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## BUYER POWER ABUSE IN THE AUTO-REPAIR INDUSTRY: IS THERE A REMEDY?

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### I. INTRODUCTION

The automotive repair industry and the automotive insurance industry are in a constant struggle. Both seek to attain the same end, the satisfaction of their mutual client, through entirely different means; the repair industry wants to be paid the highest dollar amount for the repairs it will perform, while the insurance industry desires the converse. What makes this relationship rather frustrating is that Congress has granted the insurance industry an exemption from the antitrust laws.

Congress realized that the automotive insurance industry is in a peculiar business; it neither sells a good nor provides a service.<sup>1</sup> Rather, the automotive insurance industry sells peace-of-mind; the guarantee that it will indemnify its clients in case of specified misfortunes. The entire industry revolves around a gamble, wagering that the aggregate amount of premiums it collects for a specified amount of time will exceed the amount it has to expend for that same period. The amount it must expend is contingent on the determination of the frequency and degree of its clients' misfortunes. Using information such as age, vehicle type, location of the insured, driving frequency, and driving record,<sup>2</sup> the industry makes the most informed decision it can when setting its rates. Yet this information is very limited, and it too is rooted in statistical probability, not certainty.

Congress, sympathetic to the difficulties facing the insurance industry in assessing risk, and fearful of the industry's inability to properly structure rates,<sup>3</sup> determined that the business of insurance should be allowed to operate more freely than other industries.<sup>4</sup> Thus, Congress exempted the

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1. CAL. CIV. CODE § 1761 (West Supp. 2009).

2. Insurance Questions & Answers, <http://www.carinsurance.com/kb/content19520.aspx> (last visited Mar. 19, 2008).

3. See E. THOMAS SULLIVAN & JEFFERY L. HARRISON, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS 93 (LEXISNEXIS 4th ed. 2003).

4. *E.g.*, 15 U.S.C. § 1 (2000). The statute states that “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce . . . is declared to be

business of insurance from federal antitrust legislation by enacting the McCarran-Ferguson Act<sup>5</sup> (hereafter the “McCarran Act”). But was this a good decision? What impact has the hands-off approach had on the automotive repair industry? And what consequences has it had for consumers?

This Comment examines the ramifications of the McCarran Act on the California automotive repair industry and society as a whole.<sup>6</sup> Part II explains Congressional intent behind Federal Antitrust legislation and the McCarran Act. Part III identifies how the McCarran Act has allowed the automotive insurance industry to drastically influence the automotive repair industry and the effects this has on society. Part IV describes the relationship between an insured, an insurer, and a repair facility; and how the insurance industry has managed to turn the insurer-repair facility relationship into more than a mere arm’s-length relationship. Part V analyzes how the automotive repair industry has attempted to end this burdensome relationship under a federal antitrust theory, and why these attempts have failed. Last, Part VI proposes that California Business and Professions Code section 17200 can be used to balance the competing interests of the automotive insurance and repair industries, while preserving Congress’s desire to allow the insurance industry to operate outside the purview of federal antitrust regulations.

## II. ANTITRUST HISTORY

The primary federal antitrust statute is known as the Sherman Antitrust Act (hereinafter the “Sherman Act”).<sup>7</sup> Enacted in 1890 in response to the formation of large corporate trusts, the Sherman Act sought to prevent the high prices associated with monopoly or cartel activity.<sup>8</sup> Section one of the Sherman Act states that “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.”<sup>9</sup> Courts

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illegal.” *Id.* Thus, unless there is an expressed exemption, federal antitrust legislation applies to every industry.

5. 15 U.S.C. §§ 1011-15 (2000).

6. I have limited the scope of this Comment to the California automotive repair industry. Other jurisdictions may have similar problems or similar statutes, *see* RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 1 (1995) (indexing the unfair competition laws of other states), and I will frequently make reference to non-California cases.

7. 15 U.S.C. §§ 1-7 (2000).

8. LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST: AN INTEGRATED HANDBOOK 6 (Thomson/West 2d ed. 2006) (2000).

9. 15 U.S.C. § 1 (2000).

have a significant amount of discretion in the interpretation of this broad language.<sup>10</sup> Although, when enacted, this sweeping language applied universally to every industry, it did not apply to the insurance industry.<sup>11</sup>

The business of insurance had always been considered a wholly intrastate activity.<sup>12</sup> As such, it was not within the purview of federal legislation.<sup>13</sup> However in 1942, in, *United States v. South-Eastern Underwriters Ass'n*, the Supreme Court overruled this long-standing precedent by allowing criminal antitrust charges, grounded in federal law, against an underwriting association.<sup>14</sup> Following this case, it was unclear whether the insurance industry would be subject to the full force of federal antitrust law.<sup>15</sup> In 1945, in a rushed response to request for legislation clarifying this ambiguity, Congress enacted the McCarran Act.<sup>16</sup>

Through the McCarran Act, Congress sought to limit the holding in *South-Eastern Underwriters*.<sup>17</sup> Congress believed that in order to prevent destructive competition amongst insurers, it was necessary to allow those involved in the business of insurance to share statistical data and cooperate in ratemaking to accurately assess underwriting risk.<sup>18</sup> Thus, through the McCarran Act, Congress sought to prevent the general application of federal antitrust legislation to the business of insurance.<sup>19</sup>

Congress's desire was satisfied.<sup>20</sup> Courts are extremely reluctant to apply federal antitrust legislation to any insurance activity, and the insurance industry has managed to thrive.<sup>21</sup> But this has come at a cost.<sup>22</sup>

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10. SULLIVAN & GRIMES, *supra* note 8, at 7.

