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RE: Association of Cal. Ins. Cos. v. Jones
Los Angeles Super. Ct. No. BC 463124

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Insurance Brokers and Agents of the West

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF LOS ANGELES

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

Plaintiffs,

v.

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

Defendant.

Case No. BC463124

BRIEF OF AMICUS CURIAE INSURANCE BROKERS AND AGENTS OF THE WEST IN SUPPORT OF PLAINTIFFS' MOTION FOR JUDGMENT ON THE PLEADINGS

Date: January 6, 2012
Time: 8:30 a.m.
Dept.: 36

Action Filed: June 8, 2011

Trial Date: None set

I. INTRODUCTION AND STATEMENT OF INTEREST

Insurance Brokers and Agents of the West ("IBA West") respectfully submits this amicus brief in support of the Motion for Judgment on the Pleadings filed by the plaintiffs in the above-referenced case. IBA West concurs in plaintiff's arguments that the Commissioner lacked statutory authority to promulgate 10 CCR § 2695.183 ("the Regulation")[1] and that the Regulation is therefore a legal nullity.

IBA West is a voluntary trade association representing independent insurance agents and insurance brokers. Our membership includes over 500 agencies and brokerages and tens of thousands of individual broker-agents. IBA West opposes the Commissioner's reliance on the Unfair Insurance Practices Act, Insurance Code § 790 *et seq.* **("UIPA")**, as the basis for launching major regulatory initiatives for which he presently lacks statutory authority.

The Regulation is a prime example of that practice. The Regulation imposes a variety of burdensome duties on IBA West members and other insurance producers. But the Regulation's centerpiece is its prohibition on communicating a "replacement-cost estimate" to a customer unless that estimate was calculated according to a detailed methodology that the Commissioner developed and set forth in the Regulation. The Commissioner admits that the Regulation neither requires nor assures that a replacement-cost estimate will be accurate. Rather, he asserts that the Regulation is necessary in order to standardize the definition of the phrase "replacement-cost estimate" so that insurance producers and homeowners will have a shared understanding of what the term means. ***Standardization***—not accuracy or objective "truth"—is what the Regulation aims to achieve.

The Commissioner relies on two principal statutes as authority for the Regulation. The first, Insurance Code § 1749.85(d), merely acknowledges that the Department of Insurance may, at some future date, decide to regulate the methods that ***real-estate appraisers***—not insurance producers—use to calculate replacement-cost estimates. Being limited to appraisers, § 1749.85(d) does not grant the Department any authority to dictate the methodology that

[1] "§ 2695.183" refers to the Regulation. All other section numbers refer to the California Insurance Code.

1 insurance producers must use when providing a replacement-cost estimate to a customer.

2 The UIPA is the other statute from which the Commissioner purports to derive his
3 authority. There are only two ways for an act or practice to become prohibited as unfair or
4 deceptive under the UIPA. The first way is that the specific act or practice is expressly defined as
5 unfair or deceptive in the UIPA's definitional section, § 790.03. The other way requires the
6 Commissioner to hold a special proceeding pursuant to § 790.06 to determine whether a practice
7 not referenced in the definitional section nevertheless should be declared unfair or deceptive.

8 In this case, neither applies. The Commissioner relies on paragraph (b) of the UIPA's
9 definitional section, § 790.03, which bans (among other things) "misleading" statements about the
10 business of insurance. The Commissioner asserts that the Regulation is an exercise of his power
11 to "clarify" the meaning of the word "misleading" in that provision. But the statements banned
12 by the Regulation are not "misleading" because—as the Commissioner himself admits—there is
13 no widely accepted definition of the phrase "replacement-cost estimate." Indeed, that is why the
14 Commissioner has now imposed his own definition by administrative fiat. By attempting to
15 standardize the meaning of "replacement-cost estimate," the Commissioner effectively concedes
16 that no one is really sure what the phrase means—in which case, he cannot prove that using other
17 definitions is "misleading." The Commissioner responds that using any definition other than the
18 one in his Regulation is misleading ***because*** it is not the one in his Regulation—but that is not
19 logic, it is mere "bootstrapping."

