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PIFC

STATE FARM
FARMERS
LIBERTY MUTUAL GROUP
PROGRESSIVE
ALLSTATE
MERCURY

Re: Notice of Amendment of Text of Regulations
Standards for Repair and Use of Aftermarket Parts, (REG-2011-00024)

Dear Ms. Campbell:

On behalf of the members of the Personal Insurance Federation of California (PIFC), we appreciate the opportunity to offer these written comments to the California Department of Insurance ("Department") regarding the above-mentioned amendments to the proposed regulations ("the Proposed Regulations").

The PIFC members represent six of the nation's largest insurance companies (State Farm, Farmers, Liberty Mutual Group, Progressive, Allstate and Mercury) which collectively write a majority of the personal lines auto insurance in California.

The National Association of Mutual Insurance Companies (NAMIC) a national trade association, who has over 100 property and casualty insurance company members writing property/casualty insurance in the state of California, has specifically requested that the CDI record reflect that NAMIC expressly agrees with the comments and concerns tendered by PIFC in this written submission of comments.

**SUMMARY**

We appreciate the Department's continued willingness to engage in dialogue about the Proposed Regulations. This latest draft contains important improvements, for which we are grateful.

These changes reduce, but do not eliminate, significant practical problems. If not further amended, the Proposed Regulations would allow auto repair facilities to force the use of more expensive crash parts provided by the original auto manufacturers, which would only serve to increase their ability to impose monopoly pricing upon insurance consumers. Use of original equipment manufacturer (OEM) crash parts is appropriate in some circumstances, but is often not necessary when a cost-effective, safe, non-OEM alternative crash part is available.

PIFC does not believe that the Proposed Regulations would appropriately balance the perceived competing concerns of high-quality repairs with cost containment. The rule-making file contains no justification for imposing higher costs upon California insurance consumers. The "consumer complaints" in the rule-making file are orchestrated by a handful of auto repair shops which would like to base their estimates on more expensive OEM parts. However, there is no demonstrated pattern of aftermarket parts harming consumers or any litigation results which cast doubt upon the fitness of aftermarket parts as a safe and economical alternative to more expensive OEM parts.

Further, as currently drafted and amended, the Proposed Regulations would fail to recognize a number of basic realities of the marketplace. Insurers do not mandate, manufacture, replace or otherwise interact in a legally-significant way with repair parts. Instead, insurers maintain a contractual relationship with their insureds to return vehicles to pre-loss condition. Case law supports the proposition that insurers are not within the stream of commerce and do not incur an obligation to warrant any particular part under the Uniform Commercial Code, Article 2 (beyond the statutory obligation to ensure that repair parts are of like kind, quality, fit, and performance as OEM parts, so as to fulfill the contractual obligation).

We remain concerned that the Proposed Regulations would alter twenty year old regulations to unjustly enrich repairers while unfairly placing burdens and costs onto consumers. While we understand and appreciate the idea of ensuring that non-OEM parts usage is held accountable to a standardized level of performance, the Proposed Regulations would interfere with insurer vendor relationship management and add a layer of complexity to the loss adjustment processes that will only lead to increased costs.

The proposal is, furthermore, discriminatory in that it would impact consumers differently depending on their method of payment. Under the Proposed Regulations, auto repairers would repair "owner paid" vehicles without restrictive and burdensome/non-competitive methods, while holding “insurer paid” repairs to a different standard and higher cost.

In sum, with the amendments, the PIFC member companies continue to be concerned that the Proposed Regulations would not comply with the “authority,” “necessity,” “clarity,” and “consistency” standards set forth in Government Code Section 11349.1.

**Authority**

The Department has no authority to adopt the Proposed Regulations. An administrative officer or body may not make a rule or regulation altering or enlarging terms of legislative enactment. *Cullinan v. McColgan,* 80 Cal.App2d 976 (1947). Administrative regulations that alter or amend a statute or enlarge or impair its scope are void. *Pulaski v. California Occupational Safety and Health Standards Board,* 75 Cal.App.4th 1315 (1999).

The Proposed Regulations revise the Department’s “authority” section to refer to Insurance Code Section 790.03 as a whole, rather than 790.03(h)(3). We can only assume this change was in response to the recent ALJ Opinion (OAH NO. 2011090887, Attached) which places appropriate limits on the Department’s ability to expand its power beyond the explicit limits of 790.03(h)(3). The ALJ Opinion makes clear that the Department cannot create new unfair practices in addition to the sixteen (16) specific unfair practices identified by the Legislature. Rather, if the Department believes a particular insurer auto repair practice is unfair, it has two choices: 1) either petition the Legislature for additional authority, or 2) cite that specific conduct as appropriate for a hearing under Insurance Code Section 790.06. The Proposed Regulations take a third, unlawful, path, which is to redefine by regulation current insurer conduct as illegal even though this conduct has ensued for decades without the Department ever pursuing a legislative change or commencing a 790.06 hearing.