11. AM. BAR ASS'N, FEDERAL STATUTORY EXEMPTIONS FROM ANTITRUST LAW 139 (2007) [hereinafter ABA, EXEMPTIONS].

12. *Id.*; *Paul v. Virginia*, 75 U.S. 168, 170 (1868) (holding that "[t]he issuing of a policy of insurance is not a transaction of commerce"), *overruled by* *United States v. S.-E. Underwriters Ass'n*, 322 U.S. 533 (1944); AM. BAR ASS'N, INSURANCE ANTITRUST HANDBOOK 1 (2d ed. 2006) [hereinafter ABA, HANDBOOK].

13. ABA, HANDBOOK, *supra* note 12, at 1; *see* ABA, EXEMPTIONS, *supra* note 11, at 139.

14. *See S.-E. Underwriters Ass'n*, 322 U.S. 533 (overruling *Paul*, 75 U.S. 168).

15. *See* ABA, EXEMPTIONS, *supra* note 11, at 139-40.

16. *See State Bd. of Ins. v. Todd Shipyards Corp.*, 370 U.S. 451, 452 (1962); ABA, EXEMPTIONS, *supra* note 11, at 140.

17. *Barnett Bank of Marion County, N.A. v. Gallagher*, 43 F.3d 631, 634 (11th Cir. 1995).

18. *Proctor v. State Farm Mut. Auto. Ins. Co.*, 675 F.2d 308, 315 (D.C. Cir. 1982).

19. ABA, EXEMPTIONS, *supra* note 11, at 133.

20. *See id.*

21. *See id.* at 149.

22. *See id.* at 133.

## III. COLLATERAL DAMAGE

By alleviating the threat of federal antitrust liability, Congress gave the automotive insurance industry a competitive advantage not found in most other industries.<sup>23</sup> This competitive advantage, combined with the insurance industry's drive to lower its underwriting costs, has caused the owners of automotive repair facilities to lose a great deal of control over their businesses.<sup>24</sup>

With "insurance work"<sup>25</sup> comprising seventy-five percent<sup>26</sup> of the total number of vehicles repaired, the insurance industry is the primary consumer of repair facility services. Considering that, in California alone, there were over 500,000 traffic accidents in 2007,<sup>27</sup> averaging \$3,500-\$4,500 in damages per accident,<sup>28</sup> the control possessed by the insurance industry is substantial.

Cost cutting is not the problem; it is a sound business practice adhered to by any successful company. In fact, to ensure that only the strongest businesses survive, capitalism compels a business to take every opportunity to cut costs without sacrificing revenue. This leads to fierce competition, which, in theory, benefits consumers. The problem, however, arises when this capitalist impetus pushes businesses toward strategies that hinder competition itself,<sup>29</sup> and are patently unfair.

For the insurance industry, the drive to cut costs and increase profits has materialized into practices such as steering,<sup>30</sup> capping materials or labor,<sup>31</sup> and independently conducting labor rate surveys.<sup>32</sup> These practices

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23. See *Arroyo-Melecio v. Puerto Rican Am. Ins. Co.*, 398 F.3d 56, 66 (1st Cir. 2005) ("The insurance industry, however, receives special treatment under the antitrust laws by virtue of the [McCarran Act].")

24. See *MLO's on the Grow*, BODY SHOP BUS., May 2007, at 66.

25. "Insurance work" is a term used in the repair industry to indicate that a customer expects to be reimbursed by his insurance company.

26. Interview with Gary Stephen, Repair Facility Consultant, Auto Body Resources, in Pasadena, Cal. (Mar. 12, 2008).

27. *State of the Industry Report*, BODY SHOP BUS., Feb. 2008, at 4-5 [hereinafter *Industry Report*].

28. HIGHWAY LOSS DATA INSTITUTE, AUTO INSURANCE LOSS FACTS 2 (2007), [http://www.iihs.org/research/hldi/fact\\_sheets/collision\\_coverage\\_trends\\_73-07.pdf](http://www.iihs.org/research/hldi/fact_sheets/collision_coverage_trends_73-07.pdf) (last visited Mar. 19, 2008).

29. Cf. *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 458-59 (1993) (noting the difficulties in distinguishing between robust competition and anticompetitive behavior).

30. "Steering" refers to an illegal insurance industry practice, CAL. INS. CODE § 1874.87(b)(1) (West 2005), of directing insureds and/or claimants to or away from specific repair facilities. See BRUCE CORNBLUM, AUTO BODY REPAIR LAW IN THE UNITED STATES, ENCYCLOPEDIA OF LAWS 397 (2007) [hereinafter CORNBLUM, ENCYCLOPEDIA].

