February 25, 2009

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Teresa Campbell
California Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, CA 94105
(415) 538-4126

RE: Regulation File: REG-2008-00036
Proposed Amendments to Title 10, Chapter 5, Subchapter 9 of the California Code of Regulations, new Article 7.5 Regulation Implementing and Interpreting Insurance Code 758.5

Dear Ms. Campbell:

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

For nearly a year, PIFC has participated in a small task force within the Department to discuss several issues related to auto body repair in California. This task force, convened to address allegations by the body shops of "capping" and "steering," as well as issues with labor rate surveys, was established by the Commissioner as a way to amicably resolve the disputed issues. The participants, including insurance trade and collision repair associations, were able to reach consensus on the issue of "capping," but have failed to date to agree on a resolution to allegations of unlawful labor rates and "steering."

We genuinely believed that the Department's task force would provide an opportunity to reopen discussions on the original steering statute (Insurance Code 758.5) and to reach a balance between the contractual and legal duty for insurers to explain the benefits of the insurance policy to claimants, while addressing body shop concerns that insurers are unlawfully coercing claimants to specific body shops. While the Department's task force may not have reached consensus on specific remedies, the Department, with the Proposed Regulations, has clearly gone beyond its authority in its efforts to craft a solution.

BACKGROUND

Insurance Code Section 758.5 became effective in 2004 following the passage of SB 551 (Speier). Upon its passage by the Senate, the author's office issued a press release stating, "The measure would eliminate the insurance industry practice of

'steering' auto body repair work. Steering occurs when an insurer prevents a consumer from having auto body repairs done at a repair shop preferred by the consumer."

While Section 758.5 empowers the Insurance Commissioner to prevent coercion of claimants in the selection of a specific auto repair shop, the law does not require or permit the Commissioner to stifle legitimate communication between insurers and claimants regarding auto repair choices or interfere with the lawful contractual relationship between an insurer and its policyholder, who necessarily relies upon the insurer's knowledge, expertise and experience with auto repair shops to assist him/her in the selection of a quality auto repair shop. Unfortunately, the Proposed Regulations would impose impermissible and unconstitutional restrictions on insurers' ability to provide truthful, non-deceptive information to claimants, well beyond the mandate of Insurance Code Section 758.5. The Proposed Regulation would hinder the ability of consumers to make informed choices, and attach new legal consequences to a claimant's uninformed and/or informal statements regarding selection of an auto repair shop. The only parties helped by the Proposed Regulations are those auto repair shops that desperately want to avoid any discussion of their inferior services or guarantees.

Additionally, Section 2698.93 of the Proposed Regulation could expose insurers to breach of contract and contractual bad faith claims for failing to provide policyholders with information about important contractual benefits that the policyholder is entitled to receive pursuant to the terms of the insurance policy. The Proposed Regulation would prevent insurers from being able to honor their responsibility to inform and educate their policyholders about benefits available to them, if the policyholder merely mentions that he/she is thinking of using shop "x" to repair his/her automobile. In effect, the Department's Proposed Regulation would prevent insurance policyholders from receiving contractual benefits they lawfully purchased.

SUMMARY

In its Initial Statement of Reasons, the Department states, "The Commissioner believes that the proposed regulation is necessary to implement, interpret, and make specific [Insurance Code] Section 758.5."

Section 758.5 contains three prohibitions relevant to the present rulemaking. Subsection (a) states that an insurer shall not "require" that an automobile be repaired at a "specific" automobile repair dealer. Subsection (b) states that the insurer shall not "suggest" or "recommend" an automobile be repaired at a "specific" automotive repair dealer unless a referral is expressly requested by the claimant or the claimant has been informed in writing of the right to select the automotive repair dealer. Subsection (c) provides that unless the claimant has expressly requested a referral, once the claimant has "chosen" an automotive repair dealer, the insurer shall not "suggest" or "recommend" that the claimant "select a different" automotive repair dealer. The Proposed Regulation goes beyond the scope of the underlying statute, enlarging its terms, purpose and legal

impact. The Proposed Regulations would impose restrictions well beyond applicable law while the Department has articulated no public necessity or clear standards for lawful conduct by insurers. Most importantly, the Proposed Regulation provides no consideration of the least intrusive method of regulating insurer speech in a manner that would balance the duel aims of prohibiting claimant coercion while ensuring claimants truthful, non-deceptive information that would aid in the choice of an auto repair dealer. While the Department clearly has struggled to implement a deficient statute, the Department should at least attempt to implement Section 758.5 in a constitutional manner.

The Department's Proposed Regulations fail several legal standards for promulgating regulations. For this reason, we strongly urge the Department to reconsider its proposed "steering" regulation and instead pursue a regulation that would balance the legitimate interests of prohibiting claimant coercion while preserving the ability of claimants to receive truthful, non-deceptive information regarding selection of an auto repair dealer.

THE PROPOSAL FAILS TO MEET THE STANDARDS SET FORTH IN GOVERNMENT CODE SECTION 11349.1.

NECESSITY

The Department has provided no statement of need for the proposed regulation. Government Code Section 11342.2 requires an administrative agency to adduce substantial evidence of the need for a regulation to effectuate the purpose of the statute that the regulation would implement. Evidence includes, but is not limited to, facts, studies, and expert opinion. The Department has offered no credible evidence of the need for proposed section 2698.93.

The Department's Initial Statement of Reasons merely provides that the proposed regulation would "reduce the conflict between insurance companies and automotive repair dealers in interpreting 758.5." Nowhere has the Department offered any evidence that the proposed rule is necessary to achieve the purposes of Section 758.5. Nowhere has the Department provided evidence of any insurer refusing to pay auto insurance claims depending upon which auto repair shop a claimant chooses. While there are certainly disputes with specific auto repair shops over their excessive billings, nowhere has the Department provided evidence that any insurer requires claimants to choose a specific auto body shop in violation of Section 758.5. At least if the Department presented some evidence of insurer coercion in the marketplace, responsible parties could discuss an appropriate approach for addressing such unlawful coercion.

