STATE OF CALIFORNIA
OFFICE OF ADMINISTRATIVE LAW

AGENCY: DEPARTMENT OF INSURANCE	)	DECISION OF DISAPPROVAL OF REGULATORY ACTION
ACTION: Adopt sections 2355.1 Through 2359.7 and Repeal Sections 2555, 2556, 2556.1 and 2556.2 of Title 10 of the California Code of Regulations	)	(Government Code section 11349.3)
	)	OAL File No. 07-0105-06 S

BACKGROUND

The Department of Insurance (Department) proposed the adoption of regulations to implement a comprehensive statistical plan for title insurance companies and underwritten title companies and formulas that establish the upper limits on the rates of title insurance companies and underwritten title companies and the price of services provided by them and controlled escrows in connection with residential real property transactions. On January 5, 2007, the regulations were submitted to the Office of Administrative Law (OAL) for review in accordance with the Administrative Procedure Act (APA) and on February 21, 2007, OAL disapproved them. This Decision of Disapproval explains the reasons for OAL's action.

DECISION

OAL disapproved the Department's proposed regulations for lack of clarity, defective citation of references, omission of required documents from the rulemaking file, and failure to meet all the requirements pertaining to incorporation of standards into the regulations by reference.

DISCUSSION

1) CLARITY

OAL reviews proposed regulations for compliance with the clarity standard pursuant to Government Code section 11349.1. The standard is defined in Government Code section 11349, subdivision (c). It provides:

> "'Clarity' means written or displayed so that the meaning of regulations will be easily understood by those persons directly affected by them."

OAL has adopted section 16 of title 1 of the California Code of Regulations (CCR) to guide its application of the clarity standard to proposed regulations. Among other things, it defines the concept of persons "directly affected," and includes among them persons who must comply with the regulation as well as those who must enforce it. Section 16 also creates a presumption that a regulation that can, on its face, be reasonably and logically interpreted to have more than one meaning is not clear.

The proposed regulations are especially complex and not readily amenable to simplification without changing their intended meaning. Our concern with the overall complexity inherent in rules of this kind is alleviated both by the sophistication of those who would be obliged to provide the information required by the rules and recognition that it must be tolerated with some leeway on the "easy to understand" criterion of review. Nevertheless, some of the language of the regulations must be clarified to avoid ambiguity.

(A) The Word "SHOULD"

In Subarticle 2 of the proposed regulations the Department makes extensive use of the word "should." The word appears more than 65 times in the course of describing title insurers' and underwritten title companies' duty to report information to the Insurance Commissioner (Commissioner). In common usage the reasonable inference is that a recommendation is intended, rather than a legal obligation. This conclusion is further supported when the word's context indicates an awareness of some of the other words available to clearly indicate a mandate, such as "shall" and "must" and an apparent preference for "should" in other places. The regulations of Subarticle 2 make use of all these terms, but OAL is concerned that the extensive use of "should" creates ambiguities in the rules that ought to be corrected. For example:

1. The Reporting Period

Proposed section 2356.4 specifies when reports are due and the periods that the reported information must cover. Subdivision (c) provides for a limited trial run due by June 30, 2008, with reports covering the period from January 1, 2008, through March 31, 2008. In paragraph (3) it provides an exception:

> "Report TI16 [title insurance 16, a loss development report] <u>should be reported</u> in full detail as of December 31, 2007, meaning the most current reporting year is the full year 2007." (Emphasis added.)

Although we have no knowledge of whether there could actually be a quarterly report of this kind, we simply note that a report of data from 2006 or an earlier period might also be reasonably offered in response to this provision if it is only a recommendation. If a requirement is intended, then this must be clarified in the text.

2. Records Retention

Proposed section 2356.8 is a lengthy list of instructions for title insurers' reports to the Commissioner. Subdivision (p) describes the contents of the loss development report mentioned above and in paragraph (2), provides:

> "Reporting companies should keep worksheets for Report TI16, including, for example, any ULAE allocation calculations for the five most recent annual Report TI16 submissions." (Emphasis added.)

While the language appears to be advisory, we also know that records retention provisions are often mandatory, and that an investigator might ask to see such records during an examination. Indeed subdivision (c), which describes the California and Countrywide Income Statement, has a records retention requirement set forth in paragraph (8), which provides:

> "Reporting companies shall maintain any worksheets used in preparing Report TI03 for the five most recent reporting years." (Emphasis added.)