31. "Capping" refers to an insurance industry practice of "placing . . . an arbitrary limit on the cost of paint, materials, or labor used to restore a damaged vehicle." *Id.* at 81.

have allowed the insurance industry to direct the automotive repair industry on how to conduct its business, and dictate at what price the repair industry can charge.<sup>33</sup> The insurance industry's ability control another industry is astonishing, unprecedented, and begs the question, how?

How can the California automotive repair industry, a \$2.3 billion dollar industry,<sup>34</sup> be so powerless? Answering this question requires a closer look at how the automotive repair industry became a \$2.3 billion dollar industry.

In California there are approximately 4,800 repair facilities.<sup>35</sup> Seventy-five percent<sup>36</sup> of the vehicles in need of repair by these 4,800 repair facilities are controlled by fewer than 50 insurance companies.<sup>37</sup> This oligopsonistic<sup>38</sup> power will put even the largest industry at the mercy of the oligopsonist.

At first glance this oligopsonistic power appears to benefit society, as it allows the insurance industry to keep premiums down by controlling its costs. However, whatever is saved in premiums is more than lost in unforeseen costs. Known as externalities,<sup>39</sup> these unforeseen costs include everything from lower wages for repair facility employees and unprofitable repair facilities, to improperly repaired vehicles due to the repair industry's inability to train and equip technicians to repair increasingly advanced vehicles.

#### IV. UNDERSTANDING THE RELATIONSHIPS AND THE FRUSTRATION

##### A. *The Relationship: How It Is and How It Should Be*

Most individuals understand the interaction between an insured,<sup>40</sup>

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32. A "labor rate survey" is a questionnaire that is disseminated to repair facilities in a predetermined area for the purpose of assessing the prevailing rate in that area. This prevailing rate is the maximum rate an insurance company is legally required to pay. *Id.* at 442-43.

33. *See Industry Report, supra* note 27, at 3.

34. *Id.* at 5.

35. *Id.*

36. Interview with Gary Stephen, *supra* note 26.

37. California Department of Insurance, Consumers: Auto Premium Comparison, <http://www.insurance.ca.gov/0100-consumers/0010-buying-insurance/0080-compare-premiums/auto-footnotes.cfm> (last visited Jan. 28, 2009).

38. An oligopsonist is one who shares control of a market with a few other large buyers or customers. BLACK'S LAW DICTIONARY 1120 (8th ed. 2004).

39. *See SULLIVAN & HARRISON, supra* note 3, at 175 (explaining that externalities are unforeseen costs).

40. Although a customer may be either an insured or claimant, I have chosen to refer to the customer as the "insured" to avoid needlessly complicating the hypothetical.

insurer, and repair facility as a relatively uncomplicated interaction. At its most basic level, this trio of interactions is simple, and can be broken into three stages: (1) the accident/report stage; (2) the choice of repair facility stage; and (3) the negotiation/repair stage.

First, after an accident occurs, the insured reports the accident to his insurer and files a claim. If the insured has not chosen a specific repair facility, the insurer will arrange a time and place where the vehicle can be inspected.<sup>41</sup> After this inspection, the insurer will construct a preliminary estimate.<sup>42</sup>

Second, if the insured has a repair facility in mind, the insured will take the vehicle to that repair facility, and the repair facility will prepare an estimate of its own.<sup>43</sup> If the insured does not have a repair facility in mind, which is often the case, and requests a recommendation from the insurer,<sup>44</sup> the insurer will recommend a repair facility from its directory.<sup>45</sup> Once the insured has selected a repair facility, he is almost entirely out of the picture, and any further communications will be, for the most part, exclusively between the insurer and the repair facility.<sup>46</sup>

Third, the insurer and the repair facility will compare estimates.<sup>47</sup> If there is a discrepancy, which there most often is, the insurer and repair facility will negotiate in an attempt to arrive at a price that is acceptable to both.<sup>48</sup> If an agreement is not reached, the insured is free to leave the vehicle at the repair facility, but will only receive the amount reflected on the insurance company's estimate.<sup>49</sup> Any amount in excess of the insurer's estimate will be billed directly to the insured, typically before the repaired vehicle is delivered.<sup>50</sup>

This scenario accurately depicts a triangular relationship, with points consisting of: (1) insured; (2) insurer; and (3) repair facility. These points are connected by relationships composed of: (1) insured-insurer relationship; (2) insured-repair facility relationship; and (3) insurer-repair facility relationship. Mindful of the insurer's role—to indemnify the insured—and

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41. *Workman v. State Farm Mut. Auto. Ins. Co.*, 520 F. Supp. 610, 613 (N.D. Cal. 1981).

42. *Id.*

43. *Id.*

44. CAL. INS. CODE § 758.5(b)(1) (West 2005) (prohibiting an insurer from recommending a repair facility to the insured unless and until the insured requests a recommendation, or is informed in writing of his right to select a repair facility).