20 As mentioned, the second way that a practice can become banned under the UIPA is for
21 the Commissioner to initiate a hearing under § 790.06 to determine whether a practice not
22 specified in the UIPA should be declared unfair or deceptive. But the Commissioner never
23 initiated a § 790.06 hearing, so that avenue is closed to him. And even if the Commissioner had
24 held the requisite § 790.06 hearing, he still would have lacked any legal or logical basis to declare
25 that all definitions of "replacement-cost estimate" other than his own must be unfair and
26 deceptive merely because they are not the definition that he adopted in the Regulation. Again,
27 that is not logic, it is bootstrapping.

28 IBA West has supported the Commissioner's efforts to standardize the meaning of the

term "replacement-cost estimate" by specifying a required methodology of some sort. IBA West believes that standardization could be good for consumers and producers alike. As the rulemaking process unfolded, however, IBA West grew concerned about the Commissioner's ever-evolving theories concerning his authority to promulgate the Regulation. IBA West advised the Commissioner that it believed that he would have to obtain new statutory authority before issuing the Regulation.

Thus, IBA West submits this letter, not because we oppose the general concept of the Regulation, but because we are concerned about the Commissioner's repeated attempts to ignore the limits on his statutory authority. In the past, for similar reasons, IBA West has successfully opposed the Commissioner's attempts to impose unprecedented and inappropriate fiduciary duties on insurance producers by regulation, and to use negotiated settlements with regulated persons as a vehicle for imposing improper "underground regulations" on the entire industry.

Now we are faced with yet another effort by the Commissioner to exceed his authority and thereby excise the Legislature from the policymaking process. The Commissioner appears to believe that the UIPA grants him virtually unlimited authority to do anything that he thinks is right with respect to the business of insurance. If the Court accepts that proposition, there will be nothing to prevent the Commissioner from treating the UIPA as a license to ignore any constraints that the Legislature has placed on his regulatory power.

For all these reasons, as stated more fully below, IBA West urges the Court to preserve the rule of law and to curb an excessive assertion of regulatory power by granting the plaintiffs' motion for judgment on the pleadings.

II. ARGUMENT

A. Although it has never been vetted by the Legislature, the Regulation imposes significant burdens on insurance producers.

The burden of implementing the Regulation will fall primarily on the shoulders of insurance producers, including IBA West members—the people who make and communicate replacement-cost estimates to homeowners on a day-to-day basis, as an inherent aspect of their jobs. The Regulation imposes four principal obligations and/or burdens on IBA West members:

Specific replacement-cost-estimation methodology ("the Method"). The Regulation forbids licensees from communicating an estimate of replacement cost to an applicant or an insured, in connection with an application for or renewal of "a homeowner's insurance policy that provides coverage on a replacement cost basis," unless the estimate takes into account at least 22 factors that the Commissioner believes "would reasonably be incurred to rebuild the insured structure(s) in its entirety."[2] The Regulation does not specify how these factors are to be estimated, weighed, evaluated, or prioritized. For example, the Regulation instructs insurance producers to take account of "[w]hether the structure is located on a slope"[3] and the "[g]eographic location of the property,"[4] but the Regulation does not state how to estimate the impact of those factors or what weight to give them in the overall estimate.

The Regulation also forbids consideration of certain factors[5] and requires that replacement-cost estimates be provided to the consumer in writing[6] and retained for five years (with certain exceptions).[7]

UIPA liability. The Regulation states that communicating a replacement-cost estimate "not comporting with" the Method "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 [the UIPA,] Insurance Code section 790.03." UIPA liability exposes a license to a range of penalties, including civil fines of up to $10,000 per violation.[8]

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[2] § 2695.183(a). Saying that the regulation sets out 22 factors fails to capture its full complexity. For example, we have counted the following as a single factor, even though it could necessitate hundreds of separate cost estimates: "Materials used in, and generic types of, interior features and finishes, such as, where applicable, the type of heating and air conditioning system, walls, flooring, ceiling, fireplaces, kitchen, and bath(s)."

[3] § 2695.183(a)(5)(E).

[4] § 2695.183(a)(5)(G).