To the contrary, the Department has offered testimony in the State Legislature that complaints by auto repair shops about "steering" are handled in the ordinary course of business. Testifying before a Senate committee in November 2005, CDI Deputy

Commissioner Tony Cignarale stated that the Department had investigated hundreds of allegations of insurer "steering" (a large percentage of which were submitted by one shop). Further, Mr. Cignarale noted that the Department was exercising ordinary enforcement powers regarding "steering" allegations. According to Mr. Cignarale, the fundamental problem was the Department's disagreement with the body shop activists' interpretation of the law (see attached transcript):

> "...many of the complaints that do come in regarding the labor rate, using posted labor rates, the insurance companies are saying they will guarantee the repairs in the DRP shop, but they won't guarantee it in the consumer's chosen shop. It will take us five to ten days to come out and do an inspection of the vehicle. If you go to a non DRP shop and....those are the three or four major areas that the body shops contend is, in fact, steering. All of those are required by either statute or regulation for the insurance company to do. So, if the Legislature wants to prohibit that, we don't necessarily oppose that, but in our interpretation of the statute and the associated regulations, many of the things that the body shops are contending are illegal and, in fact, are steering, based on the evidence that we do get from the shops and the documentation that we analyze, many of those things that do occur are, in fact, either permitted by law or required by law." (Senate Banking, Finance & Insurance Committee Oversight Hearing: Department of Insurance, November 21, 2005, Transcript, pg. 7-8).

Former Insurance Commissioner Garamendi testified further:

> "And you just heard from my staff that all of these complaints, all of them, are either under investigation, or have been investigated. And the issues in the older cases have been resolved. With regard to those cases that are under investigation, they're under investigation. Every one of them. Every one of these cases... But we have regulations. We have a longstanding interpretation on this. If you find, or anybody finds those interpretations, or those regulations, to be inappropriate, then please change the law. (Id. at 9)

While some activist auto repair shop owners have attempted to change current law to impose unconstitutional restrictions on insurers' commercial speech, their effort does not demonstrate a need for the Department to impose similar restrictions through regulation. The body shop owner efforts to change Insurance Code Section 758.5 stem from their desire to avoid any insurer discussion about the legitimate considerations claimants should bear in mind when selecting an auto repair shop, such as available guarantees of the work performed. Nothing in Section 758.5 prohibits such discussion. But certainly under Section 758.5, the Department maintains the authority to investigate

complaints of insurer coercion and hold accountable insurers who violate the Section 758.5.

We fail to understand how the Department's proposed regulations are needed. If the Department desires a change in the law to prohibit informed claimant choice of an auto repair shop, it should seek new *legislation* – not propose a new regulation without making the case the regulation is necessary under the existing law or stating any reason why the Department is unable to prevent insurer coercion absent this proposed regulation.

AUTHORITY

Leaving aside arguments about the possible facial invalidity of Section 758.5, proposed Section 2698.93 clearly exceeds the scope of the underlying statute upon which the Department claims its authority.

An administrative officer or body may not make a rule or regulation altering or enlarging terms of legislative enactment. *Cullinan v McColgan* 80 Cal.App.2d 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).

Government Code Section 11342.2 states, "Whenever by the express or implied terms of any statute a state agency has authority to adopt regulations to implement, interpret, make specific or otherwise carry out the provisions of the statute, *no regulation adopted is valid or effective unless consistent and not in conflict with the statute and reasonably necessary to effectuate the purpose of the statute."* (Emphasis added) An agency has no authority to promulgate a regulation that is inconsistent with controlling law. *Communities for a Better Environment v. California Resources Agency* 103 Cal.App.4th 98 (2002). The authority of an administrative agency to adopt regulations is limited by the enabling legislation. *Bearden v. Borax, Inc.* 138 Cal.App.4th 429 (2006). For administrative regulations to be valid, they must be consistent with the terms or intent of the authorizing statute. *Esberg v. Union Oil Co* 28 Cal.4th 262 (2002).

Section 758.5(c) prohibits an insurer from "suggesting" or "recommending" that a claimant should select a different automotive repair dealer after a claimant has "chosen" a body shop. The purpose of this statute is to ensure claimants can send their damaged vehicles to the body shops of choice. Whatever one might think about such a policy decision, the statute aims to prevent an insurer from coercing or bullying an insured to have a car repaired at a particular automotive repair dealer. The terms "suggest" and "recommend" are both active terms with meanings implying to "advocate" "urge" "advise" "propose" that the claimant "select a different automotive repair dealer." Nothing in the statute implies the intent to prohibit truthful, non-deceptive communication between an insurer and claimant, and/or the dissemination of consumer protection information to a claimant about the auto repair shop options and benefits available to them, even after a claimant has "chosen" an auto repair facility.

However, the Department's proposed regulation exceeds the purpose of Insurance Code Section 758.5, particularly in proposed Section 2698.93(d). This proposal would provide that once a claimant has "chosen" an auto repair facility, insurers would violate Section 758.5 merely by mentioning "the insurer's direct repair program," "the quality of the chosen automotive repair dealer" or "the quality of an automotive repair dealer other than the chosen dealer." Nothing in Insurance Code Section 758.5 requires or permits such restrictions on insurer communication, nor gives the Department authority to limit legitimate communication through regulation

In addition to the Proposed Regulation being inconsistent with Insurance Code Section 758.5, the Department's proposed Section 2698.93 is founded upon an illogical premise, i.e. that the mere transmittal of truthful and non-deceptive information to a claimant after a claimant has made an initial selection of an auto repair shop is, without any proof of undue influence or pressure, "per se" coercion.

The mere delivery of truthful and non-deceptive information is not coercive, in and of itself. If anything, the withholding of truthful and non-deceptive information necessary for a claimant to make an "informed" choice may be coercive, because it adversely impacts the claimant's ability to make a reasoned and rational decision as to which auto repair shop best addresses the consumer's needs. "Uninformed" consumer choice, which would be the result of the Proposed Regulation, is not "meaningful" consumer choice, which should be the purpose of any Department regulation.