45. *Workman*, 520 F. Supp. at 613.

46. Interview with Gary Stephen, *supra* note 26.

47. *Workman*, 520 F. Supp. at 613.

48. *Id.*

49. *Id.*

50. *Id.*

the repair facility's role—to restore the insured's vehicle to pre-accident condition—one would expect the insurer-repair facility relationship to be limited to the insurer issuing a check to the repair facility for previously authorized repairs performed to the insured's vehicle. Yet the repair facility-insurer relationship is extensive, involving preliminary estimates, supplemental estimates, and negotiations about labor rates, aftermarket parts, paint materials, and virtually every aspect of the repair process.<sup>51</sup>

One might assume that the insurer's entanglement in the repair process is to ensure that the repairs are performed properly. However, this assumption is negated by the fact that the repair facility is required by law to restore the insured's vehicle to its pre-accident condition, while the insurer is required only by contract.<sup>52</sup> What is troubling about the insurer's entanglement in the repair process is the lack of remedies available to a repair facility in the event that an insurer-repair facility relationship deteriorates.

Although the insured-insurer relationship and the insured-repair facility relationship both have some form of administrative remedy in the event of a conflict,<sup>53</sup> problems that arise in the insurer-repair facility relationship must be settled entirely amongst the parties, without any administrative assistance.<sup>54</sup> This lack of administrative remedy would not be an issue if some sort of contractual relationship existed between the insurer and repair facility. Although there is contractual privity between the insured and insurer, and the insured and repair facility, there is typically no contractual privity between the insurer and the repair facility.<sup>55</sup>

The insurer-repair facility relationship is nothing more than a non-contractual arm's-length relationship.<sup>56</sup> The legislature intended this to be

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51. See *infra* Part VI.D.

52. See *Levy v. State Farm Mut. Auto. Ins. Co.*, 58 Cal. Rptr. 3d 54, 58-59 (Ct. App. 2007) (explaining that California Code of Regulations, title 16, section 3365, which sets the acceptable trade standards for the repair industry, does not govern the insurance industry, and therefore any insurance policy that promises to restore the insured's vehicle to its pre-accident condition must be interpreted by its plain meaning, as interpreted by a lay person).

53. The Bureau of Automotive Repair governs the insured-repair facility relationship. See CAL. BUS. & PROF. CODE § 9880.3 (West Supp. 2009). The California Department of Insurance ("DOI") governs the insured-insurer relationship. See California Dep't of Ins., *Complaints Within the Jurisdiction of the California Insurance Commissioner*, GUIDE TO INS. RELATED AUTO BODY, May, 2005, [http://www.insurance.ca.gov/0100-consumers/0060-information-guides/0010-auto-mobile/upload/Guide\\_To\\_Repairs\\_Web\\_Combined.pdf](http://www.insurance.ca.gov/0100-consumers/0060-information-guides/0010-auto-mobile/upload/Guide_To_Repairs_Web_Combined.pdf) (last visited Mar. 19, 2008).

54. Although it would seem that the DOI governs this relationship, the DOI has made clear that repair facilities are not parties to insurance contracts and therefore the DOI is very limited in the assistance it can offer the repair facility.

55. See *infra* Part IV.B.

56. See BLACK'S LAW DICTIONARY 1535 (8th ed. 2004) (defining arm's-length transaction as "[a] transaction between two unrelated and unaffiliated parties").

an arm's-length relationship, allowing the insurance company only to "reasonab[ly] adjust written estimates prepared by the repair shop."<sup>57</sup> Also, the Bureau of Automotive Repair ("BAR") has stated that it is the insured, not the insurer that is responsible for authorizing any repairs to his vehicle.<sup>58</sup> This further indicates that the insurer's interaction with the repair facility is intended to be limited.

If the insurer-repair facility relationship is nothing more than an arm's-length relationship, why is the insurance industry so entangled in the repair industry's business,<sup>59</sup> and why does the repair industry allow it? First, the insurance industry wants to be extremely involved because it is able to drastically cut costs. Second, if the repair industry doesn't allow this intrusion; it is forced to deal with it.<sup>60</sup> The insurance industry's oligopsonistic power forces a repair facility to tolerate insurer entanglement if the repair facility wants to remain in business. Unfortunately, this entanglement does not end with the insurer-repair facility relationship. The insurance industry's use of "captured" shops, along with its creation of the "prevailing rate," allows the insurance industry to interfere with the insured-repair facility relationship.<sup>61</sup>

#### B. *Perpetuating the Entanglement: Captured Shops and the Prevailing Rate*

Through the creation of a repair facility "directory," the insurance industry has managed to enlist "captured" repair facilities to aid in its control of the repair industry.<sup>62</sup> A repair facility "directory" is a list of "captured shops"<sup>63</sup> that, unlike the shops involved in the scenario above, are in contractual privity with the insurance company. These shops agree to repair vehicles at the "prevailing rate," which is set by the insurer, and perform certain tasks at no charge in exchange for insurer referrals.<sup>64</sup> Additionally, these repair facilities write preliminary estimates and submit

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57. CAL. CODE REGS. tit. 10, § 2695.8(f)(3) (2007).