Mindful of the fact that the Department is a licensing entity with enforcement powers and that these are regulations adopted pursuant to the APA to implement mandatory reporting and other lawful requirements, we believe it is likely that some affected persons would understand such a formally adopted directive indicating that something should be done as equivalent to a requirement. Others might view it as only a recommendation, but with sufficient uncertainty attending the matter to warrant adherence as if it is required. Still others might ignore it and later find themselves arguing with a representative of the Department over what is actually required. These examples and other instances where "should" has been used illustrate problems that can be easily avoided. The problems might be addressed by using other words to distinguish what is required from what is recommended, or defining the word "should" for the purpose of these regulations in section 2355.3, or deleting advisory material altogether.

(B) Section 2357.13 - Policy Charge

The proposed rate setting formulas use terminology that is not commonly understood outside the industry and that has been defined with precision in the regulations. Oftentimes each word is significant; for example, we see there is the "maximum title insurance charge for a policy," and there is a formula for deriving the "maximum average title insurance charge for the amount of insurance" from that amount. That formula includes another term, the "Policy Charge" which is defined in section 2357.13. The title of this section is "Maximum policy charge," which appears to be a mistake, as the concept of a maximum is not included in the formula set forth there. We realize that the Commissioner's overall strategy is to determine a maximum rate and that it may be comprised of more than one maximum allowance, but the discrepancy between this section's title and its content appears to be an error.

(C) Clarity of Display

Proposed Subarticles 3 and 4 contain a number of fairly complex formulas that were written to define various terms and for use in determining the threshold of excessive rates. Some of the formulas have fractions in both the numerators and denominators. They are displayed in a small font using italics and were apparently printed in the text using bold typeface. As a result, they are illegible. Fortunately each is accompanied by a narrative that describes the elements of the formula, but the presentation of the formulas must be improved so they will be legible in the California Code of Regulations.

2) REFERENCE

Each of the adopted regulations has citations following the proposed text identifying the Department's rulemaking authority and references to the statutes and other provisions of law that the regulations interpret, implement, and make specific. OAL reviews these citations in accordance with Government Code section 11349.1, mindful of the definitions of authority and reference set forth in section 11349, and the provisions of CCR, title 1, section 14. Section 11349, subdivision (e) provides:

> "'Reference' means the statute, court decision, or other provision of law which the agency implements, interprets, or makes specific by adopting, amending, or repealing a regulation."

All of the regulations identify the same group of statutes and one case decided by the California Supreme Court, and they are substantially accurate. One of the common citations is a "string" identified as sections 12401.7-12401.9 of the Insurance Code. Within this range are sections 12401.7, 12401.71, 12401.8 and 12401.9.

Sections 12401.7 and 12401.71 of the Insurance Code are fairly narrow provisions relating to the first allowable date for using a new rate. Only a few of the proposed regulations address this topic, and in fact these regulations simply conform to the statutory provisions. Use of these citations as references should be limited to those regulations that address the topic of the earliest effective date of a changed rate.

Section 12401.8 of the Insurance Code authorizes charges at a higher rate when unusual insurance risks are assumed or unusual services are performed, provided certain conditions are met. This is an appropriate reference citation for the proposed section 2359.5, which imposes additional limitations on the practice, but not for the majority of these regulations.

Section 12401.9 requires the display of rate schedules in the offices of title insurers, underwritten title companies and controlled escrows, and availability of this information to the public. As in the examples above, it should only serve as a

> reference citation for regulations that actually address the rates display and availability requirements. OAL's practice has been to discourage the use of string citations in authority and reference citations as it tends to include statutes that have little or no utility in those roles.

Although it was not a reason for OAL's disapproval of the regulations, we also note that the reference citations include Insurance Code sections 12401.1-12401.2. There are only two sections within the range specified, and so the hyphen should be replaced with a comma. Finally we note that there is a numerical error in the proffered authority citation for each of the regulations that identifies section 12401.21 of the Insurance Code.

3) INCORPORATION BY REFERENCE

The proposed regulations would rely upon documents not included for publication in the CCR to provide systems of coding to describe reporting companies and claims experience. These codes include the NAIC company code for title insurance companies; the California UTC code for underwritten title companies; and the American Land Title Association Risk Codes, February 2002 edition for claims experience. Incorporation of such outside materials into the regulations by reference is permitted under the APA, and OAL has adopted section 20 of title 1 of the CCR to provide a procedure and standards for this practice. Documentation of these systems of codes was not included in the record. It is important to include copies in the file and for filing with the Secretary of State so there will be a permanent record of the actual requirements. See section 20 for other pertinent requirements that must be addressed in the final statement of reasons.

