NAMIC
NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

HEADQUARTERS
3601 VINCENNES ROAD
INDIANAPOLIS, INDIANA 46268
TELEPHONE: (317) 875-5250
FAX: (317) 879-8408
WWW.NAMIC.ORG

WASHINGTON OFFICE
122 "C" STREET, NW
SUITE 540
WASHINGTON, D.C. 20001
TELEPHONE: (202) 628-1558
FAX: (202) 628-1601

Pacific Association Of Domestic Insurance Companies
PADIC
Local Knowledge • Strong Commitment

California Department of Insurance
Teresa Campbell, Assistant Chief Counsel
45 Fremont Street, 21st Floor
San Francisco, CA 94105

Sent via email to:
Teresa.Campbell@insurance.ca.gov

August 9, 2012

RE: CALIFORNIA DEPARTMENT OF INSURANCE'S REGULATIONS ON STANDARDS FOR REPAIR AND USE OF AFTERMARKET PARTS, REGULATION FILE: REG-2011-00024

Dear Ms. Campbell:

The National Association of Mutual Insurance Companies (NAMIC) and the Pacific Association of Domestic Insurance Companies (PADIC) appreciate the opportunity to submit written comments in opposition to the contemplated Regulations on Standards for Repair and Use of Aftermarket Parts (hereinafter "Aftermarket Parts Regulation").

NAMIC is the largest and most diverse national property/casualty insurance trade and political advocacy association in the United States. Its 1,400 member companies write all lines of property/casualty insurance business and include small, single-state, regional, and national carriers accounting for 50 percent of the automobile/ homeowners market and 31 percent of the business insurance market. NAMIC has 106 member insurance carriers

writing business in the state of California who write approximately 23% of the property and casualty insurance business in the state.

PADIC member companies write approximately $1 billion in property and Casualty premium almost exclusively in California. Because the vast majority of PADIC insurance business is written in California, insurance regulation has a much greater impact on its members and, more importantly, its policyholders than companies who write insurance throughout the country. Approximately one half of the premium written by PADIC is in personal lines, including homeowners insurance.

NAMIC and PADIC are concerned that the contemplated Aftermarket Parts Regulation could: a) effectuate a "de-facto" ban on the use of aftermarket parts in California; b) hinder insurers in their ability to provide consumers with timely and cost-effective quality auto repairs; c) create an unfair and inappropriate competitive advantage for OEM parts manufacturers to the detriment of auto repair consumers; d) facilitate and empower unscrupulous auto repair shops to engage in auto repair fraud; and e) adversely impact the availability and affordability of insurance for consumers. NAMIC and PADIC are also concerned that the proposed regulation is inconsistent with the stated purpose of pending federal legislation (The PARTS Act) and the national trend toward increasing market competition in the creation and use of affordable automobile replacement parts. Interstate/international aftermarket parts manufacturing and commerce involves matters subject to the regulatory authority of the federal government pursuant to the Dormant Commerce Clause. Therefore, a state agency should not interfere with federal regulation of this activity of interstate commerce, especially when said state regulation has federal anti-trust law implications and promotes monopolistic practices in favor of OEM parts manufacturers.

We are also concerned that the contemplated Aftermarket Parts Regulation fails to comply with the Necessity, Authority, and Clarity regulatory standards of the California Administrative Procedures Act (APA) (Government Code § 11340 et seq.). In the interest of avoiding redundancy, NAMIC and PADIC specifically incorporate by reference in these written comments the APA regulatory requirements arguments articulated by the other state and national trades in their respective written submissions.

Moreover, NAMIC and PADIC are troubled by the fact that the California Department of Insurance (CDI) has violated a standard regulatory principle of not providing regulatory favoritism or preferential treatment toward a particular sector of the business community. The contemplated regulation creates a clear regulatory preference for the use of *only* OEM parts produced by automobile manufacturers. The contemplated regulation favors OEM parts manufacturers by imposing costly administrative burdens and legal notice duties on insurers, who want to offer their consumers the benefits of market competition between OEM parts manufacturers and aftermarket parts manufacturers. Since there is no evidence to support the contention that aftermarket parts are inferior in any way to OEM parts, the CDI's preferential treatment of OEM parts is entirely unjustifiable, and clearly inappropriate from a regulatory standpoint.

Additionally, the contemplated regulation improperly empowers automobile manufacturers and auto repair shops to unilaterally and conclusively establish auto repair guidelines that

could, for all practical purposes, ban the use of aftermarket parts and create monopolistic pricing to the detriment of auto repair consumers. Since the state legislature has not passed any statute prohibiting or restricting the use of aftermarket parts, the CDI should not "side-step" the law and create a regulation that imposes administrative costs and burdens on insurers that could result in a "de-facto" prohibition on the use of aftermarket parts.

