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November 22, 2011

Teresa R. Campbell
California Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, California 94105
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Re: Prenotice public discussions regarding the contemplated revisions to California Code of Regulations, Title 10, Chapter 5, Subchapter 7.5, Article 1, sections 2695.8(f) and 2695.8(g) regarding standards of reasonable repairs and the use of non-OEM parts.

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 proposed regulations ("Regulations").

The PIFC members represent six of the nation's largest insurance companies (State Farm, Farmers, Liberty Mutual Group, Progressive, Allstate and Mercury) and one national trade association (National Association of Mutual Insurance Companies) who collectively write a majority of the personal line auto insurance in California.

BACKGROUND

On September 8th PIFC and other insurance trade associations met with senior staff at the Department to review a list of concerns voiced by some auto repair industry trade groups. Their issues included standards of repair, reasonable estimates, non-OEM parts, labor rate surveys, and steering. To better understand the source of their stated concerns, we pressed the CDI staff to determine if any of the issues raised were from actual consumer complaints versus complaints from the auto repair industry. While staff did indicate that they had consumer complaints, the number was not quantified, no specifics were provided, and the Department has not offered anything but anecdotal evidence of alleged

problematic insurer behavior during the auto repair process. In response to this, we asked for a reasonable opportunity to work on these issues before action is commenced, and indicated our interest in collaborating with the Department and the auto repair industry (as we have in the past) to examine the issues and explore improvements that are in the best interests of consumers.

SUMMARY

PIFC believes the Regulations do not comply with the "necessity", "authority", "clarity," and "consistency" requirements necessary to be approved by the Office of Administrative Law under the standards set forth in Government Code Section 11349.1. Any regulation a state agency adopts through the exercise of a quasi-legislative power delegated to the agency by statute is subject to the Administrative Procedures Act (APA) unless statutorily exempted or excluded. (Gov. Code, Sec. 11346). Since no exemption applies in this instance, the proposed regulatory actions must be in compliance with the "necessity, authority, clarity, consistency, reference and non-duplication standards" set forth in Government Code Section 11349.1(a).

The Regulations would take auto repair procedures and parts usage out of the free market and, instead, would force insurance companies to handle claims in a manner which favors automobile manufacturers and certain groups within the auto repair industry. The Regulations could lead to a regulatory monopoly for the automobile manufacturers and completely eliminate alternative parts from the marketplace in California. We are concerned that the Regulations would unjustly enrich one group while unfairly placing burdens and costs onto another group and its customers. While we understand and appreciate the idea of ensuring that non-OEM parts usage is held accountable to performance, the Regulations are an inappropriate use of the Department's authority, allowing the Department to interfere in vendor relationship management and adding 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 regulate consumers differently depending on their method of payment. Under the 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.

By attempting to pass the Regulation the Department has drifted into Legislative territory. The Legislature has already addressed oversight of "nonoriginal" part installation in the following statute:

CAL. BPC. CODE § 9875.1 : California Code - Section 9875.1

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."

With the introduction of these Regulations the Department has not only overstepped its role, but has exceeded the scope of its authority. The Regulations are, in any case, vague, unnecessary and will lead to the impairment of our insurance contract by forcing us to implement repairs not consistent with our existing contractual obligations to our customers.

Necessity

There is simply no compelling evidence of a need for this regulatory scheme and the regulations are not reasonably necessary to effectuate the meaning of any statute. The Department has not offered any evidence of consumer complaints that justify the need for the Regulations. The Department has 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 fined or otherwise dealt with those insurers who have violated the 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 need for these regulations. In fact, the latest JD Powers survey (*Auto-*

Owners Insurance Ranks Highest in Overall Satisfaction among Auto Insurance Claimants For a Fourth Consecutive Year, October 27, 2011) shows that consumers have a high degree of satisfaction with the repair process.

Authority

The department has no authority to adopt the 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). Leaving aside the question of whether the Department might, under any circumstances, have the authority to promulgate regulations impacting insurers' interactions with auto repair shops, the Regulations far exceed the "reasonable" standard in Section 790.10.

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. The Regulations, however, are fraught with a **lack** of clarity. For example, the proposed changes to Section 2695.8 (g) (6):

(6) insurers specifying the use of non-original equipment manufacturer replacement crash parts that are found to be defective, unsafe, or do not otherwise comply with this section, shall immediately cease requiring the use of these parts and shall notify the collision repair estimating software provider, or other estimating entity it contracts with, of the part and request this part be removed from the collision repair estimating software.