[5] The prohibited factors are: the land's resale value (§ 2695.183(c)); the amount or outstanding balance of any loan (*id.*); and a deduction for physical depreciation. § 2695.183(d).

[6] § 2695.183(g)(1); *see also* § 2695.183 (re: updated or revised estimates).

[7] § 2695.183(i).

[8] § 790.035.

Strict liability for use of third-party sources. Licensees are bound by the Method even if they rely upon information, data, or statistical methods obtained through third-party sources.

Annual updating. The Regulation requires licensees at least annually to update the "sources and methods" that they use to generate replacement-cost estimates. The updating requirement focuses on changes in the costs of reconstructing and rebuilding.

B. Insurance Code § 1749.85 did not grant the Commissioner the authority to promulgate the Regulation.

The Commissioner cites Insurance Code § 1749.85 as his authority to require licensees to use the Method when communicating replacement-cost estimates to customers. But that statute is inapplicable on its face.

Paragraph (a) concerns insurance-producer training programs and has no bearing on the Commissioner's authority to issue the Regulation.

Paragraphs (b), (c), and (d) must be considered together. Paragraph (b) creates a general rule that people who fall outside seven identified categories are not authorized to estimate replacement values or to explain the level of coverage provided by a homeowner's policy. Specifically, paragraph (b) states that "[a] person who is not an insurer underwriter or actuary or other person identified by the insurer, or a licensed fire and casualty broker-agent, personal lines broker-agent, contractor, or architect ***shall not estimate*** the replacement value of a structure, ***or explain*** various ***levels of coverage*** under a homeowners' insurance policy."[9]

But in paragraph (c), the Legislature created three specific exceptions to paragraph (b)'s prohibition against estimating replacement value: "This section shall not be construed to preclude ***licensed appraisers***, contractors and architects from estimating replacement value of a structure."[10]

Finally, in paragraph (d), the statute singles out one of those three specific exceptions—licensed appraisers—as being potentially subject to a future Insurance Department regulation that "establishes the standards" for estimating replacement value. The paragraph states: "[I]f the

[9] Emphases added.

[10] Emphases added.

Department of Insurance, by adopting a regulation, establishes standards for the calculation of estimates of replacement value of a structure ***by appraisers***, then on and after the effective date of the regulation ***a real estate appraiser's*** estimate of replacement value shall be calculated in accordance with the regulation."[11]

At most, then, § 1749.85 acknowledges that the Department either has or may in the future be granted statutory authority to regulate replacement-cost estimates by "appraisers." The Legislature certainly knew how to identify other types of professionals—*i.e.*, "insurer underwriter or actuary or other person identified by the insurer, or a licensed fire and casualty broker-agent, personal lines broker-agent, contractor, or architect"—but pointedly excluded them all from paragraph (d). Thus, the Court should not read the word "appraisers" in paragraph (d) as including any other types of professionals.[12]

This reading of the statute also accords with the legislative history, which explains that § 1749.85(d) was enacted specifically to restore the power of appraisers to perform replacement-costs estimates, after a recent change in the law had stripped them of that power.[13]

C. The UIPA did not grant the Commissioner the authority to issue the Regulation.

The Commissioner likewise errs in citing § 790.03 of the UIPA as the source of his authority to issue the Regulation.

The UIPA represents California's attempt to fill the regulatory obligations left to the States by the federal McCarran-Ferguson Act. *See* § 790. The heart of the UIPA is § 790.02, which states that "[n]o person shall engage in this State in any trade practice which is **[1]** ***defined in this article as***, or **[2]** ***determined pursuant to this article to be***, an unfair method of competition or an unfair or deceptive act or practice in the business of insurance."[14]

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[11] Emphases added.

[12] The statute is unambiguous on this point, and there is accordingly no need to resort to canons of construction. But if there were some ambiguity, this would be a clear case for applying the canon *expressio unius est exclusio alterius*, which holds that, "where exceptions to a general rule are specified by statute, other exceptions are not to be implied or presumed." *People v. Quiroz*, 199 Cal. App. 4th 1123, 1130 (2011) (internal quotation marks and citation omitted).