Rather, the Proposed Regulations do exactly what the ALJ Opinion says the Department cannot do: use regulations to redefine currently lawful behavior beyond the scope of 790.03(h). In the Proposed Regulations, the Department would attempt to regulate the claims estimate and repair process in a way that the ALJ Opinion noted as improperly creating “additional standards and guidelines and prohibited practices added exclusively by regulatory action of the Department.” In the ALJ Opinion, the Judge states repeatedly that the Department cannot attempt to augment the prohibited practices in (h), as this can only occur through legislative mandate or the Department following the process set out by the Legislature in section 790.06. The Department may not “unilaterally alter, rewrite or relax [790.03 (h)] under the guise of “interpretation” via Regulations”. “ [A]ny

additional purportedly unlawful settlement practice is necessarily prohibited, unless the process set forth in Section 790.06 is followed, or the Legislature added it itself."

Per the ALJ Opinion, the Legislature "preempted the Department from using the process of adopting 'interpretive' regulations as an alternative to following the section 790.06 process." The Judge concluded the Department's current claims regulations provided a litany of "best practices" that could provide a "safe harbor," but the Department cannot unilaterally redefine current, legitimate insurer conduct in a manner exclusively reserved to the Legislature.

While the Department unquestionably has the authority to implement regulations to further the explicit provisions of Insurance Code Section 790, the Proposed Regulations far exceed the explicit provisions of 790.03(h) as well as the "reasonable" standard of Insurance Section 790.10, which is not an invitation for the Department to create new unfair practices or to convert perfectly lawful insurer conduct that has ensued for decades into an unfair practice.

**Necessity**

There is simply no compelling evidence of a need for this regulatory scheme and the Proposed Regulations are not reasonably necessary to effectuate the meaning of any statute. We know that national and internal surveys of our customers consistently reflect a high degree of satisfaction with all aspects of the repair process. Therefore, since September of 2011, when the Department began discussions with the industry on the Proposed Regulations, we consistently asked for evidence of valid consumer complaints that justify the need for the regulations. Even after the CDI made available its rulemaking file in August, 2011, we still fail to see the need for the Proposed Regulations. Our review indicates that the vast majority of the "complaints" in the rule-making file are not from consumers but rather repair shops who are dissatisfied with payments from insurers.

Further, the Department never revealed the results from its 2009 joint investigation with the California Department of Justice on this very same subject. This investigation consumed an inordinate amount of time of many parties, including the Department, repair shops and insurers; to date, we are unaware of any findings of problems that would necessitate the Proposed Regulations.

The Department has maintained the authority to investigate complaints of improper repairs and hold accountable insurers who violate the law. In the past, the Department has investigated complaints put forward by the automobile repair shops and has either found no violation of the law or has, on rare occasions, fined or otherwise dealt with those insurers who have violated the existing regulations. Necessity requires a showing of substantial evidence of the need for the regulation to effectuate the purpose of the statute that the regulation implements. Evidence includes, but is not limited to, facts, studies, and expert opinion. The Department has provided no documentation of the deficiency in the existing regulations and the corresponding need for the Proposed Regulations.

Furthermore, the Department has failed to address in its record the full extent of the economic impact the Proposed Regulations would have on the multiple players in the marketplace. In addition to the substantial implementation and systems costs that the Proposed Regulations (§2695.8(f)(3)) would place on insurers during the repair estimation process, the Regulations would likely lead to substantial, negative marketplace changes. Insurers unwilling to specify non-OEM replacement parts because of the difficulty of complying with the Proposed Regulations would face significantly higher repairs costs, which would lead to higher insurance rates for California consumers. The Government Code requires that these economic impacts be identified and addressed by the agency seeking to promulgate the Regulations. The Department has thus far failed to demonstrate consideration of this requirement.

**Clarity**

Clarity, as defined in Government Code Section 11349 (c), means written or displayed so that the meaning of the regulations will be easily understood by those persons directly affected by them. There are provisions of the Proposed Regulations that are still unclear. For example, the new proposed changes to Section 2695.8(g)(6):

(6) if an insurer specifying the use of non-original equipment manufacturer replacement crash parts has knowledge that the part is not equal to the original equipment manufacturer part in terms of kind, quality, safety, fit, and performance, or does not otherwise comply with this section, shall immediately cease requiring the use of the part and shall, within thirty (30) calendar days, notify the distributor of the non-compliant aspect of the part.