58. CAL. BUS. & PROF. CODE § 9884.9 (West Supp. 2009) (disallowing the insured from even assigning the ability to authorize repairs to the insurer).

59. *See infra* Part VI.D.

60. *See infra* Part VI.D.

61. *See infra* Part VI.D.

62. *Proctor v. State Farm Mut. Auto. Ins. Co.*, 675 F.2d 308, 311 (D.C. Cir. 1982).

63. *Id.*

64. *See id.* at 309; CORNBLUM, ENCYCLOPEDIA, *supra* note 30, at 441.

them for approval, alleviating the need for the insurer-written preliminary estimate.<sup>65</sup> This drastically reduces conflicts and expedites the process.

The directory is created on the basis of a survey that is distributed to, and completed by, various repair facilities in a predetermined area.<sup>66</sup> The survey is created by the insurance company and requests information such as location, description of the shop's facility, and hourly rates for labor, mechanical work, and paint.<sup>67</sup> However, these surveys do not take into account compliance with regulatory laws,<sup>68</sup> quality of workmanship, customer satisfaction, safety record, or various other attributes.<sup>69</sup> These surveys include the already discounted rates that captured shops charge the insurer. Although the inclusion of these discounted rates does not accurately reflect the "prevailing rate" of the geographic area, this practice is perfectly legal.<sup>70</sup>

Subsequent to the collection of each insurance company's survey, the data is submitted to the California Department of Insurance, and made available to the entire insurance industry.<sup>71</sup> Allegedly this information is compiled to create a "common formula" that each insurance company uses to set its "prevailing" labor rate.<sup>72</sup>

The completed surveys serve two purposes. First they assist the insurer in determining which repair facilities are eligible to be added to the insurer's directory.<sup>73</sup> Second, the surveys help the insurer compute the "prevailing competitive labor rate" for the area.<sup>74</sup> The prevailing labor rate is the cause of much frustration among repair facility owners, as it is the

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65. *Cf. A & R Body Specialty v. Progressive Cas. Ins. Co.*, No. 3:07-cv-0929, 2008 WL 2229888, at \*1 (D. Conn. May 28, 2008).

66. *Workman v. State Farm Mut. Auto. Ins. Co.*, 520 F. Supp. 610, 613 (N.D. Cal. 1981).

67. *Id.*

68. Law-abiding repair facilities must comply with numerous laws, including: environmental protection laws, workers' compensation laws, building and safety laws, and occupational safety laws just to name a few. *See, e.g.*, California Business Portal, Establishing Your Business in California, <http://www.calbusiness.ca.gov/cedpeybcbllr.asp> (last visited Mar. 10, 2009).

69. The only information required by law to be included in a prevailing rate survey is the names and addresses of the repair facilities, and the total number of repair facilities surveyed. CAL. INS. CODE § 758(c) (West 2005). Because inquiry into these issues would discredit the insurance industry's assumption that all shops in a given area are equal, the insurance industry purposefully neglects to ask these important questions.

70. *See Levy v. State Farm Mut. Auto. Ins. Co.*, 58 Cal. Rptr. 3d 54, 59-60 (Ct. App. 2007) (comparing the law of Rhode Island, which does not allow the inclusion of captured shop rates in the prevailing rate survey, with California law, which allows this practice).

71. CAL. INS. CODE § 758 (West 2005).

72. *Proctor v. State Farm Mut. Auto. Ins. Co.*, 675 F.2d 308, 311 (D.C. Cir. 1982).

73. *Hardy Bros. Body Shop v. State Farm Mut. Auto. Ins. Co.*, 848 F. Supp. 1276, 1280-81 (S.D. Miss. 1994).

74. *Workman v. State Farm Mut. Auto. Ins. Co.*, 520 F. Supp. 610, 613 (N.D. Cal. 1981).

absolute maximum rate that an insurer is contractually required to pay a non-captured repair facility, irrespective of a repair facility's posted rates.

Both the prevailing rate and the directory allow the insurance industry to interfere with the insured-repair facility relationship. Because "captured" shops are in contractual privity with specific insurance companies, and thereby have agreed to repair vehicles for the "prevailing rate," insurance companies vigorously encourage insureds to go to captured shops. Although blatant demands or suggestions to an insured will amount to illegal steering,<sup>75</sup> the insurance industry has institutionalized subtle forms of steering that harm non-captured repair facilities, but are nevertheless legal.<sup>76</sup>

The insurance industry's incredible ability to manipulate the insured-repair facility relationship is nothing new, and neither is the aggravation that it has caused the automotive repair industry.<sup>77</sup> Frustrated with this inequity, the repair industry has been pushing back in the legal arena for decades.<sup>78</sup> However, as described below, these attempts have been unsuccessful.