It is unclear how insurers would receive this information about a defective or unsafe part. Will it be a notice from the repairer or the manufacturer? As insurers do not repair vehicles, we have no direct knowledge of defective parts and rely on the auto repairer or manufacturer. Furthermore, what constitutes proof that a part is defective? 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? Additionally, why wouldn't the auto repair shop go to the part manufacturer themselves at the time of the discovery as opposed to relaying this to the insurer?

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).

Other Issues of Concern

Amendments to FCSPRS Section 2695.8 (f)

The terms and standards in section 2695.8(f) are unclear. For example, *"…in accordance with original equipment manufacturer service specifications…"*

The current specifications for most or all of the original equipment manufacturers (OEM) are to recommend only new OEM replacement parts for repairs. It is unclear how adding this language would benefit consumers. The OEMs do not write their specifications on what is best for the customer, but on what is best for the OEM. Each manufacturer may have a different set of standards on the exact same repair procedure for similar damage. The Regulations would create a system that is controlled by manufacturers who are incentivized to recommend more expensive OEM parts over affordable non-OEM parts. Is this really the goal of the Department--to enhance the OEM monopoly and prohibit others from competing in the marketplace?

Another example from this section includes: "…*service specifications that are generally accepted …"* This terminology is vague because, in the absence of clearly defined OEM service specifications, it is unknown who determines what "service specifications" are acceptable. Currently, insurers can follow the manufacturer, ICAR and/or ASE specifications.

Also in Section 2695.8(f) the phrase, "…*nationally distributed and periodically updated service specifications that are generally accepted by the autobody repair industry*," is also problematic. "Service specifications" are constantly changing. In fact, the Collision Industry Conference (CIC) is doing a feasibility study on this very subject right now – trying to determine a way to establish, distribute and validate the process/procedures of repair standards.

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. The adjusted estimate shall identify each adjustment 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 deemed necessary by the repair shop. It will have a tenuous 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.

Amendments to FCSPRS Section 2695.8(g)

The addition in Section 2695.8(g) (3) is unnecessary. It is already in existing regulations and clear to consumers that insurers stand by the repairs made to their vehicles.

Section 2695.8(g) (7) has apparently been added to address the issue of so called certified, "defective or unsafe" parts specified by insurers. While the concept may have merit, it is imprecise and fraught with legal and regulatory ramifications. The specific mention of the "*Certified Automotive Parts Association (CAPA)"* as the reporting entity creates an inappropriate

market advantage. We suggest that the filing of any "Quality Complaint Report" not be limited to any particular certifying entity.

The Regulations would have a detrimental effect on repairs paid for by the insurance industry. They would cause an increase in the use of more costly OEM parts in repairs which will lead to an increase in the number of vehicles which are declared to be total losses. The ultimate effect could be substantial economic losses for the repair industry as well as increased costs to consumers.

The Regulations place a burden on insurers to police the parts industry instead of making the auto shops accountable for the quality and oversight of the parts they install. The Regulations also imply that auto repair shops do not use non-OEM parts when, in reality, they use them often. The parts companies and distributors currently pay for delays or problems, as well as provide warranties for their products. These regulations would shift the responsibility to the insurers and take quality control away from the repair shops.

The Regulations imply that only those parts made by non-OEM manufacturers (as opposed to OEMs) are susceptible to 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? Shouldn't there be the same protections for consumers regarding the use of OEMs? We believe that the same standards should apply to all parts.

There is ambiguity in the Regulations with regard to motorcycles. In statute the definition of a private passenger auto includes a motorcycle. The use, availability, and even consumer acceptance of non-OEM parts for motorcycles is significantly different than auto. Non-OEM parts in the auto world generally means "aftermarket part," while for motorcycles it means an enhancement with a desirable accessory item (upgrade). We believe that the Regulations are meant to apply only to automobiles and therefore a clarification is necessary for motorcycles.

Conclusion

It is PIFC's position that the Department has failed to meet the requirements of the Administrative Procedure Act and has not succeeded in articulating the public policy justification for such a radical shift in repair procedures. The Department has offered no solid evidence of a specific problem the regulations would address, other than pressure from certain

automotive repair dealers over which they have no jurisdiction. It may be that the Department is attempting to create new repair standards with the Regulations, but they fail to meet the clarity requirements imposed by law and, as stated above, we would question the Department's authority to create such standards. We believe that the existing authority under the Fair Claims Settlement Regulations provide the Department with sufficient methods to appropriately penalize insurers who violate the law. PIFC respectfully requests that the Regulations be withdrawn.

Sincerely,

Michael Gunning
Vice President, Personal Insurance Federation of California

cc: Geoffrey Margolis, Deputy Commissioner
Michael R.O. Martinez, Deputy Commissioner