Calif. Regulation Revival Boosts Home Coverage Confidence

Law360

The California Supreme Court's ruling Monday 2017) reviving the state insurance commissioner's challenged regulation aimed at producing more accurate insurer estimates of home replacement costs provides greater certainty for homeowners on property coverage and should reduce litigation between policyholders and carriers, experts say.

In a unanimous decision, the California high court found that Insurance Commissioner Dave Jones was within his authority to enact a new rule designed to stamp out insurers' alleged practice of providing incomplete home replacement cost estimates, leaving homeowners underinsured and unable to rebuild homes destroyed by wildfires.

"Where, as here, the Legislature uses open-ended language that implicates policy choices of the sort the agency is empowered to make, a court may find the Legislature delegated the task of interpreting or elaborating on the statutory text to the administrative agency," Justice Mariano-Florentino Cuellar wrote for the panel.

The decision flipped a California appeals court's April 2015 decision and revived the regulation, which was struck down by a trial court in 2013.

According to experts, the California justices' decision represents a broad endorsement of the insurance commissioner's power to regulate purportedly unfair or deceptive practices by insurers, even acts that aren't specifically listed in the state's insurance code. Policyholder advocates say the regulation restored by the high court's ruling should reduce the number of underinsured homeowners — and prevent post-loss litigation — by compelling carriers to generate more accurate replacement cost estimates upfront.

"This decision was a huge vindication and sigh of relief as you have the highest court in California

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acknowledging that the law hasn't reflected the reality of the marketplace, which is that insurers are underestimating home replacement values and giving people a false sense of security about the adequacy of their coverage," said Amy Bach, executive director of United Policyholders, a policyholder advocacy group that filed an amicus brief supporting Jones.

However, the two insurance groups that challenged the regulation, the Association of California Insurance Cos. and the Personal Insurance Federation of California, told Law360 in a statement that they "respectfully disagree" with the high court's opinion, which they characterized as "upholding the commissioner's overreach," adding that they believe the decision "does not accurately reflect the [California] Legislature's intent."

Hinshaw & Culbertson LLP partner Robert Hogeboom, who represented the Pacific Association of Domestic Insurance Cos. as an amicus in the case, said that the state high court's decision to allow the insurance commissioner to create all of the details regarding homeowners replacement estimates is an expansion of his regulation adoption authority under California Insurance Code Section 790.10. In addition, the apparent shift of power to the commissioner and away from the courts raises due process concerns for insurers, he said.

"With this decision, the commissioner has eliminated the ability of the industry to adjudicate cases to determine before a court whether his regulations are valid and to determine what a misleading statement may include in the context of homeowners replacement cost estimates," Hogeboom said. "Here, the commissioner has all the power to say that his regulations are the only way that an estimate may be lawfully issued."

The contested regulation lays out a specific process under which rebuilding estimates can be calculated or else potentially be considered misleading and open the insurer to enforcement actions. The rule was prompted by complaints by homeowners whose homes were destroyed in California firestorms but later discovered that their insurance policies didn't cover the entire costs of rebuilding, according to court documents.

Specifically, the regulation sets forth how insurers are to calculate and communicate to consumers the costs of rebuilding or replacing a home in its entirety, including the cost of labor, building materials and supplies, overhead and profit, demolition, debris removal, permits and architect's plans, according to court papers.

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The insurance industry groups brought suit to challenge the regulation, accusing the commissioner of overstepping his authority by broadening the definition of unfair or deceptive insurance practices. The groups further asserted that the rule improperly restricted their insurance underwriting activities and impeded their free speech rights under both state and federal law.

In May 2013, a trial judge ruled that the regulation was invalid, opining that although rebuilding estimates are inherently inaccurate, they are not de facto misleading. Jones did not have the authority to penalize acts that can't be determined through reasonable care to be misleading, the judge found.