#### V. FAILED ATTEMPTS UNDER AN ANTITRUST THEORY

Although the Sherman Act offers attractive redress,<sup>79</sup> and has been pursued by the automotive repair industry on numerous occasions,<sup>80</sup> plaintiffs have had no significant success. Nearly every time the automotive repair industry has sought relief under a federal antitrust theory, it has lost.<sup>81</sup> In order to prevail under a federal antitrust theory, the automotive repair industry faces two enormous hurdles. First, it must be established that the activity in question is not exempted from the Sherman Act via the McCarran Act. Second the activity itself must violate the Sherman Act.

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75. See CORNBUM, ENCYCLOPEDIA, *supra* note 30, at 397.

76. For example, insurers will tell an insured that a non-captured repair facility is not in the directory. This may dissuade an insured from taking his vehicle to that non-captured shop. See *Industry Profile Report*, BODY SHOP BUS., May 2007, at 52.

77. See, e.g., *Proctor*, 675 F.2d at 311 (Litigation began in 1975.).

78. See, e.g., *Workman*, 520 F. Supp. at 612.

79. An antitrust judgment includes treble damages, the cost of the suit, and reasonable attorneys' fees. 15 U.S.C. § 15 (2000).

80. See cases cited *infra* note 81.

81. See, e.g., *Proctor*, 675 F.2d at 339; *Custom Auto Body, Inc. v. Aetna Cas. & Sur. Co.*, No. 78-0301, 1983 WL 1873, at \*21 (D. R.I. Aug. 3, 1983); *Quality Auto Body v. Allstate Ins. Co.*, 660 F.2d 1195, 1206 (7th Cir. 1981); *Workman*, 520 F. Supp. at 625-26 (stating that although granting summary judgment against an antitrust claim is rare, such an action was appropriate in this situation).

*A. The Theory*

The repair industry has typically pursued two antitrust theories against the insurance industry. First, the repair industry has claimed that the prevailing rate surveys, once compiled, amount to unlawful horizontal agreements.<sup>82</sup> The second theory is that using captured repair facilities, who agree in advance to repair vehicles for a fixed price, amounts to an unlawful vertical agreement.<sup>83</sup>

As for the prevailing rate surveys, it is not the formation, distribution, or questions that are the focus of the challenge, rather it is the manner in which the surveys are used after being collected and compiled.<sup>84</sup> This collaboration amounts to a suspect “horizontal agreement,”<sup>85</sup> because it is a concerted refusal to deal with repair shops that do not lower their rates to the “prevailing” rate.<sup>86</sup> Although horizontal agreements are often per se antitrust violations,<sup>87</sup> and although these specific horizontal agreements are created with the purpose of artificially suppressing labor rates, this practice is not only legal, but also encouraged.<sup>88</sup>

To make matters worse, these suppressed labor rates are facilitated by vertical<sup>89</sup> agreements between insurers and captured repair facilities.<sup>90</sup> Many captured repair facilities agree to become captured because there simply is no other way to remain profitable.<sup>91</sup> Thus, the insurance industry’s ability to fix cost is fostered by the repair facilities that have succumbed to the insurance industry’s pressure, and have agreed to work for the artificial “prevailing rate.”<sup>92</sup>

This combination of horizontal and vertical agreements allows the insurance industry to boycott repair facilities that do not lower their rates to the artificial prevailing rate.<sup>93</sup> Although this appears to be a relatively straightforward antitrust violation, this type of activity has been found to be

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82. *See, e.g., Proctor*, 675 F.2d at 311.

83. *Id.*

84. *See id.*

85. *See SULLIVAN & HARRISON, supra* note 3, at 115 (explaining that a horizontal agreement can take many forms).

86. *See id.*

87. *Id.*

88. *See Proctor v. State Farm Mut. Auto. Ins. Co.*, 675 F.2d 308, 315 (D.C. Cir. 1982).

89. *See SULLIVAN & HARRISON, supra* note 3, at 213.

90. *Proctor*, 675 F.2d at 311.

91. *See Industry Profile Report*, BODY SHOP BUS., May 2007, at 54 (demonstrating that sixty-four percent of captured shops believe that the concept is bad for the industry).

92. *Proctor*, 675 F.2d at 311.

93. *Id.*

immune from federal antitrust laws because it is precisely what Congress intended the McCarran Act to exempt.<sup>94</sup>

*B. First Ground For Failure: McCarran Act*<sup>95</sup>

The McCarran Act has three essential clauses. First, “[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance.”<sup>96</sup> Second, “the Sherman Act . . . shall be applicable to the business of insurance to the extent that such business is not regulated by State Law.”<sup>97</sup> Third, “[n]othing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.”<sup>98</sup>

Thus, for an insurance activity to be exempt from federal antitrust laws, three requirements must be met.<sup>99</sup> First the activity must be considered a part of the “business of insurance.”<sup>100</sup> Second, the activity in question must be “regulated by State law.”<sup>101</sup> Third, the activity must not involve “boycott[ing], coercion, or intimidation.”<sup>102</sup>

The insurance industry practices discussed above have been held to meet all three requirements.<sup>103</sup> Courts have been gracious in their interpretation of what falls within the antitrust exemption of the McCarran Act.<sup>104</sup> Thus, the most difficult hurdle facing the automotive repair industry, when seeking relief on an antitrust theory, is establishing that the alleged wrongful act is within the purview of the Sherman Act, and not exempt due to the McCarran Act.

