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8 Companies, and The Surety Association of America

9 **SUPERIOR COURT OF THE STATE OF CALIFORNIA**  
10 **FOR THE COUNTY OF LOS ANGELES**

11 **PERSONAL INSURANCE FEDERATION** Case No.  
**OF CALIFORNIA, ASSOCIATION OF** )  
12 **CALIFORNIA INSURANCE** ) **COMPLAINT FOR DECLARATORY**  
**COMPANIES, and THE SURETY** ) **AND INJUNCTIVE RELIEF**  
13 **ASSOCIATION OF AMERICA,** )  
14 Plaintiffs, )  
15 vs. )  
16 **JOHN GARAMENDI, Insurance** )  
**Commissioner of the State of California,** )  
17 Defendant. )  
18 )  
19 )

20  
21 Plaintiffs Personal Insurance Federation of California, Association of California  
22 Insurance Companies, and The Surety Association of America (“Plaintiffs”) allege as follows:  
23

24 **PREFATORY STATEMENT**

25 1. This action challenges the new Fair Claims Settlement Practices Regulations, found  
26 at California Code of Regulations, Title 10, Chapter 5, Subchapter 7.5, Sections 2695.1 through  
27 2695.14 (the “Regulations”), submitted to the Office of Administrative Law by the California  
28 Department of Insurance and scheduled to take effect on July 23, 2003. The Regulations are

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**COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF**

1 intended to implement, interpret and make specific Section 790.03(h) of the Insurance Code, which  
2 lists 16 unfair claims settlement practices. A true and correct copy of the Regulations, as printed  
3 from the California Department of Insurance website, is attached hereto as Exhibit "A."

4 2. The new Regulations, filed by Insurance Commissioner John Garamendi with the  
5 Office of Administrative Law on or about March 13, 2003, make wholesale substantive changes to  
6 the existing Regulations. These new Regulations were ostensibly proposed under the authority of  
7 Insurance Code section 790.10, which authorizes the Commissioner to promulgate rules and  
8 regulations as are necessary to "administer" the provisions of the California Unfair Practices Act,  
9 at Insurance Code sections 790, *et seq.* Under section 790.10, the Insurance Commissioner's  
10 directive is to implement section 790.03(h), but not to expand its scope. As alleged more fully  
11 herein, these new Regulations are unreasonable, improper and unlawful and therefore void in that:

- 12
- 13 (a) They improperly expand an insurer's obligations beyond the scope of  
14 Insurance Code section 790.03(h), by altering, amending, enlarging, or in some  
15 instances impairing the specified unfair claims settlement practices listed therein.  
16 In other instances, the new Regulations prohibit certain acts by insurers, without  
17 any statutory authority to support such restrictions.
- 18 (b) They mandate coverage benefits under California insurance policies by  
19 regulatory fiat without any statutory authorization as required by law. Insurance  
20 Code section 790.03(h) does not confer upon the Insurance Commissioner the  
21 authority to mandate policy coverages or limitations. Where the Legislature has  
22 determined that mandatory policy provisions are warranted, it has enacted  
23 legislation to mandate such provisions. Here, the Legislature has not mandated  
24 any of the policy provisions required by the new Regulations challenged herein.
- 25 (c) They impose duties upon insurers and dictate valuation methodologies that  
26 are inconsistent, and in many cases directly conflict, with established California  
27 law. Administrative regulations that violate acts of the Legislature are unlawful  
28 and therefore void.

1 (d) They impose standards that are arbitrary, unreasonable, burdensome and will  
2 be extraordinarily expensive for insurers to implement. These new Regulations  
3 do not meet the standard of necessity required by Government Code  
4 section 11349.1 in that the record of the rulemaking proceedings does not  
5 demonstrate by substantial evidence the need for these new Regulations to  
6 effectuate the purpose of Insurance Code section 790.03(h).

7 (e) They add undefined terms that are not easily understood by insurers or  
8 consumers, creating uncertainty, making it difficult for insurers to assure  
9 compliance, and subjecting insurers to arbitrary and inconsistent compliance  
10 standards. As such, these new Regulations do not meet the standard of clarity  
11 required by Government Code section 11349.1 and are therefore void.

12 This action is necessary because the Department of Insurance has ignored Plaintiffs' detailed  
13 written and oral objections to the amended Regulations and has rebuffed Plaintiffs' attempts to  
14 reopen the issue prior to their taking effect on July 23, 2003. If these Regulations are permitted to  
15 take effect, insurers will be subjected to unreasonably burdensome, and in some instances  
16 impossible, standards that will prove extraordinarily expensive to insurers and ultimately to  
17 consumers. Accordingly, Plaintiffs file this Complaint now and seek declaratory and injunctive  
18 relief as set forth below.

19  
20 **PARTIES**

21 3. Plaintiff Personal Insurance Federation of California ("PIFC") is, and at all times  
22 mentioned in this Complaint was, a non-profit trade association dedicated to representing its  
23 member companies' interests before governmental bodies, including the California Legislature, the  
24 Commissioner, and California courts. PIFC's members are insurers specializing in personal lines of  
25 insurance, primarily private passenger automobile and homeowners insurance in the State of  
26 California and elsewhere. PIFC's membership accounts for approximately 35% of all personal lines  
27 insurance premiums sold in California.

1 4. Plaintiff Association of California Insurance Companies (“ACIC”) is an affiliate of  
2 the National Association of Independent Insurers and represents more than 200 property/casualty  
3 insurance companies doing business in California. Members of ACIC write more than one third of  
4 the total personal lines property/casualty insurance written in California, including more than 55  
5 percent of personal automobile insurance, 35 percent of homeowners insurance, and 20 percent of  
6 business insurance. The National Association of Independent Insurers is a leading national  
7 property/casualty insurance company trade group with more than 715 members.

8 5. Plaintiff The Surety Association of America (“SAA”) is a non-profit corporation  
9 consisting of approximately 550 member companies engaged in the business of suretyship.  
10 Members of SAA collectively write the vast majority of surety and fidelity bonds in the United  
11 States and California. SAA is licensed by the California Department of Insurance as an Advisory  
12 Organization.

13 6. Defendant John Garamendi is named in his official capacity as Insurance  
14 Commissioner of the State of California (the “Commissioner”). The Commissioner is charged by  
15 law with abiding by the California Insurance Code, and with otherwise discharging his duties  
16 according to law including, among other things, the standards set forth in Government Code  
17 sections 11349, *et seq.*, as well as the California Constitution and the United States Constitution.

18  
19 **JURISDICTION AND VENUE**

20 7. This Court has jurisdiction over this action to the extent Plaintiffs seek injunctive and  
21 declaratory relief for violations of the Administrative Procedure Act (Gov. Code § 11350).

22 8. Venue is proper in this Court pursuant to Code of Civil Procedure section 401 and  
23 Insurance Code section 12905, because this action is being prosecuted against a department of the  
24 State, and the Commissioner has offices in the County of Los Angeles.

