

## Wake up Call for Regulators and Insurers

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On April 8, after a careful statutory analysis, the California Second Appellate Division held that the California Insurance Commissioner exceeded his authority in promulgating a regulation that defined a new act as an unfair or deceptive trade practice. In the *Associations of Ca. Ins. Companies vs. Jones*, \_\_\_ Ca. Rptr. 3d \_\_\_ (April 8, 2015), the appellate court reviewed whether the California Insurance Commissioner exceeded his authority by promulgating a regulation governing replacement cost coverage. The new regulation purported to require certain content requirements for "communicat[ing] an estimate of replacement value" and specified that failure to comply with such requirements would constitute a misleading practice within the meaning of California's Unfair Insurance Practices Act (the "UIPA") when providing such communication "to an applicant or insured in connection with an application for or renewal of a homeowner's insurance policy that provides [such]coverage."

In its statutory construction analysis the Second Appellate Division found that:

- The UIPA distinguished between trade practices that are **defined** in the UIPA and those that are **determined pursuant to the UIPA** to be an unfair method of competition or an unfair or deceptive act or practice in the business of insurance.
- The UIPA demonstrated that the California Legislature "**was deliberate** in choosing what conduct to brand in section 790.03 and 790.036 as 'unfair and deceptive.'"
- The UIPA granted specific powers to the Commissioner and that **did not include the "power to define by regulation acts or conduct not otherwise deemed unfair or deceptive"** in the UIPA.
- Rather, with respect to undefined acts, the UIPA:
  - Under Section 790.04, limits the Commissioner's power to examining and investigating "the affairs of every person engaged in the business of insurance . . . in order to determine whether such person has been or is engaged in any unfair method of competition or in any unfair or deceptive act or practices . . . determined pursuant to the [UIPA] to be an unfair method of competition or in an unfair or deceptive act or practice."
  - Under section 790.06, requires a multifaceted procedural process to sanction any conduct that is undefined. Under 790.06, unlike for defined unfair trade practices acts where the Commissioner may issue a cease and desist order, for an undefined act, the Commissioner must obtain a court order.
- The interpretation that the UIPA did not grant the Commissioner power with respect to undefined acts is further supported by the legislative evolution of the UIPA. If the Commissioner had such power, the Second Appellate Court noted that there would not have been the need for the legislature to specifically define other acts as unfair in Section 790.03, including in 1972, adding subdivision (h) which sets forth unfair claims settlement practices and in 1975 definitions (14) and (15) to subdivision (h).

This holding, along with California's prohibition against promulgating "underground regulations" – i.e., regulation by threatened or actual enforcement proceedings, serves as a useful reminder that the insurance regulator's powers are limited to those statutory powers delegated by the legislature. Thus, for example, when faced with a market conduct exam in which the regulator asserts a particular conduct is an unfair trade practice, the insurer should carefully consider whether the regulator has exceeded its power by either defining such conduct as an unfair trade practice or in the alternative is interpreting and enforcing the UIPA in a manner that constitutes rulemaking by enforcement, which is prohibited underground regulation.

As the appellate opinion was filed on April 8, 2015, the California Insurance Commissioner still has time to file for a petition for rehearing. In the alternative, the Commissioner may file a Petition for Review in the California Supreme Court. We will continue to monitor for any further developments in this case.

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