While Insurance Code Section 758.5 would permit restrictions on coercive insurer communication, the statute does not prohibit truthful, non-deceptive information that empowers claimants to make informed choices. For instance, it may be permissible to stop an insurer from saying "you must choose among our preferred repair shops" or "don't pick that repair shop, you should pick this one." But the Department's Proposed Regulation goes well beyond such restrictions.

The Department's proposal would unlawfully prohibit an insurer from saying "you have the right to choose that repair shop, but have you confirmed your repair shop offers the same guarantees of performance and quality that are available from a repair shop in our direct repair program?" The Department's proposal would also prohibit an insurer from saying "did you know that your chosen auto repair shop has been cited by the California Bureau of Automotive Repair for violating consumer protection laws?" These latter statements which offer a truthful comparison or other factual statements intended to improve the ability of a claimant to make a choice about auto repair are wholly consistent with Section 758.5. Such statements are not unlawful coercion; rather they are appropriate statements of fact that help claimants. Nothing in Insurance Code Section 758.5 prohibits such statements.

By prohibiting such a helpful statement to claimants, the Department's Proposed

Regulation vastly extends and gives new meaning to the terms of the underlying statute. The Department has no authority to do so.

CLARITY

The Department's proposed regulations increase uncertainty about lawful insurer conduct, not clarify it. In its Initial Statement of Reasons, the Department states that the "specific purpose of this regulation is to *clarify* the type of information which can be disclosed by an insurance company to a claimant, and when the information may be disclosed." (Emphasis added). 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.

Proposed Section 2698.93 is the antithesis of clarity. Apparently recognizing that the restrictions in proposed Section 2698.93(d) are unduly broad and anti-consumer choice, the Department seemingly attempts to undermine the restrictions with "clarifying" language in Section 2698.93(e). Specifically, the Proposed Regulation states: "Nothing in this article restricts the ability of an insurer to explain contractual provisions of the insurance policy to the claimant, including the insurer's obligation to pay only costs that are reasonably necessary to restore the damaged vehicle to its pre-accident condition." There is no clarity to the insurer when trying to reconcile these provisions.

Proposed Section 2698.93(e) implies that Section 2698.93(d) is too broad but does not help an insurer to understand what conduct is lawful. Can an insurer say "your chosen body shop charges an hourly labor rate that exceeds commercial reasonableness, so we will only pay part of the repair bill? But, there are three other local repair shops in our direct repair program that have agreed to perform the work without making you pay an outstanding balance?" Such a statement would outline an insurer's contractual promise to pay an hourly rate appropriate for the local market area and appropriately inform a claimant that his or her "choice" will require them to make an out-of-pocket payment that is not necessary because of the presence of local alternatives. But, it is unclear whether proposed Section 2698.93(e) would protect such a statement from proposed Section 2698.93(d)'s restriction on mentioning an insurer's direct repair program.

We strongly urge the Department to forthrightly address the policy choices it is attempting to make rather than muddling the issues further. If the Department believes some regulatory clarification of Insurance Code Section 758.5 is necessary (a belief we do not share), then the Department ought to ensure that regulated insurers understand how to avoid future allegations of misconduct. Our member companies do not understand which restrictions in proposed Section 2698.93(d) would be modified by proposed Section 2698.93(e), and they certainly do not understand how they would

navigate through the mine field of how to explain truthful, non-deceptive information to claimants attempting to get their cars repaired.

Instead of creating regulatory uncertainty with a stretched interpretation of Insurance Code Section 758.5, we respectfully request that the Department provide an understandable basis for preventing insurer coercion of claimants while preserving the exchange of truthful, non-deceptive information between an insurer and a claimant.

CONSISTENCY

Section 11349 (d): "Consistency" means being in harmony with, and not in conflict with or contradictory to, existing statutes, court decisions, or other provisions of law.

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 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 statute and reasonably necessary to effectuate purpose of the statute. *Rosas v. Montgomery* 10 Cal.App3d 77 (1970).

Proposed Section 2698.93 is inconsistent with federal and state constitutional provisions that safeguard insurer commercial speech, including the California Constitution, Article I, Subsection 2(a).

In crafting proposed Section 2698.93, the Department has proposed regulations that would violate commercial free speech rights. The Department has argued that constitutional law arguments are not its concern because there is no California appellate court ruling that Insurance Code Section 758.5 is unconstitutional. This legal assertion is a victim of non sequitur logical reasoning because the mere fact that the underlying statute, Insurance Code Section 758.5, which is the stated authority for the Proposed Regulation, has yet to be declared by an appellate court to be facially unconstitutional does not mean that specific provisions of the Proposed Regulation in question are automatically constitutional. Taken to its extreme, this narrow-minded regulatory approach would allow the Department to issue rules interpreting California statutes in a way so as to outlaw religious freedoms, eliminate voting rights or impose countless other obviously unconstitutional abrogations of guaranteed rights. The Department is inviting a subsequent legal challenge should it persist in promulgating the regulation as proposed.

Administrative regulations that violate acts of the Legislature are void and no protestations that they are merely an exercise of administrative discretion can sanctify them. They must conform to the legislative will if we are to preserve an orderly system of government. *California Welfare Rights Organization v. Carleson* 4 Cal.3d 445 (1971); *Morris v. Williams* 67 Cal.2d 733 (1967).

A regulation of the State Board of Equalization, which precluded reducing real property value if actual market value reduction occurred after base assessment year, was contrary to the constitutional guaranty providing for taxation on fair market value, and was null and void. *State Bd. of Equalization v. Supervisors of San Diego County* 105 Cal.App.3d 813 (1980)

Nowhere has the Department attempted to balance the legitimate state interests in (a) preventing insurer coercion of a claimant's selection of an auto repair shop with (b) the guaranteed First Amendment Commercial Free Speech Rights of insurers to provide truthful, non-deceptive information to claimants that aid in their "choice" of an auto repair facility. This need for harmonizing state law with constitutional safeguards was squarely addressed in *Allstate Ins. Co. v. Abbott*, 495 Fed.3d 151 (5th Cir. 2007). In *Abbott*, the United States Court of Appeals, Fifth Circuit, relied on a long line of cases articulating the United States Constitution's First Amendment protection of truthful and non-deceptive commercial free speech to strike down a Texas statute. That case involved two questions related to automobile repair statutes – only one of which is relevant here. That provision, arguably less restrictive than proposed Section 2698.93, placed certain restrictions as to what an insurer could say in its marketing communications, i.e. recommendations to consumers about "tied" (insurer owned) shops over other "unaffiliated" repair facilities. In the *Abbott* Case, the Court affirmed the District Court's holding that the law at issue was an unconstitutional restriction upon an insurer's First Amendment Commercial Free Speech.

