PILLSBURY WINTHROP SHAW PITTMAN LLP
ROBERT C. PHELPS 106666
BENJAMIN L. WEBSTER 132230
400 Capitol Mall, Suite 1700
Sacramento, CA 95814-4419
Telephone: (916) 329-4700
Facsimile: (916) 441-3583

Attorneys for PERSONAL INSURANCE FEDERATION OF CALIFORNIA, ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES, and AMERICAN INSURANCE ASSOCIATION

BEFORE THE INSURANCE COMMISSIONER

OF THE STATE OF CALIFORNIA

In the Matter of Auto Body Repair Labor Rate Surveys; Title 10, California Code of Regulations, Chapter 5, Subchapter 9, Article 7, Section 2698.91 and Section 2698.92 [Proposed]	Regulation File No. RH05044654 COMMENTS OF THE PERSONAL INSURANCE FEDERATION OF CALIFORNIA, ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES, AND AMERICAN INSURANCE ASSOCIATION IN OPPOSITION TO AUGUST 10, 2007 NOTICE OF SECOND AMENDMENT OF TEXT OF PROPOSED REGULATIONS Comment Deadline: August 27, 2006

TABLE OF CONTENTS

Page

Pursuant to the August 10, 2007 Notice of Second Amendment of Text of Proposed Regulations and Material Added to Rulemaking File ("Notice") by the California Department of Insurance (the "Department"), and California Government Code Section 11346.8, the PERSONAL INSURANCE FEDERATION OF CALIFORNIA ("PIFC"), the ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES ("ACIC"), and the AMERICAN INSURANCE ASSOCIATION ("AIA") (collectively, "Respondents")[1] submit the following comments objecting to the proposed adoption by the California Insurance Commissioner of Title 10, California Code of Regulations, Chapter 5, Subchapter 9, Article 7, Section 2698.91, entitled "Auto Body Repair Labor Rate Surveys," and Proposed Section 2698.92, entitled "Additional Standards for Auto Body Repair Labor Rate Surveys" (together, the "Proposal").

I. INTRODUCTION.

Enough is enough.

Even after the Office of Administrative Law ("OAL") issued its 15-page Decision of Disapproval on January 5, 2007 and spelled out a laundry list of serious deficiencies in the Department's September 2006 proposed Labor Rate Survey regulations, the Department has failed to address those issues and submitted yet another fatally flawed proposal that does not even begin to comply with the Administrative Procedure Act ("APA").

As explained in more detail below, the Department ignored most of the OAL's

---

[1] PIFC is a non-profit insurance trade association dedicated to representing its member companies' interest before governmental bodies, including the California Legislature, the Insurance Commissioner, and the California courts. PIFC's members include State Farm, Farmers, 21st Century Insurance Group, SAFECO, and Progressive. They specialize in personal lines insurance, primarily private passenger automobile and homeowners insurance, in California and elsewhere. PIFC's members account for almost 50 percent of all personal lines insurance premiums sold in California. ACIC is an affiliate of the Property Casualty Insurers Association of America ("PCI"), and represents more than 300 property/casualty insurance companies doing business in California, including 57.3 percent of personal auto insurance. PCI is composed of more than 1,000 member companies, representing the broadest cross-section of insurers of any national trade association. AIA is a national trade association representing 435 property/casualty insurers who write more than $120 billion in insurance premiums nationwide. AIA members provide all lines of insurance to California residents and businesses including auto, homeowners, commercial liability, and workers' compensation.

stated concerns, or, in some cases, proposed superficial changes that either failed to correct the identified problems or actually made them worse. For instance, the OAL criticized the Department's confusing proposed re-definition of "prevailing auto body rate" based on the higher of the mean or median rates determined by the survey, pointing out that this formula did not comply with the "clarity" requirements of the APA and, in light of this confusion, questioning the clarity of another proposed provision that "[n]othing in these regulations shall be construed to require an insurer to pay more than the reasonable amount necessary to perform workmanlike repairs." Section 2698.1(j). Instead of trying to come up with a clearer rate formula, the Department "responded" to this concern by simply deleting the proposed section providing for "reasonable" rates! By backing away from the fundamental principle that the proposed regulations will not require insurers to pay unreasonable amounts, the Department has demonstrated why this latest proposal is itself unreasonable and why it must be withdrawn.