NAMIC and PADIC respectfully request that the CDI reconsider its contemplated regulation for the following reasons:

a) The contemplated regulation could effectuate a "de-facto" ban on the use of aftermarket parts in California

The Proposed Regulation states that "[t]he estimates prepared by or for the insurer shall be of an amount upon which will allow for repairs to be made in accordance with accepted trade standards for good and workmanlike automobile repairs by an auto body repair shop . . . . *No insurer shall willfully depart from or disregard accepted trade standards for good and workmanlike repair in the preparation of claim settlement offers or estimates prepared by or for the insurer." (Emphasis added)*

The regulatory implication of this provision is that an insurer would be strictly prohibited from departing from an auto repair shop's estimate if the auto repair shop arguably was following an accepted trade standard; even in cases where the insurer's departure is reasonable, appropriate, and in the best interest of the insurance consumer. Based upon common sense and experience, one would expect that original equipment manufacturers of OEM parts and auto repair shops who financially benefit from the use of more expensive OEM parts are going to establish accepted trade standards and repair guidelines that either strictly require the use of OEM parts or make it a practical impossibility to justify the use of aftermarket parts by an insurer. In essence, the contemplated regulations would create an auto repair regime where "the fox has the final say in determining how to best safeguard the hen house."

NAMIC and PADIC believe that the proposed provision should be amended to provide insurers and consumers with reasonable flexibility to address auto repairs based upon the circumstances of the situation. Consequently, NAMIC and PADIC believe that the provision should be redrafted to read, "*Insurer should follow accepted trade standards for good and workmanlike repair in the preparation of claim settlement offers or estimates prepared by or for the insurer. Any departure by the insurer from accepted trade standards for good and workmanlike repair shall be noted in the claim settlement offers or estimates prepared by or for the insurer."*

b) The contemplated regulation will hinder insurers in their ability to provide consumers with timely and cost-effective quality auto repairs

The proposed amendment to FCSPR Sections 2695.8(g)(6) – (9) would require insurers to act as a quasi-regulator of aftermarket parts. Specifically, the proposed regulation would impose a legal duty to provide notice of alleged problems with aftermarket parts to collision repair estimating software providers, auto parts distributors, and aftermarket

parts manufacturers, at the insurer's own expense. First of all, insurers should not be required to engage in quasi-regulatory activities and be responsible for policing the activities of software companies, auto parts sales and marketing professionals, or auto parts manufacturers. Insurers do not have expertise or experience in this quasi-regulatory activity, and their insurance consumers should not be forced to pay higher insurance rates to fund this ultra-vires regulatory activity. Further, the regulatory role of the CDI is to regulate the insuring agreement relationship between insurers and insurance consumers, *not* the contractual relationship between consumers and auto repair shops or the contractual relationship between consumers or auto repair shops and auto parts manufacturers. The proposed regulations have clearly strayed away from the regulation of the insurance transaction and insurance claim practices, and have attempted to regulate the automobile repair process.

NAMIC and PADIC are also concerned that this entire section fails to conform to the APA "clarity" standard, because the regulation uses terminology that is ambiguous and overly broad in scope. For example, the phrase "implied, actual, or constructive knowledge" is extremely broad in scope and could arguable require insurers to have to provide notice in cases where one could assert the claim that the insurer should have known of latent or hidden defect in a particular aftermarket part.

The proposed notice duties will create unreasonable administrative burdens and costs on insurers that will hinder their ability to provide consumers with timely and cost-effective aftermarket parts repairs. For example, if someone merely alleges that a particular aftermarket part is "not equal to" an OEM part in fit, FCSPR Amended Section 2695.8(g)(6) could arguably be read to require that an insurer "immediately cease specifying the use of the part", even before the subject aftermarket part has been evaluated by experts. This type of prohibition could cause serious delays in repairing automobiles and lead to "demand-surge" pricing of certain auto repair parts.

The CDI does not have regulatory authority to impose blanket prohibitions on the use of any particular automobile part. Conceptually speaking, this proposed provision is akin to a regulator prohibiting Best Buy from ever selling a GE washing machine merely because there is an allegation that one particular GE washing machine has a defective part and/or is not arguably "equal to" a Whirlpool washing machine.

Moreover, the proposed "implied, actual, or constructive knowledge" notice standard could expose insurers to civil liability whenever they authorizing repairs with aftermarket parts. Insurers should only be prohibited from authorizing repairs with aftermarket parts that have failed aftermarket parts certification or have been the subject of a manufacturer or government agency recall.

Insurance companies are not in the business of mechanical forensic engineering, so this proposed notice requirement is unreasonable in nature and scope, especially in light of the fact that aftermarket parts manufacturers and automobile parts certification organizations already engage in comprehensive quality control testing. Imposing an unnecessary and duplicative testing and notification burden on insurers is really just a

clever way of preventing insurers from being able to use aftermarket parts in a cost-effective manner.

It is important to note that auto repair consumers already have to wait for auto repair shops to procure necessary repair parts, even when they have the option of using either OEM parts or aftermarket parts. Imagine what the auto repair delays will look like when insurers have no choice but to have the automobile repaired with OEM parts that may be back-ordered or in short supply because of the volatile and unstable economic condition of automobile manufacturers.