How are insurers supposed to know when a part is "not equal to the original equipment manufacturer part?" Will it receive a notice from a single auto repair shop? A certain threshold of complaints from multiple repair shops? Or even the part manufacturer itself? As insurers do not repair vehicles, there is no direct knowledge of defective parts and insurers must therefore rely on some third party to obtain "knowledge." How would an insurer have "knowledge?" Would a self-interested auto repair shop that wants the added revenue of basing its estimate on a more expensive OEM part be able to deem all non-OEM parts as "not equal?" Would a trial lawyer be able to make this declaration? Would an OEM part manufacturer interested in selling more OEM parts be able to put an insurer "on notice" that a competitive non-OEM part is no longer permissible?

Further, what is the standard of proof for something being conclusively deemed "not equal to the original equipment manufacturer part?" Even if a third party notifies an insurer that a part is "not equal," what are the standards of due process for determining whether the notification is pointing out a real problem? OEM parts have a demonstrated failure rate as well, but the Proposed Regulations do not attempt to regulate OEM part failures in a manner to cut off their use. Is the Department or some other governmental entity going to declare non-OEM parts as deficient, and trigger this regulation? How does the Department intend on enforcing the Proposed Regulation if it doesn't give an insurer any reasonable standard for knowing when it has violated the rules?

If a repair shop has difficulty with a particular non-OEM part, should the repair shop first be required to obtain a replacement part from the same non-OEM manufacturer, or does a single problem with a single part then "infect" every similar part made by that non-OEM manufacturer? Certainly, the Proposed Regulation should focus upon the specific part and lot number and contain safeguards against repair shops "gaming the system." Too many times, the repair shops substitute parts and then complain about the quality. For example, one PIFC member only uses Certified Auto Parts Association (CAPA) parts in repairs. In 2010, they specified more CAPA parts on estimates than CAPA actually distributed in the entire U.S. – meaning that shops must have switched out the CAPA parts and not installed them. Without specific information about an alleged defective part, a repair shop could game the system, resulting in more use of OEM parts, driving up the costs of repairs. If there is no consistent way to delineate the part was defective or a process to make the determination, how would the insurer know whether it was just the one part or all of those parts from that supplier? The regulations should recognize the role of the manufacturers, distributors and certifying entities in the marketplace. It is not the role of the insurance industry to perform quality assurance on these parts, especially since there is rampant part switching. Distributors and certifiers have channels for repair shops to report quality problems and both provide for part tracking.

**Consistency**

Agencies do not have discretion to promulgate regulations that are inconsistent with the governing statute, or that alter or amend the statute or enlarge its scope. *Slocum v. State Bd. Of Equalization,* 134 Cal.App.4th 969 (2005). There is no agency discretion to promulgate a regulation which is inconsistent with the governing statute. *Pulaski v. California Occupational Safety and Health Standards Board,* 75 Cal.App.4th 1315 (1999). When a state agency is authorized by law to adopt regulations to implement, interpret, make specific or otherwise carry out provisions of a statute, no regulation adopted is valid or effective unless consistent and not in conflict with the statute and reasonably necessary to effectuate purpose of the statute. *Rosas v. Montgomery,* 10 Cal.App3d 77 (1970).

Proposed section 2695.8(g)(7) is inconsistent with Business and Professions Code Section 9875.1. In this proposed regulation, the Department would create a "warranty" obligation of an insurer to a body shop that is not found in California statute:

> (7) in the repair of a particular vehicle, an insurer specifying the use of a non-original equipment manufacturer replacement crash part that is not equal to the original equipment manufacturer parts in terms of kind, quality, safety, fit, and performance, or does not otherwise comply with this section, shall pay for the costs associated with returning the part and the cost to remove and replace the non-original equipment manufacturer part with a compliant non-original equipment manufacturer part or an original equipment manufacturer part;

Not only does the Department lack the authority to require this type of reimbursement to a body shop, the language is clearly inconsistent with Business and Professions Code Section 9875.1, which already provides for a disclosure that the warranty obligations related to a non-OEM part are not provided by the OEM manufacturer:

> No insurer shall require the use of nonoriginal equipment manufacturer aftermarket crash parts in the repair of an insured's motor vehicle, unless the consumer is advised in a written estimate of the use of nonoriginal equipment manufacturer aftermarket crash parts before repairs are made. In all instances where nonoriginal equipment manufacturer aftermarket crash parts are intended for use by an insurer:
>
> (a)The written estimate shall clearly identify each such part with the name of its nonoriginal equipment manufacturer or distributor.
>
> (b) A disclosure document containing the following information in 10-point type or larger type shall be attached to the insured's copy of the estimate: "This estimate has been prepared based on the use of crash parts supplied by a source other than the manufacturer of your motor vehicle. Any warranties applicable to these replacement parts are provided by the manufacturer or distributor of the parts, rather than by the original manufacturer of your vehicle."