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**SUMMARY OF CLAIMS FOR RELIEF**

**A. Declaratory Relief**

9. By this action, Plaintiffs seek a declaratory judgment establishing the invalidity of specific sections of the Regulations for the reasons set forth in the following causes of action.

**B. Injunctive Relief**

10. Immediate and permanent injunctive relief is necessary to prevent the violation of Plaintiffs’ constitutional rights, the violations of law, and the irreparable waste of resources that will result if the challenged Regulations are permitted to take effect on July 23, 2003.

**BACKGROUND ALLEGATIONS**

11. On March 15, 2002, former California Insurance Commissioner Harry W. Low issued a Notice of Proposed Action, proposing changes to the fair claims settlement practices regulations found at California Code of Regulations, Title 10, Chapter 5, Subchapter 7.5, sections 2695.1 through 2695.14. The Regulations which the Department of Insurance sought to amend were originally promulgated, after notice and public hearing, under the authority of Insurance Code section 790.10, as necessary to administer and make specific the provisions of Insurance Code section 790.03(h).

12. Plaintiffs and various California insurers offered numerous written objections to the new Regulations, and offered further testimony at public proceedings in May 2002. These objections provided detailed written comments, citing applicable legal authority, explaining that many of the new Regulations failed to meet the standards of authority, consistency, necessity and clarity required by Government Code section 11349.1. The vast majority of these comments were rejected by Commissioner Low and were not reflected in the revised proposed regulations released by the Department on November 26, 2002. Former Commissioner Low took the position that the revisions made were either non-substantial or solely grammatical in nature, or were sufficiently related to the original text that the public was adequately placed on notice that the change could

1 result from the originally proposed regulatory action. The Department again invited public written  
2 comment on the proposed regulations.

3 13. In November 2002, Plaintiffs again offered detailed written comments, citing  
4 applicable legal authority, explaining that the proposed Regulations were improper and failed to  
5 meet the minimum requirements of the law. On March 13, 2003, the Commissioner filed the new  
6 Regulations in final form to the Office of Administrative Law (“OAL”) for review. These  
7 Regulations included additional revisions that were not made available to the public for review and  
8 comment. As a result, the OAL initially rejected a portion of the Regulations, section 2695.1(s), as  
9 improperly submitted without public comment. This section was later approved by the OAL. The  
10 new Regulations are currently scheduled to take effect on July 23, 2003, with the exception of  
11 section 2695.1(s), which is scheduled to take effect on September 3, 2003.

### 12 13 **GENERAL ALLEGATIONS**

14 14. The Commissioner has the authority to promulgate the Regulations under  
15 Insurance Code section 790.10, “as necessary to administer” and make specific the provisions of  
16 Insurance Code section 790.03(h). Any Regulations that alter, amend, enlarge or impair the scope  
17 of section 790.03(h) are unlawful and therefore void.

18 15. As is set forth more fully below, the new Regulations improperly expand an  
19 insurer’s obligations beyond the scope of Insurance Code section 790.03(h), by altering, amending,  
20 enlarging, or in some instances impairing the express statutory provisions set forth therein. In other  
21 instances, the new Regulations prohibit certain acts by insurers, without any statutory authority to  
22 support such restrictions. Many of the new Regulations challenged herein improperly impose  
23 coverage benefits and other policy terms by regulatory fiat. The Commissioner has improperly and  
24 unlawfully imposed these policy terms without the authority of the Legislature.

25 16. The new Regulations improperly impose duties upon insurers and dictate  
26 valuation methodologies that are inconsistent, and in many cases directly conflict with, established  
27 California law. Administrative regulations that violate acts of the Legislature are unlawful and  
28 therefore void.

1           17.     The new Regulations improperly impose standards that are arbitrary,  
2 unreasonable, burdensome and will be extraordinarily expensive for insurers to implement, with the  
3 potential that these expenses ultimately will be passed on to consumers. The record of the  
4 rulemaking proceedings do not demonstrate by substantial evidence the need for these new  
5 Regulations to effectuate the purpose of Insurance Code section 790.03(h).

6           18.     The new Regulations add undefined terms that are not easily understood by  
7 insurers or consumers, creating uncertainty, making it difficult for insurers to assure compliance,  
8 and subjecting insurers to arbitrary and inconsistent compliance standards.

9           19.     Plaintiffs have diligently opposed the new Regulations challenged herein and  
10 have sought, up until the time of filing this action, to have the Department of Insurance reopen this  
11 issue and re-consider the propriety and lawfulness of the new Regulations. The Department of  
12 Insurance has consistently rejected Plaintiffs' detailed written and oral objections to the new  
13 Regulations and has rebuffed Plaintiffs' attempts to reopen the issue prior to their taking effect on  
14 July 23, 2003. If these Regulations are permitted to take effect, insurers will be subjected to  
15 unreasonably burdensome, and in some instances impossible standards, all of which will prove  
16 extraordinarily expensive to insurers and ultimately to consumers.

17           20.     Taken as a whole, the new Regulations substantially increase the authority and  
18 powers of the Commissioner by permitting him to circumvent procedures mandated by the  
19 legislature and declare previously unregulated practices illegal without notice, impose penalties  
20 upon insurers for a single inadvertent act despite express statutory and case law to the contrary, hold  
21 insurers to standards that are inconsistent or in direct conflict with existing law, and impose policy  
22 benefits without a grant of authority from the Legislature, as required by law. Moreover, the fact  
23 that the definition of "Proof of Claim" set forth in Regulation section 2695.1(s) does not take effect  
24 until September 3, 2003, infects the rest of the new regulatory framework with ambiguity as the  
25 Regulations are replete with provisions that rely on this definition.

26           21.     With respect to each of the Regulations set forth below, the Commissioner and  
27 the Department of Insurance may act only pursuant to powers conferred on it by statute and  
28 consistent with the United States Constitution and the California Constitution. Any actions taken by

1 the Commissioner or the Department of Insurance in excess of the powers expressly conferred, or  
2 inconsistent with express statutory provisions, are void. Any regulations promulgated by the  
3 Commissioner that lack clarity in that they cannot easily be understood by insurers or consumers are  
4 equally void. The necessity of any Regulations promulgated by the Commissioner must be  
5 demonstrated by substantial evidence in the record of the rulemaking proceedings, or are otherwise  
6 void.

7 22. The Commissioner has a duty to promulgate regulations under Insurance Code  
8 section 790, *et seq.*, in a valid, lawful, and constitutional manner.

9 23. With respect to each section of the Regulations identified below, an actual  
10 controversy has arisen and now exists between Plaintiffs, their member companies and the  
11 Defendant Commissioner relating to their respective rights and duties in that Defendant contends  
12 the Regulations are lawful and enforceable, and Plaintiffs contend that, as described above, portions  
13 of those Regulations are invalid, unlawful, and unconstitutional.