[13] *See* P-082 to -083.

[14] Emphases and bracketed numbers added.

Thus, there are only two ways that an act or practice can fall within the UIPA's proscription: (1) if it is expressly "define[d]" as unfair or deceptive in the UIPA, or (2) if it has been "determined pursuant to [the UIPA] to be" unfair or deceptive. As discussed below, neither way applies here.

1. The UIPA does not "define" any particular use of the phrase "replacement-cost estimate" as being unfair or deceptive.

Section 790.03—entitled "Prohibited Acts"—is the UIPA provision that defines which unfair and deceptive acts or practices fall within the UIPA's proscription. The Commissioner claims to have derived authority for the Regulation from § 790.03(b),[15] which states:

> The following are hereby defined as . . . unfair or deceptive acts or practices in the business of insurance. . . .
>
> (b) Making . . . any statement . . . with respect to the business of insurance . . . which is . . . misleading, and which is known, or which by the exercise of reasonable care should be known, to be . . . ***misleading***.[16]

On its face, § 790.03(b) does ***not*** "define" any particular use of the phrase "replacement-cost estimate" as being a "misleading" statement. The Commissioner argues, however, that the Regulation is an exercise of his power to "clarify" what the statutory term "misleading" means, as used in § 790.03(b). Indeed, the Commissioner asserts that it is "***inherently misleading***" to describe an estimate as a "replacement-cost estimate" unless that estimate takes into account all of the 22 factors identified in the Regulation.[17]

Thus, the Commissioner's reliance on § 790.03(b) stands or falls on whether it is plausible to assert that it is "misleading" to describe an estimate as "replacement cost" if it was generated by any means other than the Method. But that argument is ***not*** plausible—and the Commissioner implicitly concedes as much. Repeatedly, his opposition observes that the Regulation neither

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[15] The Commissioner's opposition states that paragraph (b) is the part of § 790.03 that on which he relies for authority (*see* Opp. at 1); and paragraph (j) of the Regulation tracks the language of § 790.03(b).

[16] Emphasis added.

[17] P-031. In response to the plaintiffs' constitutional arguments, the Commissioner likewise asserts "a substantial interest in policing a regulated industry—insurance—to make sure that no false, misleading, or deceptive practices take place in determining the scope of coverage and what is being insured." Opp. at 15.

requires nor assures that a replacement-cost estimate will be accurate:

> The requirements for a replacement cost estimate that are set forth in [the Regulation] are quite modest: The [Regulation does] not require . . . any particular degree of ***accuracy*** . . . .[18]
>
> The [R]egulation imposes no substantive requirement to the effect that the estimate must turn out to be ***accurate***. Inaccurate estimates of replacement cost, in and of themselves, are not violations of the [R]egulation unless it turns out that when the licensee estimated replacement cost he failed to consider one or more of the cost elements known to be part of the cost of replacing the structure in question . . . .[19]
>
> The plaintiffs are well aware that the [R]egulation does not require that the replacement cost estimates be ***accurate*** . . . .[20]

The Commissioner fails to explain how the statutory term "misleading" is clarified by a regulation that concededly does not require or result in accurate replacement-cost estimates. Instead, he effectively concedes that ***standardization***—not accuracy or objective "truth"—is the true aim of the Regulation. Specifically, he argues that the Regulation is necessary in order to standardize the meaning of the phrase "replacement-cost estimate" so that insurance producers and consumers will have at least some shared understanding of what the term means:

> Without providing a uniform definition of the term "estimate of replacement cost," consumers have no way of determining what the licensee means when the term is communicated to them. By providing a uniform definition for the term, the regulation ensures that insureds and consumers are placed on a level playing field and can understand what a communicated "estimate of replacement cost" includes.[21]
>
> [The Regulation ensures that a]ll insurance carriers providing information relating to "estimate of replace[ment] cost" are acting on a level playing field by requiring that certain items be included within that term.[22]

But this argument fails to demonstrate that § 790.03(b) granted the Commissioner

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[18] Opp. at 10 (emphasis added).

[19] Opp. at 10 (emphasis added).

[20] Opp. at 10 (emphasis added).