In applying the test articulated by the United States Supreme Court in the seminal case, *Central Hudson Gas & Electric Corp., v. Public Service Commission of New York,* 447 U.S. 557 (1980), for determining whether a regulation restraining commercial speech is constitutionally permissible, the court in *Abbott* first cleared the threshold issue: whether the commercial speech concerns unlawful activity or is misleading. Under *Central Hudson*, the court then must determine whether 1) the state has substantial interest in regulating speech; 2) the restriction on speech directly advances the state interest involved; and 3) the state's interest could be equally well served by a more limited restriction on free speech.

The *Abbott* Court, in applying the *Central Hudson* test, found the state had a legitimate interest in consumer protection and the promotion of fair competition, but found the state advanced no legitimate interest in preventing non-misleading and truthful referrals to a tied body shop. The *Abbott* Court opined that "consumers benefit from more, rather than less, information." (*Abbott, supra,* 495 F.3d at p. 167.) The Court went

on to say that a state "attempting to control the outcome of consumer decisions following such communications by restricting lawful speech is not an appropriate way to advance a state interest in protecting consumers." *Abbott, supra,* 495 F.3d at p. 167 citing *Thompson v. Western States Med Ctr.*, 535 U.S. 357, 374 (2002).

Ultimately, the *Abbott* Court found the State did not show that consumers benefit by restricting the truthful speech about the benefits of using a tied auto body repair shop. Quoting *Central Hudson*, the Court said "Commercial expression not only serves the economic interest of the speaker, but also assists consumers and furthers the societal interest in the fullest possible dissemination of information...People will perceive their own best interests if only they are well enough informed, and the best means to that end is to open the channels of communication rather than to close them." *Abbott, supra,* 495 F.3d at p. 167 citing *Central Hudson, supra,* 447 U.S. at 562.

Finally, the Court found that the commercial speech provisions were not narrowly tailored to meet the asserted state objectives and that the State failed to meet the burden of justifying the restriction. The court suggested there could be a more limited restriction such as disclosing the ownership relationship Allstate maintained, *or informing customers of the state's anti-steering law*.

Applying the *Central Hudson* test outlined in the *Abbott* case, the Department's proposed regulation fails to satisfy the constitutional law requirements necessary to support a lawful restriction of an insurer's right to engage in Commercial Free Speech. While the Department may argue a legitimate interest in consumer protection and the promotion of fair competition, as was the case in *Abbott*, the Department advances no legitimate interest in preventing non-misleading and truthful information to a claimant. An appropriate first step would be for the Department to outline what unlawful behavior it is seeking to regulate and then provide an analysis of why proposed Section 2698.93(d) is the least restrictive means of regulating the unlawful behavior. In particular, the open-ended *"includes but is not limited to..."* phrase in Section 2698.93(d) is uniquely unhelpful.

Instead of attempting to justify why proposed Section 2698.93 is consistent with commercial free speech rights, the Department has ignored the issue and failed to demonstrate any balancing of the interests involved. The Department has not even attempted to justify its proposed limitation on information to consumers about benefits and options available to them. The Legislature has made the policy decision that claimants should be protected from being required to use the carrier-chosen body shop. But what is the public policy benefit to the consumer if his or her own insurer is prohibited from communicating truthful, non-deceptive information that would help the consumer make a choice of body shop? The goal should be consumer choice – and isn't informed choice a better option for the consumer?

The stated purpose of, and therefore the regulatory authority derived from 758.5 to promulgate the Proposed Regulations, if it exists, is to protect consumers and their ability to freely choose an automotive repair dealer. Section 2698.93 deprives the consumer of truthful and beneficial information during the difficult time following an accident, while seeming to protect certain body shops - the group pressuring the Department for protection, a group not in fact regulated by the Department.

At a minimum, regardless of whether the underlying facial constitutionality of Section 758.5 has been determined by a California appellate court, the Department is required to craft regulations that include consideration of applicable guarantees of fundamental rights, including commercial free speech rights. The Department has utterly failed to examine how the Proposed Regulation would abridge fundamental rights of insurers and, for this failure to review consistency with applicable constitutional protections, the Department should withdraw its regulations pending further consideration.

For as the *Abbott* Court held, "[i]t is well established that the party seeking to uphold a restriction on commercial speech carries the burden of justifying it." *Abbott, supra,* 495 F.3d at p. 168, citing *Thompson, supra,* 535 U.S. at 373. The Department has failed to provide any justification for its unconstitutional speech restrictions.

We respectfully request that the Department provide a justification of how the Proposed Regulation satisfies the *Central Hudson* test before any regulation is implemented.

CONCLUSION

In putting forth Section 2698.93, the Department has failed to meet the requirements of the California Administrative Procedure Act. The Department has provided no argument for the necessity of its proposal and has acted contrary to its previous public legislative testimony indicating that it was dutifully implementing Insurance Code Section 758.5 without confusion. The Department has greatly enlarged the restrictions contemplated by Insurance Code Section 758.5. In doing so, the Department has crafted a savings provision in Section 2698.93(e) that makes rules for compliance more confusing than the current state of affairs. Lastly, the Department has ignored applicable constitutional protections for insurers with no argument about the public policy served. In short, the Department's regulations are unconstitutional, unnecessary, confusing and impermissibly exceed the scope of the governing law.

For the above reasons, PIFC strongly requests that the Department withdraw the Proposed Regulations and fundamentally re-think how it would implement the anti-coercion provisions of Insurance Code Section 758.5.