NAMIC and PADIC are also concerned that the proposed notice requirement is triggered by a nebulous subjective standard. Specifically, what is meant by "*not equal to* the original equipment manufacturer parts in terms of kind, quality, safety, fit, and performance"? Whether one part is "equal to" another part is very subjective. OEM manufacturers, for marketing purposes, would strongly argue that their parts are superior to aftermarket parts in terms of kind, quality, safety, fit, and performance, so would this mean that all aftermarket parts are not equal to OEM parts? This notice trigger is unworkable, impractical, and rife with potential for conflict.

c) The contemplated regulation will create an unfair and inappropriate competitive advantage for OEM manufacturers to the detriment of auto repair consumers

The contemplated regulation is written in a way so as to create a "regulatory presumption" that OEM parts are to be strictly used *unless* the insurer is able to satisfy a litany of new regulatory burdens, accept new defective product notification duties, and provide consumers with contractual rights that are not part of the insuring agreement. In effect, the contemplated regulation creates an unfair and inappropriate competitive advantage for OEM manufacturers to the detriment of market competition in the world of auto repair parts, which keeps auto repair parts affordable for auto repair consumers. One has to remember that a significant number of auto repairs are negotiated and paid for outside of the insurance transaction by consumers that may not have procured first-party collision insurance coverage, so if the CDI promulgates a regulation that weakens the aftermarket parts manufacturing industry, consumers will be adversely impacted by higher auto repair costs. National studies have repeatedly determined that OEM parts are between 26% and 50% more expensive that comparable aftermarket parts.

No state regulatory agency, including the CDI, should engage in regulatory practices that clearly benefits one private sector of the business community to the detriment of another private sector of the business community. The contemplated regulation does exactly that by making it more difficult for insurers to use aftermarket parts, which is why the previous CDI workshop on the proposed regulation was packed with non-insurance company voices of opposition.

d) The contemplated regulation will facilitate and empower unscrupulous auto repair shops to engage in auto repair fraud

The contemplated regulation puts OEM parts manufacturers and auto repair shops "in the figurative driver's seat" on auto repairs, because they will be the ones empowered to establish "acceptable trade standards for good and workmanlike repairs" that insurers will have to strictly follow. Moreover, since the regulation does not provide for any process for insurers to contest what the OEM parts manufacturers and auto repair shops dictate, unscrupulous auto repair shops will be able to use the proposed regulation to coerce insurers into paying unnecessary and/or inflated auto repair bills – a clear form of auto repair fraud.

e) The contemplated regulation will adversely impact the availability and affordability of insurance for consumers

In addition to all of the previously mentioned administrative cost-driver provisions in the contemplated regulation, the proposed Aftermarket Parts Regulation exposes insurers to new tort claims and extra-contractual duties that will ultimately and unavoidably increase insurance costs for consumers.

For example, the proposed amendment to FCSPR Section 2695.8(g)(9) states that, "insurers . . . shall pay for the *costs* (a term not defined in the regulation) associated with *returning* the parts . . . ." (Emphasis added). Why should insurers and their policyholders be required to pay a business operating expense of auto repair shops and automobile parts manufactures?

The CDI does not have regulatory authority to create regulatory rights for businesses that are not a party to the insuring agreement, nor does it have regulatory authority to define legal damages or create contractual rights (requiring payment of shipping costs).

f) The Proposed Aftermarket Parts Regulation is inconsistent with the stated purpose of pending federal legislation (PARTS Act) and the national trend toward increasing market competition in the creation and use of affordable automobile replacement parts.

Earlier this month, the U.S. House Judiciary Subcommittee on Intellectual Property, Competition and the Internet heard testimony from the Consumer Federation of America and the Quality Parts Coaltion (QPC) comprised of independent parts manufacturers, insurers, repairers, consumers and seniors in support of pending legislation (H.R. 3889, Promoting Automotive Repair, Trade, and Sales, or PARTS Act) on aftermarket parts. Although the proposed federal legislation addresses intellectual property rights and patent protection law, the purpose of the legislation is clearly designed to promote market competition in automobile parts manufacturing for the benefit of consumers.

The CDI's proposed regulation is inconsistent with the spirit and the stated purpose of the PARTS Act, because it will hinder market competition between OEM parts manufactures and aftermarket parts manufactures by imposing unnecessary and costly regulatory burdens on insurers who authorize the use of aftermarket parts in their insurance claims process.

In conclusion, NAMIC and PADIC appreciate the opportunity to comment on the proposed regulations, and respectfully contend that the proposed changes to the Aftermarket Parts Regulations exceed the CDI's regulatory authority, fail APA regulatory requirements, and would be detrimental to the best interest of insurance consumers.

Please feel free to contact Christian J. Rataj at 303.907.0587 or at crataj@namic.org, or Milo Pearson at 530.888.6045 or milopearson@sbcglobal.net, if you have any questions about NAMIC's and PADIC's Written Comments.

Respectfully,

Christian John Rataj, Esq.
NAMIC Western State Affairs Manager

Milo Pearson
PADIC Executive Director