[21] Opp. at 6.

[22] Opp. at 15.

authority to issue the Regulation. To the contrary: the Commissioner's attempt to standardize the definition of the phrase "replacement-cost estimate" suggests that using other definitions cannot be "inherently misleading"—because there is no widely shared understanding of what that phrase means.

To be "inherently misleading," a statement must have some widely shared meaning that would lead a reasonable listener astray in circumstances where that meaning fails to describe the facts accurately. By contrast, a statement with no agreed-upon meaning cannot mislead. For example, the statement "this is a 'total make-whole' insurance policy" would not be "misleading" because it has no widely shared meaning. (Make who whole? Whole for what? What does "whole" mean?) Likewise, the statement "this is a replacement-cost estimate" is not "misleading" because it has no widely shared meaning. (Replace what? Cost of what? Calculated how? As of when?) Indeed, that very lack of any widely shared meaning is what impelled the Commissioner to impose a standardized meaning by administrative fiat.[23]

Because the phrase "replacement-cost estimate" lacked any widely shared meaning, use of that phrase couldn't have been deemed "misleading" until ***after*** the Commissioner imposed a uniform meaning on it and then declared it "misleading" to depart from that meaning when using the phrase.[24] But the Commissioner cannot manufacture his own statutory authority by engaging

[23] Relatedly: Standardizing the definition of the phrase "replacement-cost estimate" is not the same thing as clarifying the meaning of the statutory term "misleading" in § 790.03(b). Thus, it makes no sense to assert, as the Commissioner does, that "[b]y providing a uniform definition for the term 'estimate of cost of replacement' the [R]egulation is merely interpretative of the underlying statues [sic]; Insurance Code sections 790 and 790.03. [The Regulation] merely provides clarification as to what a false, misleading or deceptive practice consists of." Opp. at 13.

[24] Although IBA West does not address the Regulation's merits, it is telling that the Commissioner mounts almost no substantive defense of the Method enshrined in the Regulation. Instead, he proffers a convoluted and inadequate sort of "estoppel" argument that, during the rulemaking process, the plaintiffs and others never "suggest[ed] that a replacement cost estimate that did not contain all the ingredients [specified by the Regulation] was not inherently misleading." Opp. at 7. As the plaintiffs point out, that assertion is false. The Commissioner received numerous comments during the rulemaking process to the effect that his specification of required factors was unwarranted or unwise.

in circular, "bootstrap" arguments. That is, he cannot invent his own, unique definition of "replacement-cost estimate," declare it to be the only one that is not "inherently misleading" even though the phrase has no widely shared meaning, and then claim that he is making that declaration pursuant to his authority to ban misleading statements. Yet the Commissioner's opposition brief does exactly that by arguing, for example, that "the [R]egulation itself states that failure to comply with the 'estimate of replacement cost' definition contained with[in] the [R]egulation is a misleading and deceptive practice violative of Insurance Code § 790.03(b)."[25] In other words (argues the Commissioner), the Regulation ***must*** be a proper exercise of the power to ban misleading statements under § 790.03(b)—because "the [R]egulation itself" says so.

Moreover, it is questionable whether any use of the phrase "replacement-cost estimate" could be "inherently misleading," as the Commissioner contends, when the word "estimate" itself is a tip-off that we are dealing in a realm of uncertainty and opinion. California courts understand the subjective and debatable quality of such estimates and therefore have held that, "[w]here the parties rely on expert opinions, even a substantial disparity in estimates for the scope and cost of repairs does not, by itself, suggest [that] the insurer acted in bad faith." *Fraley v. Allstate Ins. Co.*, 81 Cal. App. 4th 1282, 1293 (2000).

IBA West takes no position here on whether the Legislature should craft and impose a standard definition of the phrase "replacement-cost estimate" in the field of homeowner's insurance, or alternatively, whether the Legislature can and should enact a law authorizing the Commissioner to do so. But the Legislature has done neither of those things so far; and until it does, the Commissioner cannot unilaterally impose such a definition by invoking his authority to "clarify" the meaning of the term "misleading" in § 790.03(b).