A state appellate panel agreed, finding in an April 2015 opinion that the commissioner's investigatory power was limited to acts expressly forbidden by the Unfair Insurance Practices Act. According to the panel, if the nonconforming estimates were actually deceptive statements as Jones claimed, there would have been no need for his regulation since he would already have the means to issue cease-and-desist orders against insurers with allegedly low-ball estimates.

In Monday's opinion, the California Supreme Court axed the appellate panel's conclusion, holding that Jones' regulation of replacement cost estimates falls within the scope of his statutory authority to "promulgate reasonable rules and regulations" that are "necessary to administer" the UIPA. The high court found that the commissioner's development of a rule applying to a specific type of statement was authorized by California's broad statutory prohibition against false and misleading statements in the insurance business.

"The Supreme Court acknowledged that the [Department of Insurance] is particularly well-positioned to understand and address the problem the regulation is meant to cure," said Nossaman LLP partner Joan Cotkin. "The court noted the care with which the agency's interpretation was promulgated. The regulation was not just a sleight of hand. The DOI did its own comprehensive, independent investigation and determined a regulation was needed here."

Bach said that Jones' regulation is necessary to protect policyholders and ensure that home replacement estimates are as accurate as possible, pointing to intense competition among insurers.

"You simply cannot accurately calculate a home's replacement value in 15 minutes," Bach said. "When you leave features out, or fail to account for local conditions, the calculation is always going to be wrong. But with insurers competing to close the sale and consumers shopping for low price, that's how much

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time insurers generally put into setting home coverage limits. We need this regulation to prevent the chronic underestimating that leaves many disaster victims underinsured."

Barnes & Thornburg LLP partner David E. Wood, who also represents policyholders, said the California high court's ruling was essentially a rejection of insurers' efforts to deregulate the industry.

The insurance groups' challenge to Jones' regulation is a continuation of a strategy stretching back to 1945, when insurers succeeded in persuading Congress that only state legislatures should consider disputes over insurance law, according to Wood. Then, in 1988, insurers convinced the California Supreme Court to rule that only the state insurance commissioner can enforce regulations applying to the industry, Wood noted.

Here, though, the California high court rejected the insurance groups' argument that the commissioner's authority to regulate their conduct should be strictly limited to the precise acts outlined in the relevant section of the state insurance code.

"The [California Supreme Court] saw this gambit as what it was: an attempt by the insurance industry to reduce the commissioner's power, give them a free hand in operations in California and deregulate the insurance industry at the state level," Wood said.

Hogeboom, meanwhile, said that the high court's conclusion that the insurance commissioner can both adopt regulations to "make specific what the term 'misleading statement' means" and include "form and content" in the regulations that insurers must follow pushes the commissioner's power into the Legislature's territory.

"From the insurance industry's perspective, that is something the Legislature should be dealing with," he said.

At this point, it remains to be seen whether, and to what extent, Monday's decision will affect other cases in which regulations adopted under the UIPA have been invalidated by administrative or trial courts, attorneys say.

"The insurance industry would say, if a regulation goes beyond the scope of the statute, it is invalid," Hogeboom said. "Those cases are certainly going to be looked at more closely."

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The Association of California Insurance Cos. is represented by Theodore J. Boutrous Jr., Julian W. Poon, Vanessa C. Adriance and Jennafer M. Tryck of Gibson Dunn, and Gene Livington, Gregory Sperla and Stephen E. Paffrath of Greenberg Traurig LLP.

The government is represented by State Solicitor General Edward C. DuMont, Assistant Attorneys General Paul D. Gifford and Diane S. Shaw, Deputy State Solicitors General Janill L. Richards and Linda Berg Gándara, and Deputy Attorneys General W. Dean Freeman, Stephen Lew and Lisa W. Chao.

The case is Association of California Insurance Cos. et al. v. Dave Jones, case number S226529, in the Supreme Court of California.

–Editing by Christine Chun and Aaron Pelc.

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