14 24. Plaintiffs desire a declaration of their rights and the rights of their members with  
15 respect to the validity, legality, constitutionality, and application of the Regulations.

16 25. Such a declaration is necessary and appropriate at this time under the  
17 circumstances so that Plaintiffs and their members may ascertain their rights and duties with respect  
18 to the Regulations.

19 26. Plaintiffs have exhausted all available administrative remedies required to be  
20 exhausted and will suffer irreparable injury unless declaratory relief is granted.

21 27. Plaintiffs are entitled to recover their attorneys fees incurred in this action,  
22 pursuant to Code of Civil Procedure section 1021.5 and Insurance Code section 12926.1(d)(2).

23  
24 **FIRST CAUSE OF ACTION**

25 (Declaratory Relief – Regulation § 2695.1(b) Invalid  
26 As Inconsistent With Insurance Code § 790.06)

27 28. Plaintiffs reallege paragraphs 1-27 above.  
28



1 29. Regulation section 2695.1(b) formerly provided that unfair practices not  
 2 specifically delineated in the Regulations may also be “a violation Insurance Code  
 3 section 790.03(h).” The new Regulation deletes the reference to section 790.03(h) and provides  
 4 instead that other “method, act(s) or practices” not prohibited by the Regulations may also be  
 5 “unfair claims settlement practices,” and thus a violation of the Regulations.

6 30. The new Regulation section 2695.1(b) is inconsistent with Insurance Code  
 7 sections 790.06 and 790.03. Insurance Code section 790.06 establishes a procedure by which the  
 8 Commissioner may designate acts as unfair that are not otherwise listed in Insurance Code  
 9 section 790.03(h). Under Section 790.06, the Commissioner must issue an order to show cause and  
 10 hold a hearing in accordance with the Administrative Procedures Act (Govt. Code section 11500, *et*  
 11 *seq.*). The new Regulation section 2695.1(b) would allow the Commissioner to circumvent these  
 12 procedures by taking action against insurers for claims handling practices to enforce Insurance Code  
 13 § 790.03(h), even where such claims handling practices are not specifically prohibited by the statute  
 14 or the Regulations promulgated thereunder.

15  
 16 **SECOND CAUSE OF ACTION**

17 (Declaratory Relief – Regulation §§ 2695.1(c) and 2695.2(j))  
 18 Invalid As Lacking the Requisite Necessity)

19 31. Plaintiffs reallege paragraphs 1-27 above.

20 32. The new Regulations delete former section 2695.1(c). That section currently  
 21 recognizes the unique relationship which exists under a surety bond between the insurer, the obligee  
 22 or beneficiary, and the principal as set described in *Cates Construction, Inc. v. Talbot Partners*, 21  
 23 Cal. 4<sup>th</sup> 28 (1999). Accordingly, this section expressly exempts the handling or settlement of claims  
 24 brought under surety bonds as to all Regulations, except as specifically set forth in therein.

25 33. Similarly, the new Regulations delete portions of Regulation section 2695.2(j),  
 26 which expressly excluded surety bonds from the definition of “insurance policy” as that term is used  
 27 in the Regulations.

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34. The deletions of Regulation section 2695.1(c) and portions of section 2695.2(j), disregarding the legal distinctions between traditional insurers and sureties, lack the requisite necessity. There is nothing in the record of the rulemaking proceedings that demonstrates by substantial evidence a need for making the entirety of the Regulations applicable to the settlement of claims brought under surety bonds. The unique tripartite relationship between the surety insurer, the beneficiary and the principal typically involves complexities inherent to that relationship which are not present in the typical insurer-insured relationship.

**THIRD CAUSE OF ACTION**

(Declaratory Relief – Regulation § 2695.1(e) Invalid  
As Beyond the Commissioner’s Authority)

35. Plaintiffs reallege paragraphs 1-27 above.

36. The new Regulation section 2695.1(e) provides: “Policy provisions relating to the investigation, processing and settlement of claims shall be consistent with or more favorable to the insured than the provisions of these regulations.”

37. The new Regulation section 2695.1(e) exceeds the Commissioner’s authority because Insurance Code section 790, *et seq.*, does not give the Commissioner or the Department of Insurance the authority to dictate *policy provisions*. Insurance Code section 790.03(h) regulates insurers’ *procedures* in handling claims, as opposed to the benefits set forth in the policy. In light of the numerous instances in which the Department is proposing to expand the scope of its authority, promulgate new Regulations that are inconsistent with California law, and mandate policy provisions without legislative authority, as alleged herein, new Regulation section 2695.1(e) is an improper attempt to impose new and expanded policy terms by regulatory fiat. Such action is beyond the scope of Insurance Code section 790.03(h).

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**FOURTH CAUSE OF ACTION**

(Declaratory Relief – Regulation § 2695.2(s) Invalid As Beyond the  
Commissioner’s Authority, Inconsistent With Insurance Code  
§ 790.03(h), and Lacking the Requisite Clarity)

38. Plaintiffs reallege paragraphs 1-27 above.

39. The new Regulation section 2695.2(s) defines a “Proof of Claim” to include “any evidence” received by the insurer that supports an insured’s claim, eliminating an insurer’s right to require documentation of a claim. The new section 2695.2(s) also eliminates the phrase “magnitude or the amount of the claimed loss” making this section susceptible to the potential misinterpretation that proof of the amount of the loss cannot be required.

40. The new Regulation section 2695.2(s) exceeds the Commissioner’s authority by expanding the scope of Insurance Code section 790.03(h)(4), which prohibits an insurer from “failing to affirm or deny coverage of claims within a reasonable time after proof of loss requirements have been completed and submitted by the insured,” to prohibit an insurer from setting proof of loss rules in its policy. Regulation section 2695.2(s) further exceeds the scope of section 790.03(h)(4) by defining a “Proof of Claim” to include “other evidence that the insurer discovers in the course of its investigation,” as opposed to evidence received from an insured. Section 790.03(h)(4) expressly limits its scope to proofs of loss “completed and submitted by the insured.”

41. The new Regulation section 2695.2(s) is also inconsistent with Insurance Code section 790.03(h)(4). That Regulation improperly and unlawfully prohibits an insurer from setting proof of loss rules in its policy as contemplated by Insurance Code section 790.03(h)(4).

42. The new Regulation section 2695.2(s) also lacks the requisite clarity because the phrase “any evidence” creates uncertainty, making it difficult for an insurer to assure compliance, and subjecting an insurer to arbitrary and inconsistent compliance standards. Further, the Commissioner’s deletion of the phrase “magnitude or the amount of the claimed loss” without further clarification as to what is meant by “any evidence” renders this Regulation hopelessly vague. This ambiguity is further compounded by the fact that this Regulation is inconsistent with Regulation section 2695.7 to the extent an that it could potentially be improperly interpreted to

1 require an insurer to accept a claim and make payment to the insured without any evidence or  
2 documentation as to the amount of damages, and possibly before any liability has been determined.  
3 Moreover, the amended Regulation section 2695.7(b) provides that the “amounts accepted or denied  
4 shall be clearly documented in the claims file” notwithstanding that the potential that this section  
5 could be improperly interpreted as eliminating the requirement of proof as to the amount of the loss.  
6 Finally, the fact that the definition of “Proof of Claim” set forth in Regulation section 2695.1(s)  
7 does not take effect until September 3, 2003 infects the rest of the new regulatory framework with  
8 ambiguity as the Regulations are replete with provisions that rely on this definition.

