Courts toss homeowners' insurance regulation

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A judge has thrown out a state regulation that insurers said allows the insurance commissioner to decide on his own what constitutes an unfair business practice — a designation that can carry severe penalties for companies and their agents.

Insurers said the court's decision was necessary to fix a deeply flawed regulation and suggested that the decision may have an impact beyond the issues relating to homeowners' coverage that spawned the lawsuit. The state's insurance regulator and consumer advocates said the rule protected consumers and stemmed from hundreds of complaints from homeowners who felt they had been misled by companies.

The crux of the case is a 2011 regulation that sets out a detailed, specific, written protocol that insurers must follow when communicating with a client or applicant about the replacement value of a home or structure.

Former Insurance Commissioner Steve Poizner's regulations tightly define how insurers can communicate with their customers when negotiating coverage, with the goal of ensuring that homeowners' protections were spelled and that people were aware of how much would be available to replace their homes if disaster struck.

Insurers complained that the formula was so rigid that it impeded accurate estimates, and that to depart from the formula left them open to accusations they were being misleading and deceptive.

The regulation's protocol "is based on their software, which is outdated. This regulation requires us to make bread but to only use one recipe. Even if we have a better software program, we can't use it," added Mark Sektnan, president of the Association of California Insurance Companies, a trade association that challenged the regulation along with the Personal Insurance Federation of California.

Backers of the rule said it had been long overdue.

"The Insurance Department was saying to insurers and their agents, 'You need to stop misleading people at the point of sale,' and the insurers came back and said 'You can't tell us what to do,' and the judge agreed with the insurers," said Amy Bach of United Policyholders, a San Francisco-based consumer advocacy group that helped draft the regulations.

Poizner's regulations and stemmed in part from wildfires that had ravaged California. Some property

owners complained that they were misled about the extent of their coverage when it came to replacing their homes.

“The regulation in question is very important because it was drafted in the wake of the San Diego and Oakland Hills wildfires, where it was discovered that homeowners were dramatically under-insured and that a significant number had gotten bad information about the level of insurance they required to replace their homes,” said state Insurance Commissioner Dave Jones, who supports the Poizner regulations.

“We respectfully disagree with the judge’s decision,” he said. “The regulation simply makes sure that homeowners are provided with complete, consistent and accurate calculations so they know how much insurance to buy.” Jones added that his office was “evaluating all of our options, including an appeal.”

The rules barred an insurance company or agent from giving any cost estimate to customer unless it was prepared and communicated in the specific, multiple-category procedure contained in the new rule. Insurers said the process blocked them from effectively communicating with a client or applicant in the event of a home’s total loss and properly calculating the dollars involved.

In his March 26 decision, Los Angeles Superior Court Judge Gregory Alarcon agreed, at least in part, saying the commissioner did not have the authority craft the rules to “define additional acts or practices as unfair or deceptive by regulation.” Establishing unfair or deceptive business practices, the judge said, requires a different process.

The problem, said attorney Gene Livingston of Greenberg Traurig, is that under the regulation, “there is only one way to calculate replacement cost and only one way to communicate it.”

“The regulation says to companies and agents, that in estimating the replacement value of a home or structure, you have to do it in accordance within the provisions of the regulation, and you have to communicate that information in writing. Any other communication about replacement value or replacement costs is deemed to be misleading untruthful and deceptive,” said Livingston, who represented the insurance industry in challenging the recommendation.

Alarcon’s ruling deals with a relatively obscure piece of insurance regulatory law — “I know we’re down in the weeds here,” one observer familiar with the issue noted wryly — but the question of who can communicate what and how is likely to extend to other forms of coverage, including automobile coverage, Livingston said.

Bach agreed. “This is huge,” Bach said. “Not only is it important, tomorrow there is going to be a hearing in the Colorado Legislature that follows the same approach.”