In the Proposed Regulations, the Department has taken these disclosure obligations related to non-OEM parts from a twenty year old statute and created a completely new "warranty" obligation for insurers. In the absence of the Department's Proposed Regulations, the market already sufficiently addresses the warranty issue. When a part is faulty, in any way, the repair shop contacts the part distributer (whether it is an OEM part or an aftermarket part) and has them replace the part or, if necessary, provide alternate restitution to the problem. Repair shop warranties, part manufacturer warranties, insurance contracts and customer service/competition

already address the warranty issue in the market today and no new regulations are necessary. The Proposed Regulations add an extra and unnecessary layer that will result in inefficiencies and increased costs. We fail to understand the need for the Department to "protect" body shop owners while increasing costs to California insurance consumers. This body shop protection requirement is inconsistent with existing law and should be eliminated.

**Other Issues of Concern**

*Repair Standards: Scope of Repair and Estimating Software*

The current draft contains improvements to proposed Section 2695.8(f), related to repair standards. PIFC members companies are grateful that the CDI has heard concerns about the previous version of proposal.

While we acknowledge the Department's changes to this section, we continue to have concerns that the proposed language presumes that a repair shop is the ultimate authority as to the scope of the repairs. The Proposed Regulations reference service specifications that are written for all OEM parts and for operations and repairs that are not completed in the real world. The language *"An insurer shall not prepare an estimate that deviates from the standards, costs, and/or guidelines provided by the third-party automobile collision repair estimating software used by the insurer to prepare the estimate…"* does not allow for repair issues that are not encapsulated into estimating software (i.e., paintless dent repair, sublet work, glass, partial refinishing, etc). We would also like to point out, as the Department heard in testimony at both its workshop and its formal rulemaking hearing from the estimating company representatives, that estimating software is not intended to be used as a conclusive standard. Also, the new language does not specify who decides if the deviation is allowable or not allowable.

Additionally, we believe that the repair standards referenced would sometimes exceed an insurer's contractual obligation to repair a vehicle to pre-existing condition, which the Department cannot alter absent a significant showing. The Proposed Regulations do not reflect constitutional protections ensuring that insurers bear no responsibility beyond their contractual obligations. There are several commonplace examples that show where a standard repair, while perhaps appropriate for the situation, should not be a covered cost in the estimate. For example: for a vehicle with unevenly worn/balding tires due to wear and tear on front ball joints, the covered damage is "curb rash" to a wheel and an alignment from a crash. Alignment would not fix worn ball joints and the vehicle would be misaligned shortly thereafter creating a potential safety issue. Ball joint replacement is not owed by the insurer, but the shop would likely feel they need to repair it to do a "standard repair." This scenario illustrates how pre-existing damage (not covered under an insurer's policy contract) is in conflict with the Proposed Regulations. In those scenarios, the claimant is responsible to pay the difference and the Proposed Regulations cannot force an insurer to pay extra-contractual liability. The Proposed Regulations should be drafted to be consistent with this commonplace occurrence.

*Suggested Changes*

To fix the Proposed Regulations, we respectfully request the following additional changes to Section 2695.8 (f), to read:

> (f) If a partial loss~~es are~~ is settled on the basis of a written estimate prepared by or for the insurer, the insurer shall supply the claimant with a copy of the estimate upon which the settlement is based. The estimate prepared by or for the insurer shall be of an amount which will allow for repairs **of covered damage** to be made in accordance with accepted trade standards for good and workmanlike

automotive repairs by an "auto body repair shop" as defined in section 9889.51 of the Business and Professions Code, and in accordance with the standards of automotive repair required of auto body repair shops, as described in the Business and Professions Code, and associated regulations, including but not limited to Section 3365 of the California Code of Regulations, Title 16, Division 33, Chapter 1, Article 8. ~~No insurer shall willfully depart from or disregard accepted trade standards for good and workmanlike repair in the preparation of claim settlement offers or estimates prepared by or for the insurer~~. An insurer shall not prepare an estimate **for repairs of covered damage** that ~~is less favorable to the claimant than~~ deviates from the standards, costs, and/or guidelines provided by the third-party automobile collision repair estimating software used by the insurer to prepare the estimate, if such deviation would result in an estimate that would not allow for repairs to be made in accordance with accepted trade standards for good and workmanlike automotive repairs by an auto body repair shop, as described in this section (f). ~~a workmanlike manner~~. **The insurer is not responsible to pay to repair damage not covered by the insurance contract.** If the claimant subsequently contends, based upon a written estimate which he or she obtains, that necessary repairs **for covered damage** will exceed the written estimate prepared by or for the insurer, the insurer shall:

*Estimating Process*

Section 2695.8(f) (3) would require insurers to provide a copy of the estimate to the repair shop. It also requires:

"The adjusted estimate provided to the claimant and repair shop shall be either an edited copy of the claimant's repair shop estimate or a supplemental estimate based on the itemized copy of the claimant's repair shop estimate. The adjusted estimate shall identify the specific adjustment made to each item and the cost associated with each adjustment made to the claimant's shop's estimate."

Utilizing an edited copy of the repair shop estimate or a supplemental estimate to resolve differences unnecessarily disadvantages the estimate prepared by the insurer, which may be lower than what is recommended by the repair shop. It will have a deleterious impact on customer relations. It has the effect of making the repair shop's estimate the "starting point" (or point of accuracy) for making any adjustments. By doing so, the changes made by the insurer will be judged as the denial of segments of the loss. In reality, many of these changes would be audits to non-claimed damages, non-loss related damages and possible other over charges and unnecessary repairs and operations. To the consumer, the insurer's adjustments will look as if the insurer is somehow shortchanging the payments instead of stopping an overpayment or otherwise complying with the insurer's obligations under its contract.

PIFC would rectify this problem by amending the Proposed Regulation to allow insurer estimates, along with shop and supplemental estimates, to be provided to claimants to satisfy the notice demands of 2695.8(f)(3)—thus providing a greater balance between the repair shop and the insurer.

Amendments to FCSPRS Section 2695.8(g)(1)

A number of sections have removed "like" from "…kind, quality, safety, fit, etc." We recommend that the original language of "like kind, quality, safety, fit and performance" be added back into the sections where

it is not currently included. This is what is consistent with our current regulatory obligations and contractual language. Deviations from the original language open up new litigation avenues, whereas the current language has settled case law.

Amendments to FCSPRS Section 2695.8(g)(2)

We support the Department's decision to strike "inspections and tests" from the Proposed Regulations. We viewed this language as an unnecessary cost driver.

**Economic Impacts to the Marketplace**

While these draft amendments to the Proposed Regulations include important changes, they still have an impact on repairs paid for by the insurance industry and will have a dramatic economic impact upon California insurance consumers. They will cause an increase in the use of more costly OEM parts in repairs, which would lead to an increase in the number of vehicles which reach the dollar threshold at which vehicles are declared total losses. The ultimate effect could be substantial economic losses for the repair industry and increased costs to consumers (as well as many consumers being upset that they cannot "keep their car" after OEM parts repairs lead to a "total").

The Proposed Regulations place a burden on insurers to police the parts industry, which is clearly an inappropriate obligation. The Proposed Regulations also imply that auto repair shops do not use non-OEM parts when, in reality, they use them often; somehow, when an individual is paying out-of-pocket without an insurance policy, their auto repair shops are glad to have non-OEM alternatives that keep costs low and ensure they get the repair job. The parts companies and distributors currently pay for delays or problems, as well as provide warranties for their products. The Proposed Regulations would shift the responsibility to the insurers.

The Proposed Regulations imply that only those parts made by non-OEM manufacturers (as opposed to OEMs) have defects. It is common knowledge that both non-OEM and OEM parts are manufactured overseas, some often at the same plant. Why is there no similar requirement to notify with OEMs? Should there be the same protections for consumers regarding the use of OEMs? We believe that any regulatory protections should apply to both kinds of parts, rather than acceding to the well-publicized agenda of the organized auto repair industry and auto manufacturers that would like to increase the use of more expensive parts.

**Conclusion**

The Proposed Regulations do not meet the requirements of the Administrative Procedure Act. The Department has provided no public articulation of a public policy justification for such a radical shift to longstanding repair procedures. The Department has offered little evidence of specific and significant problems that the Proposed Regulations would address, other than those auto repair shops that would like the added revenue of basing their estimates on more expensive repair parts. The Proposed Regulations would create new repair standards that are unclear, inconsistent with existing law and unsupported by the Department's current statutory authority. Existing law provides the Department with sufficient authority to ensure high-quality repairs consistent with an insurer's contractual obligations; the Proposed Regulations are unnecessary.