### 9 10 **FIFTH CAUSE OF ACTION**

11 (Declaratory Relief – Regulation § 2695.4(a) As Beyond the Commissioner’s  
12 Authority and Lacking the Requisite Necessity)

13 43. Plaintiffs reallege paragraphs 1- 27 above.

14 44. The new Regulation section 2695.4(a), formerly subsection (b), improperly and  
15 unlawfully expands an insurer’s disclosure obligations to require the disclosure of “any pertinent  
16 statutes and regulations, that may apply to the claim presented or that the insurer relies upon to  
17 process the claim.” This Regulation also requires an insurer to disclose *all* policy provisions that  
18 the insurer relies upon to process, or that “may” apply to an insured’s claim.

19 45. The new Regulation section 2695.4(a) exceeds the Commissioner’s authority  
20 because Insurance Code section 790.03(h) does not give the Commissioner or the Department of  
21 Insurance the authority to require insurers to disclose every law and regulation that “may” touch  
22 upon the claims process. The Regulation would require insurers to make legal representations and  
23 potentially disclose privileged material. As such, this Regulation would set an impossible standard  
24 for insurers, imposing upon them the unreasonable burden to require claims handling employees to  
25 determine all statutory and regulatory provisions that “may” apply under the circumstances. It  
26 would force claims handling employees to have legal knowledge beyond their training and would  
27 require insurers to improperly practice law in violation of California Business & Professions Code

1 section 625. As the new Regulation section 2695.4(a) expands an insurer’s disclosure obligations  
2 under section 790.03(h), it exceeds the authority of the Commissioner and is therefore void.

3 46. The new Regulation section 2695.4(a) further exceeds the authority of the  
4 Commissioner and the Department of Insurance to the extent that it requires insurers to advise  
5 insureds of **all** policy provisions that the insurer relies upon, or that “may” apply to an insured’s  
6 claim. Insurance Code section 790.03(h)(9) requires an insurer, upon request, to inform the  
7 claimant of “the coverage under which payment was made.” Insurance Code section 790.03(h)(13)  
8 requires insurers to provide an explanation of the facts or applicable law relied upon in denying a  
9 claim. Nothing in section 790.03(h) requires insurers to disclose **all** applicable policy provisions,  
10 including those that “may” apply under the circumstances. Insureds are already in possession of the  
11 insurance policy setting forth all coverages, benefits and limitations. As a matter of law, insureds  
12 are charged with knowledge of these policy provisions.

13 47. The requirements set forth in this section are particularly burdensome for sureties  
14 in light of the fact that surety bonds are not drafted by insurers, but by the obligee. A surety is not  
15 in a better position to cite particular provisions of the “policy” than its obligee.

16 48. In addition, new Regulation section 2695.4(a) does not meet the standard of  
17 necessity under Government Code section 11349(a) to the extent that it requires insurers to advise  
18 insureds of **all** policy provisions that the insurer relies on to process the claim, or that “may” apply  
19 to a claim. As set forth above, insureds are already in possession of the insurance policy setting  
20 forth all coverages, benefits and limitations, and are charged with knowledge of these policy  
21 provisions as a matter of law. Nothing in the record of the rulemaking proceedings demonstrates by  
22 substantial evidence the need for this Regulation to effectuate the purpose of section 790.03(h).

23  
24 **SIXTH CAUSE OF ACTION**

25 (Declaratory Relief – Regulation § 2695.7(b) Invalid As  
26 Lacking the Requisite Necessity and Clarity)

27 49. Plaintiffs reallege paragraphs 1- 27 above.  
28

1            50.      The new Regulation section 2695.7(b) requires that upon accepting or denying a  
2 claim, in whole or in part, “[t]he amounts accepted or denied shall be clearly documented in the  
3 claim file.”

4            51.      The new Regulation section 2695.7(b) does not meet the standard of necessity  
5 under Government Code section 11349(a) to the extent that it requires insurers to clearly document  
6 the amounts denied even when the insurer denies liability in its entirety. After reviewing public  
7 comments to this new Regulation, the Department responded that “the commissioner agrees that the  
8 actual amount of a claim that is denied in its ‘entirety’ need not be documented.” The Department  
9 therefore stated that this Regulation should be modified, requiring documentation of the amount  
10 denied “unless the claim has been denied in its entirety.” The Department elected, without any  
11 explanation, not to add the quoted language to the final Regulation. Nothing in the record of the  
12 rulemaking proceedings demonstrates by substantial evidence the need for this Regulation to  
13 effectuate the purpose of section 790.03(h).

14            52.      The new Regulation section 2695.7(b) also lacks the requisite clarity because the  
15 phrase “clearly documented” can be subject to various interpretations. The requirement that  
16 documentation must be “clear” creates uncertainty, making it difficult for an insurer to assure  
17 compliance, and subjecting an insurer to arbitrary and inconsistent compliance standards.  
18 Moreover, this new Regulation is confusing as to how an insurer can document the amount accepted  
19 or denied in light of the fact that the new Regulation section 2695.2(s) could potentially be  
20 misinterpreted to eliminate the requirement that a proof of claim document the “magnitude or the  
21 amount of the claimed loss.”

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### **SEVENTH CAUSE OF ACTION**

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(Declaratory Relief – Regulation § 2695.7(b)(1) As  
Beyond the Commissioner’s Authority)

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53.      Plaintiffs reallege paragraphs 1- 27 above.

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54.      The new Regulation section 2695.7(b)(1) provides: “Where an insurer’s denial  
of a first party claim . . . in whole or in part is based on a specific statute . . . or policy provision . . .

1 the written denial shall include a reference thereto and provide an explanation of the application of  
2 the statute, provision, condition or exclusion of the claim.”

3 55. The new Regulation section 2695.7(b)(1) exceeds the Commissioner’s authority  
4 because Insurance Code section 790, *et seq.*, does not give the Commissioner or the Department of  
5 Insurance the authority to require insurers to provide legal analysis and explanation of statutes that  
6 may be applicable to a claim. The Regulation would improperly require insurers to make legal  
7 representations and potentially disclose privileged material. As such, this Regulation would set an  
8 impossible standard for insurers, imposing upon them the unreasonable burden of determining the  
9 applicable statutory and regulatory provisions in each circumstance and thereby forcing claims  
10 handling employees to have legal knowledge beyond their training. This Regulation would further  
11 require insurers and their claims handling employees to improperly practice law in violation of  
12 California Business & Professions Code section 625. As the new Regulation section 2695.7(b)(1)  
13 expands an insurer’s disclosure obligations under section 790.03(h), it exceeds the authority of the  
14 Commissioner and is therefore void.