The Department's seemingly endless series of attempts to use the two-sentence enabling statute (California Insurance Code ("CIC") Section 758(c)) as a springboard to set up an elaborate system of surveys, which will increase prices for insurers and consumers, should come to an end. If there is any need for any revision of the current regulatory structure, it should be brought about through constructive face-to-face discussions between interested parties rather than the hit-and-run process which has consumed the past two years.

II. BACKGROUND.

A. The underlying statutory scheme.

CIC Section 758(c) was passed by the California Legislature in 2000 and became effective on January 1, 2001. The statute states – in its entirety:

> Any insurer that conducts an auto body repair labor rate survey to determine and set a specified prevailing auto body rate in a specific area shall report the results of that survey to the department, which shall make the information available upon request. The survey information shall include the names and addresses of the auto body repair shops and the total number of shops surveyed.

CIC Section 758(c). In 2002, the Department issued regulations, seven sentences in length, to clarify and interpret this statute. California Code of Regulations, Title 10, Section 2698.91 (the "Regulations").[2] Under these current Regulations, a "survey" is "any gathering of information from auto body repair shops regarding what auto body repair labor rates the repair shops charge…." Regulations, .91(a). The Regulations define "prevailing auto body rate" to mean "the rate determined and set by an insurer as a result of conducting an auto body labor rate survey." Id., .91(b). See also id., .91(c)(4) (the prevailing rate is to be "established by the insurer"). This language is entirely consistent with the text of CIC Section 758(c), which states that an insurer may "determine and set" the prevailing rate.

Respondents have included the quotations in the preceding paragraph because the Department has completely lost sight of the underlying law and the provisions of Section .91 which are currently in effect. In fact, the Department has launched so many unsuccessful attempts to revise and enlarge the Regulations that the redline of the second amendment to the text in the Proposal compares (a) the latest draft to (b) the September 2006 proposal which was disapproved by the OAL in January; the text of the actual Regulations is nowhere to be found.[3] The Proposal states that the Department "has proposed text changes to Sections 2698.91 and 2698.92" (Proposal, p. 1), without even acknowledging that there is no such thing as "Section 2698.92" – despite the Department's multiple efforts to create such a new section, the text of the existing Regulations stops at the

---

[2] Further citations to the Regulations will be shortened to ".91" or, in the case of the proposed new Section 2698.92, ".92" for ease of reference.

[3] The tortuous procedural history of the Proposal began in July 2005, when the Department issued a notice of proposed revisions to Section .91 which consisted of 21 sentences and sought, among other things, to prevent insurers from using "any rate negotiated with members of its Direct Repair Program" in conducting the surveys. Respondents timely objected to this proposal, noting that excluding the use of negotiated discounts would lead to a false depiction of the market rates. In May 2006 the Department issued a so-called "Amendment" to the initial proposal, including further revisions and a brand new Section .92. Respondents again objected, the Department issued a further proposal in September 2006 (this time with more than 50 sentences, plus 110 new "Geographic Zones"), Respondents and numerous other parties again objected, the Department nevertheless submitted its proposal to the OAL, and the OAL issued its Decision of Disapproval in January 2007.

end of Section .91.

B. The OAL's January 2007 Decision of Disapproval.

The OAL's January 5, 2007 Decision of Disapproval of Regulatory Action (the "Disapproval") could not be more specific in its rejection of the Department's September 2006 proposal. "OAL disapproved the regulation because provisions of the regulation did not comply with the consistency, authority, reference, necessity, and clarity standards of the Administrative Procedure Act (APA) and for failure to comply with the procedural requirements of the APA." Disapproval, p. 1.