4) OTHER OMISSIONS OR DEFECTS

Government Code section 11346.3, subdivision (a), obliges state agencies proposing to adopt any administrative regulation to assess the potential for adverse economic impact on California business enterprises and individuals. The Commissioner made his assessment and indicated that these regulations will have adverse effects for some businesses. Note that subdivision (c) of section 11346.3 provides:

> "No administrative regulation adopted on or after January 1, 1993, that requires a report shall apply to businesses, unless the state agency adopting the regulation makes a finding that it is necessary for the health, safety, or welfare of the people of the state that the regulation apply to businesses."

Obviously the proposed regulations would be meaningless if their reporting requirements did not apply to business. The necessary finding must be included to avoid a conflict between the intended application of these regulations and section 11346.3. The reviewer was unable to locate such a finding in the file.

For the foregoing reasons, OAL disapproved the Department's proposed regulations.

SETTING RATES AND LIMITING RATES

This rulemaking is controversial and met strong opposition from the affected industry. In addition to objections to the burden of complying with the Commissioner's statistical plan, there were numerous challenges based upon the view that the proposed regulations are not consistent with Insurance Code sections 12401, 12401.3, and 12401.5. The commenters noted that under section 12401.3, subdivision (a)(2), the Commissioner may only determine a rate to be excessive if a reasonable degree of competition does not exist in the business, and they disagreed with the Commissioner's finding regarding competition. In this regard, OAL notes that for the purposes of its review, substantial evidence is sufficient to support such a finding. Based upon that finding, he proceeded to adopt standards of general application to bring uniformity to his determination of the rate level that is unreasonably high for the insurance or services provided.

The commenters pointed to language in Insurance Code section 12401, and subdivision (d) (3) of section 12401.5, indicating that the Commissioner must not fix rates for title insurance and escrow services. The Commissioner relies upon the rationale of the California Supreme Court as set forth in *20th Century Insurance Company v. Garamendi* (1994) 8 Cal.4th 216 [32 Cal.Rptr.2d 807] to show that he may adopt limits on the range of allowable rates without fixing the rate in a manner that would violate these provisions. He notes that title insurers, underwritten title companies and controlled escrows will still prepare their own rating plans and rates under the new regulations. OAL agrees with the Commissioner that the rationale articulated in *20th Century v. Garamendi* is pertinent to the decision on these regulations and it persuades us that he may set the upper limit on rates that are not excessive, notwithstanding the language in section 12401 which indicates that Article 5.5 [beginning with Insurance Code section 12401] does not provide the power to fix and determine a rate level.

Since its early days the Administrative Procedure Act has included a limitation indicating that it does not apply to a regulation that sets a rate, price or tariff. Government Code section 11340.9, subdivision (g), provides:

> "This chapter [Chapter 3.5] does not apply to any of the following: [¶] … [¶] (g) A regulation that establishes or fixes rates, prices, or tariffs."

In *20th Century v. Garamendi* the California Supreme Court determined that the Commissioner's regulations setting an upper limit on insurance rates for prospective use in applying the excessive rate prohibition under Proposition 103 qualified for exemption from the APA and OAL review based upon section 11340.9, subdivision (g). Thus we see from the *20th Century* case that those limits: (1) were consistent with that regulatory scheme wherein the insurers determined and filed their own rates and, (2) are exempt from the APA under the rate fixing exemption. This shows that the proper analysis of whether a regulation sets a rate may depend upon the context of the inquiry. Since the time of that decision and on this basis, OAL has filed the regulations of Subchapter 4.8 [commencing with CCR, title 10, section 2641.1] and any subsequent amendments with the Secretary of State without substantive review.

RESUBMISSION OF THE FILE

This entire rulemaking proposal, which is comprised of five subarticles collected under new Article 7.1, was submitted for OAL review as a single unit, without a claim by the Department that any part is exempt from the APA. We note that the Commissioner's regulations limiting the rates for title insurance companies and underwritten title companies set forth in Subarticle 3 and the formulas for rates and prices for escrow services set forth in Subarticle 4 are in many ways similar to the regulations of Subchapter 4.8 mentioned above. In order to clarify the basis for subsequent review, OAL requests that the Commissioner indicate his position on whether the rationale of exemption described in *20th Century v. Garamendi* is applicable to any of the title insurance and escrow regulations, and whether the rate-limiting regulations in Subarticles 3 and 4 are subject to the APA.

Date: February 28, 2007

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