15  
16 **EIGHTH CAUSE OF ACTION**

17 (Declaratory Relief – Regulation § 2695.7(b)(5) As Beyond the Commissioner’s  
18 Authority and Inconsistent With Established Law)

19 56. Plaintiffs reallege paragraphs 1- 27 above.

20 57. The new Regulation section 2695.7(b)(5) provides: “The cost of labor is not  
21 subject to depreciation.”

22 58. The new Regulation section 2695.7(b)(5) exceeds the Commissioner’s authority  
23 by expanding the scope of Insurance Code section 790.03(h), which does not mention depreciation,  
24 and does not give the Commissioner the authority to dictate policy provisions. The practical effect  
25 of this new Regulation is to mandate that insurers extend replacement cost coverage to all policies  
26 despite the fact that such coverage goes beyond the concept of indemnity coverage. Insurance Code  
27 section 790.03(h)(5) merely requires insurers to attempt “in good faith to effectuate prompt, fair,  
28 and equitable settlements of claims in which liability has become reasonably clear.” Prohibiting the

1 depreciation of labor costs is beyond the scope of the general standard of fair and equitable  
2 settlements and rewrites insurers' existing policy language.

3 59. The new Regulation section 2695.7(b)(5) is also inconsistent with established  
4 California law. As discussed above, the practical effect of this new Regulation is to mandate that  
5 insurers extend replacement cost coverage to all policies. Established California law upholds fair  
6 market value as a fair measure of damage. *See Jefferson Ins. Co. v. Superior Court*, 3 Cal. 3d 398,  
7 402 (1970). Since the cost of labor is intrinsic to any repair, depreciation logically applies to the  
8 entire repair job, including labor. The "unit cost" method, which incorporates all expense items into  
9 one price estimate, is a well-accepted method for estimating property damage. Requiring insurers  
10 to implement new systems itemizing original labor costs would not only be contrary to established  
11 existing law, but would also be extraordinarily expensive for insurers and, potentially, for  
12 consumers.

### 13 14 NINTH CAUSE OF ACTION

15 (Declaratory Relief – Regulation § 2695.7(d) Invalid As Beyond the  
16 Commissioner's Authority and Lacking the Requisite Clarity)

17 60. Plaintiffs reallege paragraphs 1 - 27 above.

18 61. The new Regulation section 2695.7(d) adds the requirement that insurers  
19 "conduct and diligently pursue a thorough, fair and objective investigation."

20 62. The new Regulation section 2695.7(d) exceeds the Commissioner's authority by  
21 expanding the scope of Insurance Code section 790.03(h), which does not authorize the  
22 Commissioner to require insurers to conduct a "thorough, fair and objective" investigation. This  
23 language appears to create a new standard of conduct in potential bad faith and unfair competition  
24 actions.

25 63. The new Regulation section 2695.7(d) also lacks the requisite clarity to the extent  
26 that it requires a "thorough, fair and objective" investigation. The new language is not defined  
27 anywhere in the Regulations, creating uncertainty as to its meaning, making it difficult for an  
28 insurer to assure compliance, and subjecting an insurer to arbitrary and inconsistent compliance



1 standards. In light of the additional requirement set forth in this section that an insurer shall not  
2 persist in seeking information “not reasonably required or material” to the claim, the new language  
3 appears to require investigations that achieve perfection.  
4

5 **TENTH CAUSE OF ACTION**

6 (Declaratory Relief – Regulation § 2695.7(e) Invalid  
7 As Inconsistent With Established Law)

8 64. Plaintiffs reallege paragraphs 1- 27 above.

9 65. Regulation section 2695.7(e) provides that no insurer may delay or deny  
10 settlement of a first party claim on the basis that responsibility for payment should be assumed by  
11 others. The changes to this Regulation make this section applicable to sureties.

12 66. The new Regulation section 2695.7(e) is inconsistent with established California  
13 law. A surety’s obligation to perform is secondary and requires proof of default by the principal  
14 before the obligation even begins to exist. This process and proof requirement is lengthy and  
15 complex making the timeframes set forth in section 2695.7 unreasonable. The new Regulation fails  
16 to recognize the legal duty of a principal to perform under a surety bond as the primary duty in the  
17 contract.  
18

19 **ELEVENTH CAUSE OF ACTION**

20 (Declaratory Relief – Regulation § 2695.7(g)(2) Invalid  
21 As Beyond the Commissioner’s Authority)

22 67. Plaintiffs reallege paragraphs 1 - 27 above.

23 68. The new Regulation section 2695.7(g)(2) provides that in determining whether or  
24 not a settlement offer made by an insurer is too low, the Commissioner shall consider the extent to  
25 which the insurer considered “legal authority” known to it.

26 69. The new Regulation section 2695.7(g)(2) exceeds the Commissioner’s authority  
27 by improperly requiring insurers to disclose to the Department confidential attorney-client opinions  
28

1 and communications. The new Regulation would further require that every claim submitted to an  
2 insurer be handled by a person who has broad knowledge of all possible legal authority.

3  
4 **TWELFTH CAUSE OF ACTION**

5 (Declaratory Relief – Regulation § 2695.7(g)(7) Invalid  
6 As Beyond the Commissioner’s Authority)

7 70. Plaintiffs reallege paragraphs 1- 27 above.

8 71. The new Regulation section 2695.7(g)(7) makes any early settlement offer  
9 subject to review by the Department in determining whether a settlement offer is too low.

10 72. The new Regulation section 2695.7(g)(7) exceeds the Commissioner’s authority  
11 because Insurance Code section 790.03(h) does not give the Commissioner the authority to actively  
12 participate in the claims settlement process. This new Regulation fails to recognize the negotiation  
13 process inherent in claims investigations and will cause insurers to refrain from making early  
14 settlement offers, to the detriment of claimants. The new Regulation would also change the role of  
15 the Department from regulator to an arbitrator of an on-going negotiation.

16  
17 **THIRTEENTH CAUSE OF ACTION**

18 (Declaratory Relief – Regulation § 2695.7(h) Invalid  
19 As Inconsistent With Established Law)

20 73. Plaintiffs reallege paragraphs 1- 27 above.

21 74. Formerly, Regulation section 2695.7(h) prescribed time limits and other duties of  
22 an insurer in paying a claim upon acceptance. This section would require insurers, in cases of  
23 multiple claimants, to tender payment to the first claimant to come forward. It could also  
24 potentially be misinterpreted to require partial payment to third party claimants without a binding  
25 release.