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94. *Id.* at 315; ABA, HANDBOOK, *supra* note 12, at 43, 45.

95. 15 U.S.C. §§ 1011-15 (2000).

96. *Id.* § 1012(b).

97. *Id.*

98. *Id.* § 1013(b).

99. *Arroyo-Melecio v. Puerto Rican Am. Ins. Co.*, 398 F.3d 56, 66 (1st Cir. 2005).

100. *Id.*

101. *Id.*

102. *Id.*

103. *See, e.g.*, cases cited *supra* note 81.

104. *See, e.g.*, cases cited *supra* note 81.

1. “Regulated By State Law”

The McCarran Act is a form of “reverse-preemption.”<sup>105</sup> Thus, in the arena of insurance regulation, state law will preempt contrary federal law unless the federal law expressly applies to insurance.<sup>106</sup> Although this may seem to give the insurance industry an advantage, it is nevertheless a requirement. Even if the activity in question is within the meaning of “business of insurance,” the activity will only be exempt if it is also “regulated by State law.”<sup>107</sup> However, over the past six decades, this requirement has been so broadly interpreted that even “general regulatory supervision or legislation in the state where the activity occurs is sufficient, without inquiry into the efficacy of enforcement.”<sup>108</sup>

Additionally, the California automotive insurance industry is heavily regulated,<sup>109</sup> and the California Legislature created an entire body of law for the purpose of satisfying this prong.<sup>110</sup> Thus, there would be no doubt that the activity is “regulated by state law.” Hence, the automotive repair industry has never sought to establish that an insurance activity was outside of the reach of the McCarran Act due to a lack of state regulation.

2. “Boycott, Coercion, or Intimidation”

Insurance activity does not avail itself of the McCarran exemption if the activity or practice involves boycott, coercion, or intimidation.<sup>111</sup> This prong of the three-part analysis has been the focus of litigation.

In *Workman v. State Farm Mutual Automobile Insurance Co.*, a group of repair facility owners sought relief from several insurance companies for alleged violations of federal antitrust laws.<sup>112</sup> Plaintiffs alleged that the insurance companies engaged “in two different conspiracies to boycott plaintiffs’ businesses[:] (1) a horizontal conspiracy among insurance

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105. *Barnett Bank of Marion County, N.A. v. Gallagher*, 43 F.3d 631, 634 (11th Cir. 1995).

106. *Id.*

107. *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 210 n.4 (1979).

108. ABA, EXEMPTIONS, *supra* note 11, at 150; *accord* *Proctor v. State Farm Mut. Auto. Ins. Co.*, 675 F.2d 308, 317 n.17 (D.C. Cir. 1982).

109. *See generally* CAL. INS. CODE §§ 1-16030 (West 2005).

110. *See Mfr.’s Life Ins. Co. v. Superior Court*, 895 P.2d 56, 60 (Cal. 1995) (holding that the Unfair Insurance Practices Act (UIPA) was enacted with the purpose of displacing federal law).

111. 15 U.S.C. § 1013(b) (2000).

112. *Workman v. State Farm Mut. Auto. Ins. Co.*, 520 F. Supp. 610, 622 (N.D. Cal. 1981). Plaintiffs claimed that the insurance companies boycotted their repair facilities by: (1) dissuading vehicle owners from using their repair facilities; (2) threatening to remove vehicles from their facilities unless they yielded to price demands; and (3) informing vehicle owners not to use plaintiffs’ facilities because their prices were too high. *Id.* at 623.

companies to boycott; and (2) a conspiracy between the insurance companies and their insureds.”<sup>113</sup> Although the *Workman* court noted the Supreme Court’s holding in *St. Paul Fire & Marine Insurance Co. v. Barry*,<sup>114</sup> which expanded the definition of “boycott” beyond “blacklisting,”<sup>115</sup> it held that the defendants’ did not “boycott” the plaintiffs’ repair facilities.<sup>116</sup> The court reasoned that the plaintiffs “fail[ed] to recognize . . . that the lynchpin of an actionable group boycott under the antitrust laws is concerted action[,]” and plaintiffs were “unable to point to any shred of evidence which would suggest that defendants concertedly directed insureds away from plaintiffs’ autobody shops.”<sup>117</sup> This holding was further supported by the fact that two-thirds of plaintiffs’ business came from the defendants.<sup>118</sup>

Although this prong’s interpretation has been broadened, establishing concerted action has proven difficult and repair industry challenges have generally failed.

### 3. “Business of Insurance”

The McCarran Act does not provide a definition of the “business of insurance.”<sup>119</sup> Unlike the “regulated by state law” requirement, the “business of insurance” requirement is highly litigated and has been narrowly construed.<sup>120</sup> The definition of “business of insurance” has tapered from its original interpretation, encompassing all activities of an insurance company, to a more definitive, element-driven understanding.<sup>121</sup>

Today’s interpretation traces its origins to two seminal cases heard by the Supreme Court in 1979 and 1982: respectively, *Group Life & Health Insurance Co. v. Royal Drug Co., Inc.*<sup>122</sup> and *Union Labor Life Insurance Co. v. Pireno*.<sup>123</sup> In these cases, the Court expressed three elements that must be considered when determining whether a specific practice is the within the McCarran Act’s definition of “business of insurance.” First, the

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113. *Id.* at 623.