Sincerely,

Rex D. Frazier
President

Kimberley Dellinger
General Counsel

Attachment

Senate Banking, Finance and Insurance Committee
Oversight Hearing: Department of Insurance
November 21, 2005
10 a.m. to 3 p.m. Room 112

1. Opening Statements

    a. Chair
    b. Vice Chair
    c. Insurance Commissioner

2. Administration and Licensing Services

    a. Dennis Ward
    b. Witness

3. Enforcement Branch

    a. Dale Banda- Fraud
        i. Agent/broker enforcement actions
        i. Insurance fraud
    b. Witnesses

4. Consumer Services and Market Conduct Branch

    a. Tony Cignarale
        i. Auto body steering

    b. Joel Laucher
        i. 2003 wildfires and subsequent investigations
        ii. Unum-Provident

    c. Witnesses related to "a" and "b" above

5. Financial Surveillance

    a. Ramon Calderon

SENATE COMMITTEE ON BANKING, FINANCE & INSURANCE

Oversight Hearing: Department of Insurance

November 21, 2005
Sacramento, CA

Senator Jackie Speier, Chair

COMMISSIONER GARAMENDI: When we receive a complaint, we have a process that has been longstanding to investigate the complaint. If we find there is evidence that the complaint is valid and there is a breach of either the regulations or the law, then appropriate action has been taken. I'd like Tony to bring you up to date on where we are with these complaints and others of this kind. Tony.

MR. CIGNARLE: To date, we've received, over the last two years, about 600 complaints regarding labor rate surveys and the steering issue. Sixty percent have been filed by Mr. Crozat; another total of perhaps 80-90 percent has been filed by about six shops, out of the 4,000 that are licensed by the Bureau of Automotive Repair. We've investigated every single one of them. We've responded to every single one of them. The implication that there has been no response is not accurate. We communicate with Mr. Crozat on a weekly basis, if not a daily basis between him and his assistant, Elaine Saturday, between all telephone communication, all the letters that go back and forth between the department and Mr. Crozat. We're aware of his Geico....Mr. Crozat will file complaints on a two-month period, let's say, against a particular insurance company. For a couple of months it will be Farmers, and in a couple of months it will be the Auto Club, a couple of months it will be State Farm. As of about three or four months ago he began a complaint filing with the department regarding Geico. We're currently investigating all those complaints. He's received a letter from us regarding those complaints. We've contacted all of the consumers that are identified in those complaints. We've contacted Geico in every single one of those complaints. If we are able to find evidence of steering, or labor rate survey issues, we will take action. We have take three enforcement actions, to date, over the last....it was probably in the last three or four months against three different insurance companies. Each of those actions, two of them were specifically....the primary allegations in those complaints and those accusations are the labor rate survey issue and the steering issues. One was against Progressive; one was against Infinity; and one was against Mercury. We have a number of other cases in the works that we're looking at. At any point in time a case rises to the level of finding violations and putting together a case for our legal division, it will be sent up there. And we have a number of cases that we're looking at now.

I think one of the major issues though is the body shop industry, specifically Mr. Crozat and others have a different interpretation of the law. Specifically, almost all of Mr. Crozat's complaints and the

body shop's industry complaints, state as their primary allegation, the fact that the labor rate surveys are invalid or inaccurate because the surveys do not contain the posted labor rate of the body shops. We do not share that interpretation. And in fact, that is absolutely contrary to how we interpret the law.

CHAIR SPEIER: Wait, wait, wait. Let's stop there. So you're saying that a posted rate, I walk into a body shop and the posted rate is not the rate.
MR. CIGNARLE: Is not the rate that is required based on our interpretation of SB 1988, that enacted 758 of the Insurance Code regarding labor rate surveys. The primary reason for that is, during the course of the year 2000, when SB 1988 went through its amendment process, for example in the April 13th version of the SB 1988, it added the sentence that would have specifically required the posted labor rate to be used in the surveys. Obviously, the insurance industry opposed this amendment. In the June 15th amended version of the survey, that sentence was taken out, therefore, it was left silent.

We believe the legislative intent is that we cannot require the insurance companies to use the posted labor rate as their basis for their surveys. We believe that the prevailing rate, which we define as the rate actually charged by shops within a geographic area regardless of what they may post as their labor rate, is the rate that should be used in the insurer's surveys. And that is the primary basis for the great majority of the complaints filed by the body shops.

CHAIR SPEIER: Now the fact that 250 cases go to small claims court and 95 percent of them are upheld would suggest that judges, or an attorney serving as a judge, has reviewed the law and interpreted it in a manner, and it's consistent. It's case after case after case.

Now, Mr. Crozat is an unusual person who has the time and the energy and the craziness, excuse me for saying that, Mr. Crozat, but who would take that kind of energy and pursue it in court? Who has the time and the money to do that?

Now, you said most of your complaints have come from Mr. Crozat and 40 percent from a smaller group of others. You and I both know that there's a whole sea of auto body shop owners out there that are fearful of coming forward, because if they come forward, they will be blackballed, they will lose their business, and they can't afford it. So our job is to fix it so that no one has to be fearful about it and just do the right thing. No steering. It's real clear. It's real clear in the law.

MR. CIGNARLE: We acknowledge that.
CHAIR SPEIER: And this issue about the posted....just because it came out of the legislation doesn't mean....you know what the process is here. That's not necessarily legislative intent. That's about trying to get a bill through the process and getting it signed into law. It's then up to you and

the department to interpret that law and do what is fair and reasonable. Then why do we have posted rates at all? If they're not going to be used by anyone, why even require posted rates?

MR. CIGNARLE: I agree. We have interpreted it as I have described. That it does not require....these surveys do not require the posted rate to be used as the basis. If however, in a geographic area the shops as a rule charge their posted rate to customers, then obviously the posted rate and the labor rate used in the surveys, the margin will be greatly narrowed. But if the shops are charging much less money than what their posted rate is, then the prevailing rate which is in the statute, the prevailing rate charged by shops, that is how we interpret the statute, and that is how we've developed regulations...