> The broad scope of this regulation immediately suggests the question of whether or not it violates section 11342.1…[,] a global statute designed to guard against regulatory over-reaching by a state agency…. Here the Department has taken a statute saying little more than 'if an insurer does a survey, it must report the results to the Department' and produced and exhaustive and prescriptive set of requirements for what is permitted and what is required in a survey.

Id., pp. 4-5 (emphasis added). Accordingly, the OAL deferred its ruling under Section 11342.1, stating that "the record before OAL is incomplete on this issue." Id., p. 5. In particular, "the Department has not adequately documented the authority for and necessity of many of the components of the proposed regulation to effectuate the purposes of IC 758." Id. The next ten pages of the Disapproval went into great detail about numerous provisions in the Department's September 2006 proposal that were described as improper, unclear, confusing, irrelevant, unnecessary, conclusory, and otherwise "in violation" of the APA.

C. Post-Disapproval activities by the Department.

In view of the "inadequate documentation in the rulemaking record," the OAL gave the Department 120 days "to modify the regulation and supplement the rulemaking record…." Id. On March 13, 2007, the Department issued a Notice of Second Amendment to the rulemaking, but one week later issued a "Rescission" of its own notice, noting that the OAL had "granted a 90 [day] extension to submit revised regulations." The 90-day extension came and went on June 18, 2007. Almost sixty days later (and more than seven months after the Disapproval), the Department issued its second "Notice of Second

Amendment of Text of Proposed Regulations and Material Added to Rulemaking File," dated August 10, 2007. In addition, to the further proposed revisions to Section .91 and proposed Section .92 – this time totaling more than 60 sentences in length – the Department added one one-page document to the rulemaking file: a report entitled "Minimum Recommended Requirements for a 'Class A' Collision Center," as published by the Collision Industry Conference in 2005. See Proposal, pp. 1-2.

III. THE PROPOSAL HAS EVEN MORE DEFICIENCIES THAN ANY OF ITS PREDECESSORS AND SHOULD BE WITHDRAWN BY THE DEPARTMENT.

A. The Department fails to address key concerns spelled out in the OAL Disapproval.

One would think that when the OAL rejects a proposed regulation and issues a point-by-point critique of the draft, any party intending to re-submit an amended proposal would try to revise the submission substantially and provide supplemental evidence to address each of the OAL's concerns, and do so in a timely fashion. But in this case, the Department submitted its "revised" Proposal months after the deadline articulated by the OAL, and made only minimal substantive revisions from the September 2006 draft which had been so severely criticized in the January 2007 Disapproval. Comparing the multitude of deficiencies spelled out in that decision with the minor modifications set forth in the current submission, it is obvious that the great bulk of the questions raised by the OAL remain unanswered in any meaningful way. Accordingly, the newest Proposal is in violation of the APA for virtually all of the same reasons already discussed in the Disapproval.

Perhaps the most troubling example of the improper response to the Disapproval decision (as mentioned in the Introduction above) is the way the Department "responded" to the OAL's concerns about the lack of clarity in the proposed rate formula – by leaving the confusing formula untouched but deleting the one provision that had reflected the realistic expectations of both carriers and consumers, i.e., proposed Section .91(j): "~~Nothing in these regulations shall be construed to require an insurer to pay more than the reasonable~~

~~amount necessary to perform workmanlike repairs~~."[4]

The Department used the same approach to side-step the OAL's criticism of another provision in the September 2006 proposal that "'[t]o be a statistically valid survey, the insurer must survey all known auto body repair shops' in the survey area. The rulemaking record provides no evidence demonstrating that a statistically valid survey cannot be accomplished by surveying fewer than 'all known' auto body repair shops in a given geographic area." Disapproval, p. 10. Instead of responding to the Disapproval with evidence about how to accomplish a statistically valid survey, the Proposal blithely deleted the clause "[t]o be a statistically valid survey," leaving intact the "all known auto body shops" requirement that triggered the OAL's criticism in the first place. See Proposal, proposed Section .92(c) ("~~To be a statistically valid survey, the~~ The insurer must survey all know auto body repair shops…."). With this proposed revision the Department is throwing away an important standard and replacing it with no standard at all.[5]

