

Case No. B239943

**COURT OF APPEAL OF
THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT, DIVISION ONE**

ASSOCIATION OF CALIFORNIA INSURANCE COMPANIES and
PERSONAL INSURANCE FEDERATION OF CALIFORNIA,

Petitioners,

v.

SUPERIOR COURT OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES, JOSEPH A. LANE

COURT OF APPEAL - SECOND DIST.
FILED

APR 20 2012

Clerk

Deputy Clerk

Respondent,

DAVE JONES in his capacity as Commissioner
of the California Department of Insurance,

Real Party in Interest.

**AMICUS BRIEF OF UNITED POLICYHOLDERS
IN SUPPORT OF RESPONDENT**

From a Decision By the Los Angeles Superior Court
Case No. BC463124, Hon. Gregory W. Alarcon, Presiding

AMY BACH (142029)
UNITED POLICYHOLDERS
381 Bush St., 8th Floor
San Francisco, CA 94104
Telephone: (415) 393-9990

Ivo Labar (203492)
KERR & WAGSTAFFE LLP
100 Spear St., 18th Floor
San Francisco, CA 94105
Telephone: (415) 371-8500
Facsimile: (415) 371-0500

Attorneys for Amicus Curiae
UNITED POLICYHOLDERS

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Telephone: (415) 371-8500
Facsimile: (415) 371-0500

Attorneys for Amicus Curiae
UNITED POLICYHOLDERS

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I. INTRODUCTION

United Policyholders (“UP”) respectfully submits this amicus brief in support of the Respondent Commissioner of the Department of Insurance’s Preliminary Opposition to Writ of Mandate in the above-reference case. UP concurs in Respondent’s contentions that the Regulation is sorely needed and that the Commissioner has the authority to implement the regulation.

UP is an information resource and a voice for consumers throughout California. The regulations the insurance industry plaintiffs are challenging here were promulgated after years of fact-finding and attempts by the California Department of Insurance, our organization and many other interested parties to solve a very serious problem that has impeded disaster recovery in communities throughout California for over twenty years.

According to surveys conducted by United Policyholders after past wildfires, two thirds of Californians who lose homes in wildfires find themselves underinsured by an average of more than \$200,000, and thus are forced to scramble to find alternative sources to fund the rebuilding of their homes instead of being able to rely on the insurance they purchased for that purpose. Studies conducted by

construction cost estimating industry leader Marshall Swift yielded a similar finding that two-thirds of the homes in California are not fully insured against destruction in a wildfire.

A person's home is generally their most valuable asset, both from a financial and a human perspective. It is neither logical nor true that homeowners would knowingly expose or underinsure that most valuable asset. Instead, the clear cause of this pervasive underinsurance is a failure of insurance companies to sell the necessary amount of coverage at the point of sale. The challenged regulations, adopted after substantial study and public input, including from insurers, are a reasonable and necessary attempt to address this problem.

The insurance industry Petitioners do not want to discuss the problem of underinsurance and the harm that it causes California insureds following a loss. They seek to divert attention from this real issue by making the strained argument that the Commissioner does not have the authority to implement these simple and necessary Regulations to address the underinsurance problem. However, there can be no reasonable dispute about the Commissioner's authority to implement the Regulations. The Commissioner's powers are not

limited to those expressly conferred by statute, but also include additional powers that are necessary for the efficient administration of powers expressly as may fairly be implied from the statute granting the powers. Accordingly, the Commissioner has broad discretion to adopt regulations as necessary to promote the public welfare.

Calfarm Ins. Co. v. Deukmejian, 48 Cal.3d 805, 824 (1989). The Regulations at issue here plainly promotes the public welfare by imposing a standardized process for estimating a home's replacement cost at the time a consumer purchases insurance on his or her home.

For all these reasons, as stated in detail below, UP respectfully requests that the Court deny Petitioners' writ.

II. STATEMENT OF INTEREST

United Policyholders ("UP") was founded in 1991 as a non-profit organization dedicated to educating the public on insurance issues and consumer rights. The organization is tax-exempt under Internal Revenue Code §501 (c)(3). UP is funded by donations and grants from individuals, businesses, and foundations. UP does not accept financial contributions from insurance companies.

Through a Roadmap to Recovery™ program United Policyholders helps individuals navigate the insurance claim process

and recover fair and timely settlements. Through an Advocacy and Action program, UP works with public officials, other non-profit and faith-based organizations and a diverse range of entities – including insurance producers, insurers and trade associations to solve problems related to claims and coverage. UP’s Executive Director Chairs the California Department of Insurance Consumer Advisory Task Force, and is an official consumer representative in the National Association of Insurance Commissioners. UP was an active participant in the informal and formal proceedings that led up to the issuance of the challenged regulations.