CHAIR SPEIER: One last question and then Senator Cox has one. The law says that the car is to be returned to you in the pre-accident condition and that you have the right to take your car wherever you want and that any fair and reasonable charges will be paid. For all intents and purposes, that's what the law says. So, I take my car to G & C, my insurance company or the third party insurance company doesn't want to pay their rate, but it's a fair and reasonable rate. What should prevail? Shouldn't the fair and reasonable rate prevail regardless of whether the insurance company likes it or not? I mean, the differential between these two rates is $86, so it's $11 an hour differential. And if all these cases have gone to small claims court and a judge there has found that to be fair and reasonable, I mean, it's not just one case. We've got 250 cases here.

MR. CIGNARLE: We absolutely take into account the fact that a consumer or a body shop has gone to small claims court and been successful. However, while that may allow us to more intensely focus on an issue and ferret out whether in fact there was or was not violations, in itself it is not a violation by the mere fact that a body shop or a consumer was victorious in small claims court.

CHAIR SPEIER: Okay. But let's go back to the conduct of the adjuster/agent. Go ahead.

MR. CIGNARLE: I'm sorry.

CHAIR SPEIER: If we go back to the conduct of this agent, I'm sure you've seen these complaints from Mr. Crozat, correct?

MR. CIGNARLE: Yes, I have.

CHAIR SPEIER: So many of the same people are making the same statements over and over again to different consumers saying basically, "You can't go there. You've gotta go here." There's signed affidavits. At what point does the department say to this insurance agent, or this adjuster, that you're not following the law? Have you taken any action against any of these adjusters?

MR. CIGNARLE: With regards to the Geico case, no. We are in the process of investigating that issue. And if we are able to gather the evidence and show that there is a violation, we will prosecute them. And it would not necessarily be against the adjuster specifically, it would be against the insurance company that employs that adjuster, because I understand it's an employee of the insurance company.

CHAIR SPEIER: So, there's no standard that the adjuster has got to maintain separate from the insurance company. It's an action against the insurance company?

MR. CIGNARLE: He acts for the insurance company.

CHAIR SPEIER: He's an agent of the insurance company, so you go after the insurance company.

Actually, Senator Cox had a question.

SENATOR COX: I wanted to just talk about this labor rate survey for just a moment. And I've got three of four questions, Madam Chair, relative to this.

Talk to us about the labor rate survey. That's done by the department; it's done by the company; it's done based upon a region; the region is amalgamated; how was done, just for our edification?

MR. CIGNARLE: The insurance code statute requires that if an insurance company conducts a labor rate survey to determine and set a prevailing labor rate in a geographic area, that it must submit that survey to the Department of Insurance. And the Department of Insurance gathers those surveys and then makes that information available to the public upon its request.

SENATOR COX: All right. So, now then the question becomes about fair and reasonable. What goes into the labor rate survey, is it the contractual rate that the insurance company has....Mr. Crozat indicated that he has some contracts with some insurance companies. Is it that rate which is considered? What is the rate that is used?

MR. CIGNARLE: The rate that we believe should be used is the prevailing rate that is charged by the shops within a given geographic area. Not necessarily the posted rate, and not, specifically, the contracted rate because we believe the contracted rate to also be an unfairly discounted rate. So it's somewhere in between, and it's basically what we consider it to be in terms of whether it's accurate or not is, is the rates being charged by shops within the geographic area determined by the insurance companies.

SENATOR COX: So then it would be my understanding, based upon what you have said, that if the contracted rate, the body shop, it would be in their best interest to continue to raise their posted rate? It would be in their best interest to raise that.

MR. CIGNARLE: In our opinion it would have no effect on a valid survey because we would suggest that the posted rate is not used, and also the contracted rate. So, whether they raise their posted rate, it would only be applicable if they actually charged that higher posted rate to customers.

SENATOR COX: But then with respect to the prevailing rate, there is a situation of where that may very well be higher than the contracted rate?

MR. CIGNARLE: We would suggest that it should be. The contracted rate is a discounted rate that insurance companies contract with direct repair program shops for both their parts and labor.

SENATOR COX: Exactly. Kind of like a preferred provider organization.

MR. CIGNARLE: Correct. And therefore, our opinion is that those rates should not be included in these surveys performed.

SENATOR COX: Which rates should not be?

MR. CIGNARLE: The discounted contract rates should not be included in the surveys.

SENATOR COX: Well, and my question, and the question is why? I need to understand that.

MR. CIGNARLE: Why not?

SENATOR COX: Yes. The question is, why not?

MR. CIGNARLE: Because we believe that rate is a discounted rate and the consumer should not be harmed because all the policies essentially, as Senator Speier suggested, need to put you back in substantially the same condition of that vehicle. And the regulations require that the insurance company pay for the amount which will cause the vehicle to be repaired in a workman like manner. Now, that can vary.

If you go to a high end shop like, Mr. Crozat's, he's going to charge higher than perhaps the going rate or prevailing rate in that geographic area. Do consumers have a right to go to his shop? Absolutely. Does he have a right to charge that higher rate? Absolutely. The question that we look at is, whether the insurance company is required to pay that amount, or whether in making its offer

to the consumer, in essence, and to the shop, it has made a reasonable offer and what support did it provide in making that reasonable offer?

SENATOR COX: Is the reasonable and fair offer then, is that rate the prevailing rate?

MR. CIGNARLE: If the insurer has conducted a survey and has determined and set a prevailing rate in that geographic area, then in most cases the insurer will use that survey to suggest that is why we're setting that labor rate at, for example, $76 an hour. We believe that to be fair and reasonable, and that is the amount that we're going to pay, and any additional amount that Mr. Crozat or other shops may charge, the consumer could be out of pocket.

SENATOR COX: Well, let me tell where I'm going with this. Mr. Crozat presented a bill and said he wrote off $800 off of this bill. I don't see this anywhere on the document. But I'm just trying to figure, it would seem to me that Mr. Crozat always is going to have his bill higher and he's going to look at the prevailing rate and say, "That's less than I, in fact, am charging and therefore, I'm going to write off x-number of dollars for you." So, tell me how that fits into the picture.

