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California Supreme Court Denies Insurance Industry's Attempt To Deregulate Insurance In California

February 7, 2017 | | Insurance, Policyholder Protection

David E. Wood
Partner
Insurance Recovery and Counseling Group
Co-Chair

On January 23, in *Association of California Insurance Companies v. Dave Jones*, the California Supreme Court rejected carriers' attempt to deregulate the insurance industry in the state by stripping from the insurance commissioner much of the broad power to supervise insurer conduct. This case is a big win for policyholders. The issue before the court was whether the California Department of Insurance can regulate the representations insurers make to their customers about the cost to replace a policyholder's home. In 2010, the insurance commissioner promulgated a regulation -- C.C.R. sec. 2695.183 -- governing what an insurance underwriter must do in setting the replacement cost of a home when selling homeowners coverage. This was expressed as a series of tasks the carrier must perform to ensure the policy limit is sufficient to rebuild the home in the event of its destruction, and takes into account such project costs as labor, materials, architect fees and permits – costs that can (and usually do) increase after the policy is issued. A trade association of insurance companies filed a declaratory relief action against the insurance commissioner asking the trial court to invalidate this regulation on two grounds:

1. In enacting the 2010 regulation, the insurance commissioner exceeded his authority by defining a new unfair or deceptive insurance practice for addition to Insurance Code sec. 790.03(h) (which itemizes certain prohibited conduct by a carrier, like advising a claimant not to engage counsel, or misleading a claimant about the applicable statute of limitations); and

2. In enacting Insurance Code sec. 790.03, the Legislature did not intend to extend regulatory authority over the underwriting process applicable to the cost of replacing homes.

The trial court agreed, and the California Court of Appeal upheld the trial court's decision. It ruled that the Legislature could have included estimating replacement costs as an unfair and misleading, but did not, and that therefore the regulation was beyond the authority of the insurance commissioner. Very recently, the California Supreme Court reversed the Court of Appeal, finding that the insurance commissioner does have the authority to regulate how replacement cost coverage is administered in this state. The court held that

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(1) the regulation fits within the rule-making authority of the commissioner delegated by the legislature; and (2) the commissioner was not precluded by rules of statutory interpretation from regulating carrier conduct not expressly described in Insurance Code § 790.03(h). This case is important because it confirms the broad regulatory power of the insurance commissioner over insurance company practices, underwriting and claims. The insurance companies' effort to limit the commissioner's authority in a way that would have substantially reduced the Department of Insurance's influence over carriers was squarely rejected. This litigation, initiated by a consortium of insurance companies doing business in California, was a bold attempt to deregulate insurance in this state. In 1945, during the wave of conservatism immediately following World War II, insurance companies successfully lobbied Congress to allow the states alone to regulate insurance, and partially exempted the insurance industry from federal antitrust laws. (See McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015.) When California later adopted third party bad faith – allowing a plaintiff to sue a defendant's liability carrier for unreasonable claim-handling under Insurance Code § 790.03(h) – the insurance industry convinced the California Supreme Court in 1988 to take this remedy away from private litigants and permit only the insurance commissioner to enforce this statute. In *Association of California Insurance Companies v. Dave Jones*, insurers argued that the insurance commissioner's authority under the same statute to regulate their conduct should be severely reduced to allow them a freer hand in their California operations. The California Supreme Court saw this gambit for what it was – an attempt by the insurance industry to deregulate the insurance industry in this state – and upheld the Department of Insurance's power to hold insurance companies in check.