A diverse range of policyholders throughout California communicate on a regular basis with UP, which allows us to provide important and topical information to courts via the submission of amicus curiae briefs in cases involving insurance principles that are likely to impact large segments of the public and business community.

UP’s amicus brief was cited in the U.S. Supreme Court’s opinion in *Humana v. Forsyth*, 525 U.S. 299, 314 (1999), and its arguments have been adopted by the California Supreme Court in *TRB Investments, Inc. v. Fireman’s Fund Ins. Co.*, 40 Cal.4th 19 (2006) and *Vandenberg v. Superior Court*, 21 Cal.4th 815 (1999). UP has

filed amicus briefs on behalf of policyholders in over three hundred cases throughout the United States.

III. STANDARD OF REVIEW

An administrative agency's action comes before a court with a presumption of correctness and regularity. *Tomlinson v. Qualcomm, Inc.*, 97 Cal.App.4th 934, 941 (2002). Thus, an administrative agency's "regulation, like a statute, is presumed valid and a challenger bears the burden of pleading and proof of invalidity." *Bell v. Board of Supervisors*, 23 Cal.App.4th 1695, 1710 (1994). Where, as here, a regulation is challenged on its face as not authorized by the governing statute, a question of law is presented that is subject to independent review by this Court. *Southern California Edison Co. v. Public Utilities Com'n*, 85 Cal.App.4th 1086, 1096 (2000). While the final responsibility for the interpretation of the governing law rests with the courts, "the appropriate mode of review in such a case is one in which the judiciary ... accords great weight and respect to the administrative construction." *Yamaha Corp. of America v. State Bd. of Equalization*, 19 Cal.4th 1, 12 (1998). Indeed, in reviewing an administrative agency's rulemaking, courts will interfere only where the agency "clearly [has] overstepped its statutory authority or violated a

constitutional mandate.” *Ford Dealers Assn. v. Department of Motor Vehicles*, 32 Cal.3d 347, 356 (1982).

In reviewing the validity of a regulation, the judicial function is limited to determining whether the regulation is: (1) consistent and not in conflict with the governing statute and (2) reasonably necessary to effectuate the purpose of the statute. Gov. Code, § 11342.2; *see also*, *Yamaha Corp. of America*, 19 Cal.4th at 10-11 (“If satisfied that the rule in question lay within the lawmaking authority delegated by the Legislature, and that it is reasonably necessary to implement this purpose of the statute, judicial review is at an end.”). To determine whether a regulation is consistent with the governing statute, the proper inquiry is whether the regulation alters or amends the governing statute or case law, or enlarges or impairs its scope and is within the scope of the authority conferred. *Communities for a Better Environment v. California Resources Agency*, 103 Cal.App.4th 98, 108 (2002). Stated differently, “[t]he task of the reviewing court in this regard has been described as ‘decid[ing] whether the [agency] reasonably interpreted the legislative mandate.’ [Citation.]” *County of Santa Cruz v. State Bd. of Forestry*, 64 Cal.App.4th 826, 834 (1998).

IV. ARGUMENT

A. THE REGULATION WILL BENEFIT INSURED BY ALLEVIATING THE EPIDEMIC OF UNDERINSURANCE

1. Underinsurance is rampant in California

To address the problem of underinsurance, it is important first to understand how replacement cost coverage works. Most homeowners now purchase replacement cost policies with “extended coverage” endorsements including inflation adjustments and code upgrade coverage. These policies, which are far more expensive than Actual Cash Value policies, are intended to provide insureds with the security of knowing they will have sufficient insurance proceeds to replace their home in the event of a disaster. They are sold as products that allow the homeowner to replace the home they had with one of like kind and quality in compliance with applicable laws and ordinances. *Yet even with these extras, two thirds of California homeowners come up short because their basic dwelling replacement cost was not correctly calculated at the point of sale.*

However, even under a replacement cost policy, if an insured does not rebuild or replace the home, the insurer is obligated only to pay the actual cash value of the property (replacement cost less depreciation.) It is thus critical that replacement cost policies have

limits sufficient to rebuild or replace – otherwise, insureds will only receive actual cash value coverage despite their payment of increased premiums for an extended replacement cost policy.