MR. CIGNARLE: Well, I don't think it necessarily fits in because Mr. Crozat was charging higher than everybody else in the geographic area, or at least at the high end of that range prior to the survey law coming into effect. So he was always charging higher than the rest of the shops in that area.

SENATOR COX: All of the adjusters and/or insurance company direct writers who have direct claim service, are they all required to read from the script as to what the law is?

MR. CIGNARLE: Yes. At any point in time an insurance company makes a referral to a consumer, they're required to either send a verbatim by statute based on SB 551, notice to the consumer advising them that they have a right to have the vehicle repaired in the shop of their choice; that they have agreed to go with the shop recommended by the insurance company; and the requirement that I think causes some misunderstanding between the shops is that specifically it requires the insurance company to advise the consumer that they will warrant the repairs once they've agreed to the DRP shop. So, many of the complaints that do come in regarding the labor rate, using posted labor rates, the insurance company is saying they will guarantee the repairs in the DRP shop, but they won't guarantee it in the consumer's chosen shop. It will take us five to ten days to come out and do an inspection of the vehicle. If you go to a non DRP shop and....those are the three or four major areas that the body shops contend is, in fact, steering. All of those are required by either statute or regulation for the insurance company to do. So, if the Legislature wants to prohibit that, we don't necessarily oppose that, but in our interpretation of the statute and the associated regulations, many of the things that the body shops are contending are illegal and, in fact, are steering, based on the evidence that we do get from the shops and the documentation that

we analyze, many of those things that do occur are, in fact, either permitted by law or required by law.

SENATOR COX: Does the department from time to time verify that it's the script that's being used?

MR. CIGNARLE: Correct. Both when we receive an individual consumer complaint, we look at that, as well as in our market conduct examinations of the insurance company.

SENATOR COX: Okay.

CHAIR SPEIER: And you do that because all of those are taped conversations with the adjusters, are they?

MR. CIGNARLE: No.

CHAIR SPEIER: Well, have you ever listened to....any complaint that's come to you, have you then gone to the insurance company and said, "We want the tape of that individual and that conversation?" Have you done that?

MR. CIGNARLE: We've analyzed that request. I'm not able to comment as to whether we've done or not done that. Our legal counsel has looked at that along with our investigators, and I'm not able to comment on whether....if we have, in fact, done that, it would be an investigatory issue that I'm not able to comment on.

CHAIR SPEIER: Well, I guess my only point is this, my understanding is, they're all taped conversations. So, it is the clearest, quickest way to find out whether or not there's steerage by just subpoenaing the actual tapes and then reviewing those tapes. And the fact that that hasn't happened, is probably not a good reflection.

And I guess....you know what I worry about, Mr. Commissioner, I worry about a lot of class action suits being filed. That's where this is going. And I don't think the insurance companies want to see that. And I don't think that we want to see that. We just want to see people get their cars repaired and that they get payment.

COMMISSIONER GARAMENDI: Madam Chair, this conversation has gone on for some time and it seems to me as though there is a fundamental question of what the law is, and how it is to be put into effect. If you would like to clarify the law with a piece of legislation, we'd be happy to work with you on such clarification.

CHAIR SPEIER: I don't think it needs to be clarified.

COMMISSIONER GARAMENDI: But obviously from this conversation, there is a difference of opinion as to exactly what the law requires.
CHAIR SPEIER: Well, I guess I disagree with you. I think it's real clear. Geico, for instance, has not done a labor survey, so how can you possibly cap a rate if you haven't even had a labor survey. That's real clear in the law. You don't do a labor survey...
COMMISSIONER GARAMENDI: No, that's not where the lack of clarity is that I'm referring to. That, of course, is....

CHAIR SPEIER: Well, I'm talking about these Geico cases that I just referenced. Those are the ones that I was talking about.

COMMISSIONER GARAMENDI: And you just heard from my staff that all of these complaints, all of them, are either under investigation, or have been investigated. And the issue in the older cases have been resolved. With regard to those cases that are under investigation, they're under investigation. Everyone of them. Every one of these cases.

CHAIR SPEIER: But my understanding is, that in all of these cases, the only way the consumers were made whole was by going to small claims court, not by the Department of Insurance intervening.
COMMISSIONER GARAMENDI: This takes us to the ambiguity I was speaking to. The question that the small claims court dealt with the labor rate, and apparently the small claims court was not satisfied with the labor rate and required an additional payment to be made. That's fine. Now, if this goes to a superior court and we get a superior court decision, then we have to obey that. But we have regulations. We have a longstanding interpretations on this. If you find, or anybody finds those interpretations, or those regulations, to be inappropriate, then please change the law.

CHAIR SPEIER: All right. Mr. Cignarle, how much did Progressive pay?

MR. CIGNARLE: All three of those cases are currently scheduled for administrative hearing and they have not been settled or adjudicated at this point.

CHAIR SPEIER: So they actually haven't made any kind of....you've done market conduct...

MR. CIGNARLE: No. The pleadings have been filed and served against those three insurance companies. Once they're filed, a hearing is scheduled. The filings only occurred maybe 90 days ago, ballpark, and so the hearings are scheduled and there are settlement conferences, etc. going on.

CHAIR SPEIER: Okay. All right. Mr. Crozat, if you would close. And then there are some other people that want say…

MR. CROZAT: I have a few recommendations.

CHAIR SPEIER: All right.

MR. CROZAT: One, the Commissioner wanted to know what he could do about adjusters that walked in arbitrary…Penal Code 550(b), It is unlawful to do, or to knowingly assist or conspire with any person to do any of the following: To present, or cause to be presented, any written or oral statement as part of, or in support of, or in opposition, to a claim for payment or other benefits pursuant to an insurance policy knowing that the statement contains any false or misleading information concerning any material fact. Every person who violates paragraph 1, 2, 3, 4, or 5 of this subdivision is guilty of a felony and punishable by imprisonment in state prison for 2, 3, or 5 years and a fine not exceeding $50,000.

If you, Mr. Garamendi, want to stop adjusters walking in and taking money off the table and making our consumers in California pay it out of their pocket, implement this. This is the law. It's never been implemented.