26 75. The new Regulation section 2695.7(h) is inconsistent with the established  
27 California law to the extent that it could potentially be misinterpreted to require partial payment to  
28 third party claimants even where the “accepted” amount does not terminate the insured’s liability

1 and before a release of liability can be obtained on behalf of an insured. The new Regulation would  
2 also require insurers, in cases of multiple claimants, to tender payment to the first claimant to come  
3 forward despite the fact that the first claimant may not have suffered the most damage, which is also  
4 inconsistent with California law. (*See Schwartz v. State Farm Fire and Casualty Co.*, 88 Cal. App.  
5 4<sup>th</sup> 1329, 1339 (2001); *Kinder v. Western Pioneer Industries Co.*, 231 Cal. App. 2d 894, 902  
6 (1965).)

#### 8 FOURTEENTH CAUSE OF ACTION

9 (Declaratory Relief – Regulation § 2695.7(r) Invalid As Beyond  
10 the Commissioner’s Authority and Lacking Clarity)

11 76. Plaintiffs reallege paragraphs 1- 27 above.

12 77. The new Regulation section 2695.7(r) provides: “No insurer shall pursue a claim  
13 for subrogation without having conducted a thorough, fair and objective investigation as to whether  
14 subrogation is appropriate.”

15 78. This Regulation exceeds the Commissioner’s authority because Insurance Code  
16 section 790, *et seq.*, does not give the Commissioner or the Department of Insurance the authority to  
17 in any way limit an insurer’s right to subrogation. Subrogation is a right, derived from the  
18 insurance contract, under which the insurer steps into the shoes of the insured for the purpose of  
19 seeking indemnity from the person responsible for a loss after the insurer has made payment on the  
20 insured’s claim. Nothing in section 790.03(h) addresses an insurer’s right to subrogation or in any  
21 way limits it. In fact, this Regulation is improperly and unlawfully designed to protect third parties  
22 responsible for losses to insureds, a class of persons not protected by section 790.03(h). This  
23 Regulation may also potentially expose insurers to claims of improper subrogation or failure to  
24 subrogate, without any legal authority for limiting the discretion of the insurer.

25 79. The new Regulation section 2695.7(r) also lacks the requisite clarity because the  
26 standard for a “thorough, fair and objective investigation” is too vague and creates uncertainty,  
27 making it difficult for an insurer to assure compliance, and subjecting an insurer to arbitrary and  
28 inconsistent compliance standards. This Regulation may potentially expose insurers to claims by

1 third parties that an insurer failed to conduct a “thorough” and “fair” investigation, despite the lack  
2 of clear and unambiguous standards.

3  
4 **FIFTEENTH CAUSE OF ACTION**

5 (Declaratory Relief – Regulation § 2695.7(s) Invalid As Inconsistent  
6 With Established Law, Beyond the Commissioner’s Authority,  
and Lacking the Requisite Clarity)

7 80. Plaintiffs reallege paragraphs 1- 27 above.

8 81. The new Regulation section 2695.7(s) makes an insurer responsible for the  
9 accuracy of data used in the adjustment of claims, whether prepared by the insurer itself or by a  
10 third party, and regardless of whether the insurer relied upon such data in good faith: “Insurers are  
11 responsible for the accuracy of data used to establish the value of insurance claims. Insurers  
12 choosing to use data from a computerized database source or any other source remain responsible  
13 for the accuracy of data they use, whether this data is derived in-house or through third parties.”

14 82. This Regulation is inconsistent with Insurance Code section 790.03(h), which  
15 requires insurers to attempt in good faith to effectuate prompt, fair and equitable settlements of  
16 claims to the extent that liability has become “reasonably clear.” This is a good faith standard.  
17 Regulation section 2695.7(s), on the other hand, prescribes a strict liability standard for any  
18 information used by an insurer to value an insured’s claim. The Commissioner expressly rejected  
19 public comments suggesting that the Regulation instead require insurers to secure accuracy  
20 statements from third party vendors along with documented evidence supporting the data provided.  
21 This strict liability standard is extremely burdensome and impossible for any insurer to comply  
22 with, and is inconsistent with the good faith standard of section 790.03(h).

23 83. This Regulation also exceeds the Commissioner’s authority because Insurance  
24 Code section 790, *et seq.*, does not give the Commissioner or the Department of Insurance the  
25 authority to impose a strict liability standard upon insurers. Nothing in the Insurance Code  
26 prohibits or restricts insurers from using database information in adjusting claims or creates any  
27 type of liability for use of such information, whatever the source. Nothing in the Insurance Code  
28

1 prohibits an insurer from relying on information provided by an insured. This Regulation is  
2 extremely burdensome and impossible for any insurer to comply with, will create unnecessary  
3 litigation, and will increase the costs of processing claims. This Regulation exceeds the good faith  
4 standard provided by section 790.03(h) and is therefore void.

5 84. The new Regulation section 2695.7(s) also lacks clarity to the extent that it  
6 makes an insurer responsible for the accuracy of data from a computerized database source “or any  
7 other source.” Such language would appear to make an insurer responsible for erroneous  
8 information submitted by the insured. However, in response to public comments on this new  
9 Regulation, the Commissioner offered the opinion that “this subsection does not prohibit an insurer  
10 from paying claims based on unverified data such as estimates and receipts submitted by  
11 claimants.” There is nothing in the text of the Regulation to support this statement. The Regulation  
12 therefore creates uncertainty, making it difficult for an insurer to assure compliance, and subjecting  
13 an insurer to arbitrary and inconsistent compliance standards.

## 14 15 **SIXTEENTH CAUSE OF ACTION**

16 (Declaratory Relief – Regulation § 2695.8(b) Invalid  
17 As Beyond the Commissioner’s Authority)

18 85. Plaintiffs reallege paragraphs 1 - 27 above.

19 86. The new Regulation section 2695.8(b) deletes the term “first party” making this  
20 section relating to total loss valuations and replacement vehicles applicable to third party claims.

21 87. This Regulation exceeds the Commissioner’s authority because Insurance Code  
22 section 790.03(h) does not give the Commissioner or the Department of Insurance the authority to  
23 dictate coverage benefits under an insurer’s policy. Insurers have no contractual obligation to  
24 provide replacement vehicles to third parties.

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**SEVENTEENTH CAUSE OF ACTION**

(Declaratory Relief – Regulation § 2695.8(b)(1) Invalid As  
Inconsistent With Established Law and  
Beyond the Commissioner’s Authority)

88. Plaintiffs reallege paragraphs 1 - 27 above.

89. The new Regulation section 2695.8(b)(1), relating to cash settlements for total loss claims, requires that cash settlements shall include all taxes and one-time fees incident to transfer of ownership, including license fees and other annual fees, to be computed based upon the remaining term of the loss vehicle’s current registration. This Regulation requires the inclusion of fees and taxes whether or not the insured purchases a replacement vehicle. This Regulation, as amended, is also expanded in scope to apply to third party claimants.