Unfortunately, underinsurance is a pervasive and devastating problem for California insureds. As stated above, homeowners whose properties are severely damaged or destroyed in natural disasters chronically find themselves far short of the insurance dollars they need to replace what they lost. Underinsurance causes the claim settlement process to be delayed and often derailed because insureds cannot finance the underinsured portion of replacement or reconstruction.

UP first witnessed the pervasive underinsurance problem when it responded to the Northern California wildfire that destroyed 3000 homes in 1991. Since then, UP has witnessed the devastating effects of the underinsurance epidemic in California and throughout the country. The underinsurance problem most often affects disaster victims, but it also affects people who lose structures in isolated incidents. UP staff and volunteers now spend approximately half their working hours helping underinsured consumers.

Underinsurance is thus one of most challenging obstacles to recovery following a loss, and is a problem suffered by numerous Californians. The Regulations aim to alleviate this serious problem.

2. Determining the proper amount of insurance is a point-of-sale underwriting problem

Underinsurance is not caused by homeowners skimping on insurance. To the contrary, many homeowners find themselves underinsured after a total loss *even though they followed their agent or insurer's recommendations in purchasing insurance.*

A properly insured dwelling is one that is covered by a policy with high enough limits to pay for what it would cost to rebuild that dwelling with a like kind and quality structure at its existing location and in compliance with local building codes/ordinances in the event of a total loss. Calculating that cost requires a complete review of the size, style, components and materials of the dwelling, as well as consideration of local market conditions. The average homeowner has no idea what that cost would be, so they rely on insurance professionals to perform this estimate.

When a homeowner undertakes to insure his or her home, a producer (an agent or broker) calculates the amount of coverage based on the information the homeowners provides about the characteristics

of the home. The consumer does not estimate the amount of coverage necessary. Instead, at the point of sale, the producer (agent, broker or company sales representative) sets the amount of insurance in accordance with insurance company guidelines. Insurance companies have underwriting guidelines and use various computer software programs to set the value they will agree to insure. The software program purportedly uses current construction costs and the individual features of the homes. The producer then multiplies these costs with the square footage of the structure and calculates the amount of insurance on the structure. Other coverage amounts such as contents, landscape, etc are automatically set as derivative percentages of the dwelling coverage (Coverage A). Thus, if the dwelling coverage is calculated in a manner that does not consider all of the relevant factors, then all of the other coverages will be wrong as well.

If a producer does not properly use this software or if he or she fails to input the accurate information as to the features of the dwelling or if he wants to ensure his commission by quoting a low figure along with a false promise of adequate coverage, the home will be underinsured.

Prospective insureds do not obtain contractor bids in order to buy insurance, much less do so periodically to renew their coverage. It is absurd to suggest that every homeowner would retain the services of a contractor each year to provide a bid for replacing then-undamaged home. Contractors are not in the business of providing free estimates for hypothetical construction projects. And it is fantasy to suggest that an insurer will agree to insure a home based on an insured's determination of value. As discussed above, insurers use detailed software programs and other underwriting guidelines to determine how much insurance to provide.

Because of these undeniable facts, the insurer is clearly in a better position to provide an accurate estimate of the needed amount of insurance than individual homeowners. The vast majority of homeowners have no expertise in calculating construction costs and at best only a vague idea of what it would cost to replace their home and possessions in the event of a total loss. But they know they want to protect their biggest asset so they rely on insurance professionals to assume their risk of loss in exchange for the premiums they pay. These Regulations merely seek to standardize the methods used by insurers when calculating replacement cost estimates.

In addition, requiring insurers to properly estimate the replacement cost of homes avoids the risk that unscrupulous insurers will deliberately or negligently underinsure homes so that, when the home is not rebuilt, only actual cash value is paid instead of the replacement cost coverage the insured paid higher premiums to receive. Whether deliberate or not, a widespread practice of underinsurance means greater profits for insurers who are paid for replacement cost coverage that is consistently not provided.

3. The Regulation attempts to solve this problem at its root cause

It is thus undeniable clear that, deliberately or not, insurers and their sales representatives are not accurately calculating dwelling replacement costs before issuing homeowners insurance policies. As a result, consumers have been chronically led to believe they are fully insured when in fact they are not.