In a half-hearted attempt to shift the focus of its submission (and invoke the specter of "unfair" claims activities), the Department placed somewhat more emphasis in the Proposal on CIC Section 790.03(h), which "enumerates sixteen claims settlement practices that, when either knowingly committed on a single occasion, or performed with such

---

[4] The formula (set forth in proposed Section .92(g), as underscored in the Proposal) seeks to perpetuate the unreasonable and unworkable definition of "prevailing auto body rate" to mean "the greater of: (1) the mean average labor rate charged by auto body repair facilities in the specific geographic area or, (2) the rate, at or below which, the majority of surveyed shops charge in a specific geographic area" (emphasis added). By forcing insurers to follow the mean rather than the mode, the prevailing rate could be unfairly inflated by a small set of aberrant shops. Without the "reasonable" protection of Section .91(j) (which the Department now proposes to delete), there certainly would be situations where the prevailing rate as determined under the Proposal would be unreasonably high.

[5] The proposed requirement that insurers survey "all known" shops, without regard to statistical validity, and then file reports at least on an annual basis, would create a huge burden on the insurers and shops alike. Insurers would have to process hundreds of forms each year, consuming untold person-hours and gathering reams of redundant data. In particular, the 114 proposed "zones" would create an administrative nightmare (e.g., the zones as delineated in the Proposal do not necessarily bear any relation to information that is in the insurers' exiting claims systems). Carriers and auto body repair specialists need to focus on the work that they are in business for, unencumbered by excessive bureaucratic red tape.

frequency as to indicate a general business practice, are considered to be unfair claims settlement practices…." See Proposal, Section .91(a). However, this statute is not proper authority for the proposed regulatory revisions, because, as noted by the OAL, Section 790.03 "makes no reference to labor rate surveys and has no apparent relation to labor rate surveys." Disapproval, p. 6.[6] Although the pending Proposal mentions Section 790.03(h) in a newly-added prefatory statement, it makes no effort to respond to the OAL's statement that the statute has "no apparent relation" to the subject matter of the Proposal.

Indeed, the Department's typical response to the OAL's concerns is no response at all; the Proposal for all intents and purposes is simply a re-submission of the same provisions that were rejected by the OAL in connection with the September 2006 proposal. See, e.g., Disapproval section entitled "Compliance With Substantive Rulemaking Standards"; re Reference ("None of the cited statutes [cited as "Reference" in both proposals] addressed the subject matter of the proposed regulations") (p. 8); re Necessity ("the rulemaking record must contain information explaining the specific purpose of each provision of the regulation and explaining why each provision is required to carry out its purpose") (p. 10); re Clarity ("Should the Department resubmit this rulemaking file…it must ensure that each provision of the regulation is written or displayed so that the meaning of the regulation may be easily understood by those persons directly affected by them") (pp. 12-13).

In a rare attempt at responsiveness, the Department has included in the rulemaking file a copy of the one-page Collision Industry Conference report from 2005, which the Disapproval identified as missing from the record. See id., p. 13. However, this single document deals with just one narrow issue in the proposed Section .92. Significantly, the

---

[6] "An administrative regulation may not alter or amend a statute or enlarge or impair its scope." See "How to Influence State Government Rulemaking[;] A One-Day Class on the Administrative Procedure Act Process," October 6, 2006, by William L. Gausewitz, Director, and Michael McNamer, Senior Counsel, and cases cited therein (Communities for a Better Environment v. Cal. Resources Agency, 103 Cal. App. 4th 98, 108 (2002); Henning v. Div. of Occupational Saf. & Health, 219 Cal. App. 3d 747 (2002); Ontario Community Found., Inc. v. State Bd. of Equalization, 35 Cal. 3d 811 (1984); Yamaha Corp. v. State Bd. of Equalization, 19 Cal. 4th 1 (1998)).

