecessary terms in a statute should not by itself,

produce an interpretation that will defeat the Legislature’s central aim in enacting the law.” (*General Development Co., L.P., v. City of Santa Maria* (2012) 202 Cal.App.4th 1391, 1395; see also Civ. Code, § 3537.)

Confirming the Commissioner’s rulemaking authority in this case, and upholding the challenged regulations—notwithstanding any ability to enforce against misleading cost replacement estimates under section 790.05 or 790.06—serves the Act’s intent. It preserves the Commissioner’s “delegated responsibilities” to administer the Unfair Insurance Practices Act, respecting the rule that “the choice between proceeding by general rule or by ad hoc adjudication ‘lies primarily in the informed discretion of the administrative agency.’” (*Agricultural Labor Relations Bd. v. Superior Court, supra*, 16 Cal.3d 392, 413, quoting *Securities and Exchange Com. v. Chenery Corp., supra*, 332 at p. 203]; see also *Bixby v. Pierno* (1971) 4 Cal.3d 130, 150.)

### CONCLUSION

The Commissioner respectfully requests that this Court reverse the court of appeal’s judgment, uphold the replacement cost regulation, and remand this matter for entry of judgment in favor of the Commissioner.

Dated: October 9, 2015

Respectfully submitted,

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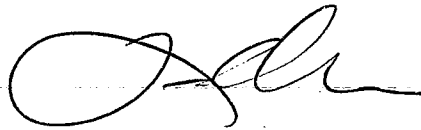
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**CERTIFICATE OF COMPLIANCE**

I certify that the attached **OPENING BRIEF ON THE MERITS** uses a 13 point Times New Roman font and contains 10,389 words.

Dated: October 9, 2015

KAMALA D. HARRIS  
Attorney General of California

A handwritten signature in black ink, appearing to read 'L. Chao', with a large loop at the beginning and a horizontal line extending to the right.

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**DECLARATION OF SERVICE BY U.S. MAIL**

Case Name: **ACIC v. Dave Jones (DOI) (Appeal)**  
No.: **S226529**

I declare:

I am employed in the Office of the Attorney General, which is the office of a member of the California State Bar, at which member's direction this service is made. I am 18 years of age or older and not a party to this matter. I am familiar with the business practice at the Office of the Attorney General for collection and processing of correspondence for mailing with the United States Postal Service. In accordance with that practice, correspondence placed in the internal mail collection system at the Office of the Attorney General is deposited with the United States Postal Service with postage thereon fully prepaid that same day in the ordinary course of business.

On October 9, 2015, I served the attached **OPENING BRIEF ON THE MERITS** by placing a true copy thereof enclosed in a sealed envelope in the internal mail collection system at the Office of the Attorney General at 300 South Spring Street, Suite 1702, Los Angeles, CA 90013, addressed as follows:

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I declare under penalty of perjury under the laws of the State of California the foregoing is true and correct and that this declaration was executed on October 9, 2015, at Los Angeles, California.

\_\_\_\_\_  
Linda Richardson  
Declarant

  
\_\_\_\_\_  
Signature