90. This Regulation exceeds the Commissioner’s authority because Insurance Code section 790.03(h) does not give the Commissioner or the Department of Insurance the authority to dictate coverage benefits under an insurer’s policy. The Regulation requires an insurer to compensate a claimant beyond the amount necessary to indemnify the claimant by requiring the insurer to pay sales tax even where the claimant elects to keep the vehicle. This would result in betterment to the claimant rather than fair compensation. Even where a claimant elects not to retain the vehicle, nothing in the Insurance Code section 790.03(h) requires an insurer to pay transfer fees, annual fees, license fees, or sales taxes.

91. This section is also inconsistent with established California law, which provides that a loss payable on a total loss claim is not the cost of the automobile to the claimant, but its fair market value just prior to the loss. *See, e.g., Martin v. State Farm Mutual Auto. Ins. Co.*, 200 Cal. App. 2d 459, 470 (1962). The Regulation requires an insurer to compensate a claimant beyond the amount necessary to indemnify the insured by requiring the insurer to pay sales tax even where the claimant elects to keep the vehicle. This would result in betterment to the claimant rather than fair compensation.

1 92. This section also violates Article XIII, section 28(f) of the California  
2 Constitution to the extent that it seeks to arbitrarily and improperly impose new taxes on insurers  
3 doing business in California.

4  
5 **EIGHTEENTH CAUSE OF ACTION**

6 (Declaratory Relief – Regulation § 2695.8(b)(2)-(3) Invalid As Inconsistent  
7 With Established Law, Beyond the Commissioner’s  
8 Authority, and Lacking the Requisite Clarity)

9 93. Plaintiffs reallege paragraphs 1 – 27 above.

10 94. The new Regulation section 2695.8(b)(2) sets the standards for comparable  
11 automobiles used by an insurer to determine the actual cash value of the loss vehicle in total loss  
12 claims. This section significantly limits insurers’ ability to evaluate total loss values. Regulation  
13 section 2695.8(b)(3) requires insurers to “take reasonable steps to verify that the determination of  
14 the cost of a comparable vehicle is accurate and representative of the market value of the  
15 comparable automobile in the local market area.”

16 95. This Regulation exceeds the Commissioner’s authority because Insurance Code  
17 section 790, *et seq.*, does not give the Commissioner or the Department of Insurance the authority to  
18 dictate an insurer’s methods for determining the value of comparable automobiles. As authority for  
19 this Regulation, the Commissioner relies upon Insurance Code section 790.03(h)(5), which makes it  
20 a violation of law for an insurer “not attempting in good faith, to effectuate prompt, fair, and  
21 equitable settlements of claims in which liability has become reasonably clear.” The Regulation  
22 provides that an insurer may value a total loss vehicle, in part, based on the “asking price” of  
23 comparable vehicles that have not yet been sold. It also limits the use of deductions for the  
24 condition of a loss vehicle unless the documented condition of the vehicle is below average. This  
25 would restrict an insurer’s ability to account for the condition of the total loss vehicle and impair the  
26 insurer’s ability to determine the fair market value of the vehicle just prior to the loss. To the extent  
27 that this Regulation would require an insurer to use valuations based on vehicles in better condition  
28 than the total loss vehicle, without adjustment or consideration of condition, it is an attempt to  
dictate increased coverage benefits under an insurer’s policy without authority and contrary to

1 California law. The Regulation further prohibits the use of newer model year vehicles as  
2 comparable vehicles unless the insurer cannot locate sufficient comparable vehicles of the same  
3 model year. Nothing in section 790.03(h) limits an insurer’s ability to make comparisons, or the  
4 type of information an insurer may rely upon in making valuation determinations. This Regulation  
5 exceeds the Commissioner’s authority under section 790.03(h)(5), which merely sets a good faith  
6 standard, and is therefore void.

7 96. Regulation section 2695.7(b)(2) also lacks clarity to the extent that it requires an  
8 insurer to value a total loss vehicle based on the “asking price” of a comparable vehicle that has not  
9 yet been sold. Such language would appear to require an insurer to base total loss valuations on the  
10 “sticker price” of comparable unsold vehicles. However, in response to public comments on this  
11 new Regulation, the Commissioner offered the opinion that a total loss valuation “should be based  
12 upon what an average consumer, with average negotiating skills, would pay.” There is nothing in  
13 the text of the Regulation that reflects this statement. The Regulation therefore creates uncertainty,  
14 making it difficult for an insurer to assure compliance, and subjecting an insurer to arbitrary and  
15 inconsistent compliance standards.

16 97. Regulation section 2695.7(b)(3) further lacks clarity to the extent that it requires  
17 an insurer “verify” the accuracy of comparable vehicle data. The Regulation contains no  
18 explanation as to what steps are required of an insurer to verify comparable vehicle data. In  
19 response to public comments, the Commissioner explained that this section “does not require the  
20 insurer to verify and recreate each valuation it obtains from a third party.” This statement further  
21 confuses an insurer’s obligations since it is inconsistent with the text of the Regulation, making it  
22 difficult for an insurer to assure compliance, and subjecting it to arbitrary and inconsistent  
23 compliance standards.

24  
25 **NINETEENTH CAUSE OF ACTION**

26 (Declaratory Relief – Regulation § 2695.8(f)(2) Invalid As Beyond the  
27 Commissioner’s Authority and Proposed Without Proper Notice)

28 98. Plaintiffs reallege paragraphs 1 - 27 above.





1 the authority to dictate coverage benefits under an insurer’s policy. This new Regulation has the  
2 effect of prohibiting insurers from offering PPO policy options for automobile repairs, imposing  
3 existing policy terms by regulatory fiat. This section unfairly prohibits a significant cost-saving  
4 option for consumers without citing any authority for such action.

5  
6 **TWENTY-FIRST CAUSE OF ACTION**

7 (Declaratory Relief – Regulation § 2695.8(i)(2) Invalid As Inconsistent With  
8 Established Law and Beyond the Commissioner’s Authority)

9 105. Plaintiffs reallege paragraphs 1 - 27 above.

10 106. The new Regulation section 2695.8(i)(2), relating to the restoration of partial loss  
11 vehicles, adds language requiring the insurer “to cause the damaged vehicle to be restored to its  
12 condition prior to the loss at no additional cost to the claimant.” The term “restore” implies that the  
13 insurer must return the vehicle to its previous value and does not allow for the fact that some  
14 claimants may allege that a damaged vehicle loses some market value even after adequate repairs.

15 107. This section of the Regulations exceeds the Commissioner’s authority because  
16 Insurance Code section 790, *et seq.*, does not give the Commissioner or the Department of  
17 Insurance the authority to dictate coverage benefits. Under established California law, an insurer  
18 must place a claimant’s vehicle in “substantially” the same condition as it was prior to the loss. *See*  
19 *Owens v. Pyeatt*, 248 Cal. App. 2d 840, 849 (1967). The term “restore” implies that the insurer  
20 must return the vehicle to its previous value and does not allow for the fact that some claimants may  
21 allege that a damaged vehicle loses some market value even after adequate repairs. This Regulation  
22 therefore improperly and unlawfully exceeds the statutory standard requiring insurers to attempt in  
23 good faith to effectuate fair and equitable settlements under section 790.03(h)(5).