In circular fashion, the Commissioner also argues that, "[i]f all of the relevant elements and components necessary to calculate an estimate or replacement cost are not considered, the use of the term 'replacement' is inherently misleading. It leads an applicant or insured to expect that the estimate was based on all of the necessary components . . . ." Opp. at 7. But what components are "necessary"? The ones listed in the Regulation, apparently. And why does the Regulation list them? Because they are necessary. The Commissioner relies entirely on this echo-chamber logic to justify its Method, and cites no evidence that the phrase "replacement-cost estimate" has a widely shared meaning that incorporates that Method.

[25] Opp. at 6.

2. Prior to issuing the Regulation, the Commissioner never "determined pursuant to" § 790.06 of the UIPA that it is unfair or deceptive to use the phrase "replacement-cost estimate" to describe any estimate not based on the Method.

As previously mentioned, if the UIPA does not expressly define an act or practice as unfair or deceptive, the only other way that that act or practice can fall within the UIPA's proscription is if it has been "determined" to be unfair or deceptive "pursuant to" the provisions of the UIPA.[26] But that never happened here.

Section 790.06 sets out a specific procedure for "determining whether" "any [insurance-related] . . . act or practice . . . that is not defined in Section 790.03" "should be declared to be unfair or deceptive within the meaning of [the UIPA]." The procedure requires the Commissioner to serve an order to show cause upon one or more persons believed to be engaging in such conduct.[27] A hearing conducted in accordance with the Administrative Procedure Act must be held on at least 30 days' notice, after which the Commissioner may serve upon the accused person a report declaring the act or practice to be unfair or deceptive.[28] If that person does not halt the act or practice within 30 days, the Commissioner may petition the superior court for an injunction.[29]

The § 790.06 procedure is the sole and exclusive means by which a practice not "defined" as unfair and deceptive by § 790.03 can be "determined" to be so by the Commissioner "pursuant to" the UIPA. The procedure that the Legislature set forth in § 790.06 ensures that determinations of new unfair and deceptive practices will be grounded in the fully developed factual record of an adversarial proceeding. Any other definitions of unfair or deceptive practices must issue from the Legislature.

The Commissioner concedes that he never invoked the § 790.06 process before issuing the Regulation. The Regulation, in effect, "determined" that a practice that was not defined in § 790.03 was unfair and deceptive within the meaning of the UIPA. But the Commissioner did

[26] § 790.

[27] *See* § 790.06(a).

[28] *See id.*

[29] *See* § 790.06(b).

not make that determination "pursuant to" the UIPA—that is, pursuant to the procedure that the Legislature provided in § 790.06. Had he done so, his determination would have been grounded in—and possibly significantly influenced by—a detailed factual record and adversarial arguments about the real-world practices that concerned him. He might have reached the only legally supportable conclusion—which is that it makes no sense to pluck a new definition of "replacement-cost estimate" out of the air and then declare that any other definition is unfair and deceptive, when there is no consensus on how such estimates should be performed.

III. CONCLUSION

Neither of the statutes cited by the Commissioner authorized him to issue the Regulation. Accordingly, the Court should grant the plaintiffs' Motion for Judgment on the Pleadings.

Dated: December 30, 2011

KEKER & VAN NEST LLP

By: Steve Hirsch
STEVEN A. HIRSCH

Attorneys for Amicus Curiae
Insurance Brokers and Agents of the West

1 PROOF OF SERVICE

2 I am employed in the City and County of San Francisco, State of California in the office of a
3 member of the bar of this court at whose direction the following service was made. I am over the age of eighteen years and not a party to the within action. My business address is Keker & Van
4 Nest LLP, 633 Battery Street, San Francisco, CA 94111-1809.

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16 Executed on December 30, 2011, at San Francisco, California.

17 I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

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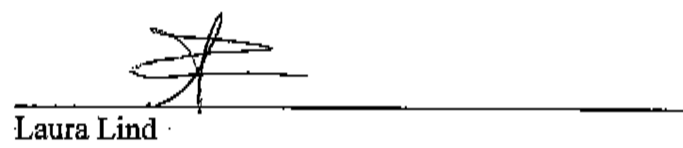
19 

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