So, what I recommend is, you change the ruling. The Department of Insurance is not going to fairly handle people taking surveys. I suggest through the Bureau of Automobile Repair, that every year when you submit your license, that you submit your posted labor rate—what you charge off the street.

Why should Geico get any better deal than you, Senator, when you're coming to get something done? Why are they a sacred cow that they get a better deal than you? Lowered rates are deals you make for….concessions you make for volume work sent to you for a discount, and that helps them save money. But when you don't have a deal with them, you don't owe them a deal. They shouldn't get any better deal than you. That's what they don't seem to understand.

CHAIR SPEIER: All right.

SENATOR COX: Just a question.

CHAIR SPEIER: Go ahead.

SENATOR COX: Mr. Crozat, let me just ask you a question. You've got three shops. You're doing pretty well for yourself, I understand.

MR. CROZAT: I don't know. I go home at midnight. That isn't pretty well.

SENATOR COX: I understand.

MR. CROZAT: But I go home at midnight and so does my wife. I see her once a week on Saturday.

SENATOR COX: I do the same thing. I didn't mean to get you into that particular situation.

MR. CROZAT: Okay. I just want to clarify.

CHAIR SPEIER: Maybe it's be design, is that what you're suggesting?

SENATOR COX: How many repairs do you do a month?

MR. CROZAT: Probably 600 repairs a month.

SENATOR COX: How many insurance companies do you have a preferred contract with?
MR. CROZAT: Probably a dozen.

SENATOR COX: How many major companies are in the marketplace in your judgment?

MR. CROZAT: Oh, I'd say 100, really. Maybe 50, really, in the marketplace.

SENATOR COX: And you do business with 12.

MR. CROZAT: I have discounted rates with 12.

SENATOR COX: You have a contract with 12.

MR. CROZAT: Right.

SENATOR COX: Is that 12, is that something that goes up and down?

MR. CROZAT: Sure, year to year. Their philosophy change; yours. You end some agreements, you take some on.

SENATOR COX: And so it's a situation of where that number fluctuates from time to time.

MR. CROZAT: Certainly.

SENATOR COX: Based upon what they pay. They decide that you're charging too much, or you want to much, or...

MR. CROZAT: Well, I've had some companies that stuck me at the same rate for six straight years. I finally had to say, "Look, my guys have families and wives that need insurance. I can't work for this anymore." They say, "Well, that's all we're going pay you."

Arrangements are dissolved because one side or the other doesn't like the agreement anymore.

SENATOR COX: I understand. And when a person comes into your shop, I just need to know for...

MR. CROZAT: Certainly. Anything you want to ask me.

SENATOR COX: When they come into your shop, do you say, "By the way, I do not have an agreement with XYZ Company, which is one of the 12, and my rate may or may not be higher than the insurance company," is there a notification on your part?

MR. CROZAT: I have it posted right in my shop. I ask them what the insurance company it is for, just for information. If it's one of my direct repair companies, I have certain people that write those sheets for those companies, therefore, I'll get someone out there to help them.
SENATOR COX: And just tell me whether or not you tell the customer that your bill may be higher than the insurance company pays you in the event that they're not one of the 12.

MR. CROZAT: Yes, I do. Right here.

SENATOR COX: That written statement, you give it to them.

MR. CROZAT: I give it to them and then I have them sign it.

SENATOR COX: And you have them sign it.

MR. CROZAT: I make up an estimate, I say this is what it's going to take to fix your car. Now, if the insurance company should take part of it, they don't want to pay....I've had insurance come on and say, "Mr. Crozat, you lassoed them." And Allen Woods, who is here, which I have hired, who used to be at the Bureau of Automobile Repair, and Moses Gomez, who is sitting in here, used to be the Bureau chief for fraud, who also works for me now, are working on these problems. And what I'm trying to say is, we as a garage, do everything we can to inform everybody, this is what will happen; and if it does; sign it; we'll call you and let you know what you're options are. That's why we've gone to court so much.

As afraid as people are of going to court, they're so angry. We had one woman who has flown out from the Midwest twice who moved. She's been to court five times with State Farm, and they keep taking her back to court for $300. Five times, and twice she's flown out from the Midwest, which we paid her flight.

SENATOR COX: You paid her flight to come out. So with respect to the small claims, I want to understand, tell me what role you play with respect to the small claims. Do you pay their filing fee?

MR. CROZAT: We explain to the customer what her...

SENATOR COX: Just explain it to me.

MR. CROZAT: I'm trying to. We explained to her what she can do. It's right here. It's very clear.

SENATOR COX: If you do small claims, do you, in fact, pay the filing fees?

MR. CROZAT: I don't know, as we sit here today. I didn't get some questions to answer that. I don't know if we do or not.

SENATOR COX: Okay.

MR. CROZAT: We assist them. We tell them, "Look, you go in and tell them you've had...

SENATOR COX: Do you send them with representation? He's trying to coach you, by the way...

MR. CROZAT: I don't need coaching at all. Go ahead.
SENATOR COX: So do you send someone with them?

MR. CROZAT: Of course we do. They're afraid. They're petrified. Have you ever gone up in church and given a speech? You can't even open your mouth up. They're petrified. I've got women 70-years-old in a wheelchair shaking in front of court, but they're so mad, they're willing to roll into court and say, "Why am I paying this out of my pocket?"

SENATOR COX: I'm not suggesting you're right or wrong. All I'm trying to do is gather information.

MR. CROZAT: The information, as we've said, if you want to pay the bill to us...

SENATOR COX: So you, in fact, send someone with them?

MR. CROZAT: Yes, we do. Of course we do.

SENATOR COX: Okay. All right. And then, does the insurance company show up for the small claims action?

MR. CROZAT: They do when they appeal it. When they lose. Sometimes a few of them, which I think mistakenly, appeal it, because it's showing, like this here, they're telling people they're going to have to pay a certain amount and it's $550, I read to you, when they do get sued for a pattern of action of telling their people they're going to have to pay this, when, in fact, they don't. That's fraud. That's why we do it.

SENATOR COX: All right. Okay. Thank you, Madam Chair.

CHAIR SPEIER: All right. The next witness.