24 108. This section of the Regulation is inconsistent with established California law,  
25 under which an insurer need only place a claimant’s vehicle in “substantially” the same condition as  
26 it was prior to the loss. *See Owens v. Pyeatt*, 248 Cal. App. 2d 840, 849 (1967). The term “restore”  
27 implies that the insurer must return the vehicle to its previous value and does not allow for the fact  
28 that a damaged vehicle may lose some market value even after adequate repairs. This language

1 inappropriately opens the door for potential “diminished value” third-party claims in cases where  
2 insurers have made the necessary repairs, and it is in direct conflict with policy provisions that  
3 exclude such first-party claims. This section of the Regulation increases insurers’ obligations under  
4 current law and is therefore void.

5  
6 **TWENTY-SECOND CAUSE OF ACTION**

7 (Declaratory Relief – Regulation §§ 2695.8(m) and 2695.85(c) Invalid As  
8 Beyond the Commissioner’s Authority and Lacking Requisite Clarity)

9 109. Plaintiffs reallege paragraphs 1 - 27 above.

10 110. The new Regulation section 2695.8(m), relating to towing and storage charges,  
11 provides: “The insurer shall pay reasonable towing and storage charges incurred by the insured.”  
12 The new section 2695.85(c) similarly requires an insurer to “pay reasonable towing and storage  
13 charges incurred by the insured.”

14 111. These Regulations exceed the Commissioner’s authority because neither  
15 Insurance Code sections 790, *et seq.*, nor Insurance Code section 1874.87, providing for an  
16 insured’s right to be *informed* about coverage for towing services, give the Commissioner or the  
17 Department of Insurance the authority to dictate coverage benefits provided by the policy. These  
18 Regulations would require insurers who do not provide coverage for such expenses to alter current  
19 policy language so as to cover reasonable towing and storage costs. These Regulations therefore  
20 improperly and unlawfully exceed the scope of section 790.03(h), which does not authorize the  
21 Department to mandate that insurers provide coverage for towing and storage costs.

22 112. These Regulations also lack clarity to the extent that they fail to provide any  
23 guidance whatsoever as to what amount of towing and storage costs will be considered “reasonable”  
24 under these Regulations. This ambiguity makes these Regulations uncertain, making it difficult for  
25 an insurer to assure compliance, and subjecting it to arbitrary and inconsistent compliance  
26 standards.

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**TWENTY-THIRD CAUSE OF ACTION**

(Declaratory Relief – Regulation § 2695.10(b) Invalid  
As Lacking the Requisite Necessity)

113. Plaintiffs reallege paragraphs 1 - 27 above.

114. The new Regulation would delete section 2695.10(b) in its entirety and replace it with language providing that a principal’s absence, non-cooperation, or failure to meet the bonded obligation shall not excuse delay by the surety insurer in determining whether a claim should be accepted or denied.

115. The section does not meet the standard of necessity under Government Code section 11349(a) to the extent that it requires surety insurers to accept or deny a claim within 40 days despite a principal’s “absence, non-cooperation, or failure to meet the bonded obligation.” A surety is simply the guarantor of the principal’s obligation and has no knowledge with respect to a claim against the principal unless it has an opportunity to discuss the claim with the principal and review any documents relative to the obligation. Elimination of the bulk of section 2695.10 is unreasonable, unnecessary and will create an enormous burden upon the surety. Nothing in the record of the rulemaking proceedings demonstrates by substantial evidence the need for the new language to effectuate the purpose of Insurance Code section 790.03(h).

**TWENTY-FOURTH CAUSE OF ACTION**

(Declaratory Relief – Regulation § 2695.10(c) Invalid  
As Inconsistent With Established Law)

116. Plaintiffs reallege paragraphs 1 - 27 above.

117. The new Regulation deletes section 2695.10(c) in its entirety and replace it with language placing limits on a surety’s unconditional right to refer a claimant to the principal for performance under the bond without documenting its conclusion that the principal would meet the bonded obligation. This subsection also requires the surety to inform claimants of the applicable statute of limitations, regardless of whether the claimant is represented by counsel.

1           118. This section is inconsistent with Civil Code section 2845, which provides a  
2 surety with an unconditional statutory right to require the claimant to proceed against the principal.  
3 Prohibiting a surety from referring a claimant to the principal for performance without first  
4 establishing that the principal would meet the bonded obligation directly conflicts with this statutory  
5 right and exceeds the Commissioner’s authority.

6           119. This section is further inconsistent with section 2695.7(f) of these Regulations, as  
7 applicable to insurers in general, to the extent that it requires the surety to inform claimants of the  
8 applicable statute of limitations even when the claimant is represented by counsel. Under section  
9 2695.7(f), there is no such obligation for insurers in general, thereby imposing a stricter and  
10 unreasonable obligation on sureties. Nothing in the record of the rulemaking proceedings  
11 demonstrates by substantial evidence the need for the new language to effectuate the purpose of  
12 Insurance Code section 790.03(h).

13  
14   **TWENTY-FIFTH CAUSE OF ACTION**

15           (Declaratory Relief – Regulation § 2695.12 Invalid As Beyond the Commissioner’s  
16           Authority and Inconsistent With Established Law)

17           120. Plaintiffs reallege paragraphs 1 - 27 above.

18           121. Former Regulation section 2695.12 lists certain factors to be considered “in  
19 determining noncompliance with this subchapter and appropriate penalties, if any . . .” The  
20 Department proposes to eliminate the words “noncompliance” and “if any” so that subsection (a)  
21 assumes that a violation of Insurance Code section 790.03(h) has occurred if an insurer has acted  
22 contrary to the Regulations in even one instance. The factors listed in subsections (a)(7) and (a)(10)  
23 replace the words “non-complying act(s)” with “violations.” The new Regulation section 2695.12  
24 also deletes subsection (c), which provides that the “Commissioner shall not consider reasonable  
25 mistakes” in determining an insurer’s noncompliance or penalties to be assessed. The combined  
26 effect of these new Regulations is to convert a single or a few non-complying acts into a violation  
27 of Insurance Code section 790.03(h).





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- 2. On the Twenty-Seventh Cause of Action, for preliminary and permanent injunctive relief as asserted therein according to proof;
- 3. For attorneys fees and costs incurred herein, according to proof, pursuant to Code of Civil Procedure section 1021.5 and Insurance Code section 12926.1(d)(2);
- 4. For an expedited trial on the merits on all claims asserted herein; and
- 5. For such other and further relief as this Court deems just and proper.

Dated: July 1, 2003

BARGER & WOLEN

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