Department has submitted no other evidence in the rulemaking record in response to the repeated requests in the Disapproval for additional information to supplement the "inadequate documentation" in the "incomplete…record." Id., p. 5 (emphasis added).

B. The Proposal fails to comply with the APA..

Aside from the Department's unwillingness or inability to respond to the OAL's Disapproval, the Proposal fails to meet the standards set forth in Government Code Section 11349.1. The latest version is more verbose and over-reaching than any of its many predecessors, and the Department cannot get around the fact that the only statute that mentions labor rate surveys (CIC Section 758) makes them optional and gives the insurer, not the Commissioner, the ability to determine whether and how to conduct them, and how to go about calculating the prevailing rate. The cornerstone of the Department's proposals for the past two years has been the indefensible position that the insurers should be prohibited from including discounted rates in the surveys, despite the fact that the vast majority of labor rates fit in this category. As the Respondents stated in their Comments relating to the Department's first proposal in July 2005 (and in all subsequent submissions), such a limited approach would result in an invalid survey and increased rates harmful to insurers and their insureds. In particular, the Proposal's requirement that the rate must be the higher of the mean and median rates is insupportable for multiple reasons: e.g., there is no authority or necessity for the provision, and it is incurably unclear.[7]

The most obvious addition to the Proposal is the "rebuttable presumption" that an insurer whose labor rate survey complies with Section .91 and proposed Section .92 "has offered an adequate labor rate." See Proposal, proposed Section .92(a). While the Department may have thought that the notion of a "presumption" would placate the

---

[7] Although the Proposal does not expressly "require" insurers to conduct labor rate surveys, the message "between the lines" appears to be that an insurer who has not conducted its own survey, and complied with each and every requirement of proposed Section .92, will be hung out to dry in any rate dispute. This ignores the fact that many insurers have devised their own reasonable surveys as provided by CIC Section 758(c), as well as the availability and validity of data that can be gathered by highly reputable estimate platform companies based on rates actually paid in California.

insurers, as long as the labor rate survey has to comply with the Proposal – and cannot take into consideration the discounted rates that most body shops offer – the imposition of any presumption (rebuttable or irrebuttable) would do nothing to alleviate the insurers' concerns that costs will rise for the industry and for consumers. Indeed, Respondents submit that the additional "objective" set forth in the Proposal, "To promote the good faith, prompt, efficient and equitable settlement of claims on a cost effective basis" (Proposal, Section .91(a)(3)), can never be achieved as long as the Department's formula for conducting the surveys is skewed in favor of the higher-priced shops.[8]

III. CONCLUSION.

For the foregoing reasons, Respondents respectfully request that the Proposal be withdrawn in its entirety. Indeed, because the Department's current "revised" draft is so similar to the September 2006 proposal which was resoundingly rejected in the January 2007 Disapproval, this Proposal would be rejected on similar grounds if it were ever re-submitted to the OAL. Respondents reserve the right to supplement these comments, and to rely upon points raised in any comments submitted by any of their member companies or other respondents. Respondents also remain willing to discuss potential issues of concern with the Department upon the withdrawal of the Proposal and/or upon receipt of an explanation of what issues are in need of resolution.

[8] Respondents are mindful that the Department has not requested comments on "unchanged portions" of the regulations. However, because several provisions in the Proposal have been "changed" (e.g., moved from one section to another section of the draft, or re-worded), Respondents request that their Comments and supporting evidence timely submitted to the Department on October 24, 2006 be incorporated into this record in connection with the pending Proposal.

Dated: August 27, 2007.

PILLSBURY WINTHROP SHAW PITTMAN LLP
ROBERT C. PHELPS
BENJAMIN L. WEBSTER
400 Capitol Mall, Suite 1700
Sacramento, CA 95814-4419

By _____
Robert C. Phelps

Attorneys for PERSONAL INSURANCE FEDERATION OF CALIFORNIA, ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES, and AMERICAN INSURANCE ASSOCIATION