The challenged regulations are a common sense approach to solving these problems. They standardize the process of estimating the replacement cost of a structure for purposes of setting insurance limits. They require producers and insurers to be trained in home replacement cost estimating and to use their professional expertise and the data that is uniquely available to them to more accurately estimate

wrong. The Commissioner's powers are *not* limited to those expressly conferred by statute, but also include ... “ ‘such additional powers as are necessary for the due and efficient administration of powers expressly granted by statute, or as may fairly be implied from the statute granting the powers.’ [Citation.]” *20th Century Ins. Co. v. Garamendi*, 8 Cal.4th 216, 245 (1994) (italics in original). Thus, the Commissioner has broad discretion to adopt regulations as necessary to promote the public welfare. *Calfarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805, 824 (1989).

The Commissioner's regulations are valid so long as they are “consistent and not in conflict” with a statute. Gov. Code, § 11342.2. California law makes clear that the Commissioner has the power “to implement, interpret, make specific or otherwise carry out the provisions of the statute.” Gov. Code, § 11342.2. The Regulations falls squarely within each of these parameters.

The Unfair Insurance Practices Act, Insurance Code section 790, (“UIPA”) provides that the authority that is needed for the Commissioner to implement the Regulation. The UIPA was enacted in 1959, “. . . to regulate further in areas of perceived lacunae in the state control of the insurance business.” *Karlin v. Zalta*, 154

Cal.App3d 953, 972 (1984). As the statute itself states, the UIPA is intended to allow the Commissioner a means of “. . . *providing for the determination of*, all such practices in this State which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined.” Ins. Code § 790 (emphasis added)

Any argument that a replacement cost estimate is not “misleading” simply because it does not take into account the factors required by the Commissioner in the Regulation is misguided. Perhaps one or two underinsured homes do not suggest a misleading system of estimates, but the pervasive nature of underinsurance does. It is not simply a coincidence that so many homeowners are underinsured. The Commissioner was well within his authority to determine that an estimate should take into account the square footage of property, the cost of labor, and all other relevant factors in a systemic matter designed to provide for reliable estimates. The Commissioner plainly has the power to prohibit insurers from using estimating methods that only consider some of the relevant factors, and thus lead to consistently misleading low estimates.


Similarly, any argument that the Regulation fails because it calls for an “estimate” rather than the actual cost that will be incurred when the structure is replaced is nonsensical. It is impossible to know the exact cost of replacing a structure at some unknown point in the future. The best that can be done is what the Commissioner has done here – require a reliable estimate, provided on a standardized basis. The old system – letting each insurer use its own method of determining how much insurance to offer on each home – has patently failed. Only by requiring uniformity in this process can the Commissioner hope to ensure that homeowners will receive reliable estimates of the amount of coverage they may need in case of a fire or other substantial loss.

V. CONCLUSION

For the foregoing reasons, United Policyholders respectfully requests the petition for writ of mandate should be denied.

DATED: April 17, 2012

KERR & WAGSTAFFE LLP

By 
IVO LABAR
*Attorneys for Amicus Curiae
United Policyholders*

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CERTIFICATION OF COMPLIANCE WITH WORD LIMIT

Pursuant to California Rule of Court, rule 8.360 and rule 8.412, I certify that this Amicus Brief of United Policyholders in Support of Appellants is proportionately spaced, has a typeface of 14-point, proportionally-spaced font, and contains 3,038 words according to the word count feature of Microsoft Word 2010.

DATED: April 17, 2012

KERR & WAGSTAFFE LLP

By



IVO LABAR

*Attorneys for Amicus Curiae
United Policyholders*

PROOF OF SERVICE

I, Sarah Guzman, declare that I am a resident of the State of California, over the age of eighteen years, and not a party to the within action. My business address is 100 Spear Street, 18th Floor, San Francisco, California 94105.

On April 17, 2012, I served the following document(s):

AMICUS BRIEF OF UNITED POLICYHOLDERS IN SUPPORT OF RESPONDENT

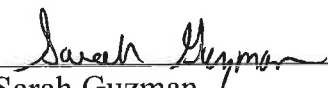
on the parties listed below as follows:

Clerk of the Court Los Angeles Superior Court Stanley Mosk Courthouse 111 North Hill Street Los Angeles, CA 90012	Kamala Harris W. Dean Freeman Felix Leatherwood Anthony Sgherzi Attorney General of California 300 South Spring Street, Suite 1702 Los Angeles, CA 90013
Gene Livingston Greenberg Traurig, LLP 1201 K Street, Suite 1100 Sacramento, CA 95814-3938	Steven A. Hirsch KEKER & VAN NEST, LLP 633 Battery Street San Francisco, CA 94111-1809
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I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on April 17, 2012, at San Francisco, California.



Sarah Guzman