114. 438 U.S. 531, 532 (1978).

115. *Id.* at 532.

116. *Workman*, 520 F. Supp. at 622.

117. *Id.* at 623.

118. *Id.*

119. *Custom Auto Body, Inc. v. Aetna Cas. & Sur. Co.*, No. 78-0301, 1983 WL 1873, at \*6 (D. R.I. Aug. 3, 1983).

120. ABA, EXEMPTIONS, *supra* note 11, at 149.

121. *See id.*

122. 440 U.S. 205 (1979).

123. 458 U.S. 119 (1982).

activity in question must have the effect of transferring or spreading the insurer's risk.<sup>124</sup> Second, the activity must be "an integral part of the policy relationship between the insurer and the insured."<sup>125</sup> Last, the activity must be limited to entities in the insurance industry.<sup>126</sup>

Because the "business of insurance" requirement appears to be the weak-link in the chain of protection, it is the focus of much attack.<sup>127</sup> These challenges are made by the repair industry consistently in two forms.<sup>128</sup> First, challenges to horizontal agreements between multiple insurance companies; and second, challenges to vertical agreements between insurance companies and repair facilities.<sup>129</sup>

Horizontal agreements are "arrangement[s] among rivals to divide the market or set prices."<sup>130</sup> Courts have recognized that horizontal agreements are fundamentally different from vertical agreements because they are "wholly intra-industry agreements" and as such, should not be analyzed in the same manner.<sup>131</sup> Unfortunately for the repair industry, determining the magnitude of loss is within the meaning of business of insurance, and knowing the cost to repair a damaged vehicle is part of that calculation.<sup>132</sup> Thus, the "business of insurance" includes horizontal agreements between insurance companies used to establish the prevailing rate.<sup>133</sup>

Conversely, the "business of insurance" does not include vertical agreements<sup>134</sup> between the insurance industry and captured repair facilities.<sup>135</sup> This crack in the insurance industry's nearly impenetrable McCarran Act defense began with the holding in *Royal Drug*.

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124. *Id.* at 129; accord *Arroyo-Melecio v. Puerto Rican Am. Ins. Co.*, 398 F.3d 56, 67 (1st Cir. 2005).

125. *Union Labor*, 458 U.S. at 129; accord *Arroyo-Melecio*, 398 F.3d at 67.

126. *Union Labor*, 458 U.S. at 129; accord *Arroyo-Melecio*, 398 F.3d at 67.

127. *See, e.g.*, *Proctor v. State Farm Mut. Auto. Ins. Co.*, 675 F.2d 308, 312 (D.C. Cir. 1982) (challenging the district court's holding that the creation of a common formula to reimburse insureds was within the meaning of "business of insurance"); *Quality Auto Body v. Allstate Ins. Co.*, 660 F.2d 1195, 1201 (7th Cir. 1981) (claiming that vertical agreements were not within the meaning of "business of insurance").

128. *See, e.g.*, *Proctor*, 675 F.2d at 318, 335.

129. *Id.*

130. SULLIVAN & GRIMES, *supra* note 8, at 185.

131. *Proctor*, 675 F.2d at 322 (distinguishing *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979), on the grounds that it dealt with vertical agreements not horizontal agreements).

132. *Id.* at 323.

133. *See, e.g., id.* at 324-25; *Quality Auto Body v. Allstate Ins. Co.*, 660 F.2d 1195, 1201 n.4 (7th Cir. 1981); *Workman v. State Farm Mut. Auto. Ins. Co.*, 520 F. Supp. 610, 615-16 n.7 (N.D. Cal. 1981).

134. SULLIVAN & GRIMES, *supra* note 8, at 317.

135. *See, e.g., Proctor*, 675 F.2d at 336.

In *Royal Drug*, Justice Stewart held that the McCarran Act is concerned with exempting the “business of insurance,” not “the business of insurers.”<sup>136</sup> This distinction is crucial, as Justice Stewart explained, and is supported by the legislative intent behind the McCarran Act.<sup>137</sup> Thus, arrangements between insurers and suppliers that “do not involve any underwriting or spreading of risk, but are merely arrangements for the purchase of goods and services” are not within the purview of the McCarran Act and therefore not exempt from the Sherman Act.<sup>138</sup> Accordingly, the McCarran Act does not exempt the “captured” shop agreements from antitrust regulation. However, this is just the tip of the iceberg, as the question of whether this is a violation of federal antitrust remains.

C. *Second Ground for Failure: The Sherman Act*<sup>139</sup>

If the automotive repair industry is able to convince a court that the McCarran Act does not protect an insurance company’s practice, the battle is only half over. At this point, all the auto repair industry has established is that the practice can be analyzed under a federal antitrust theory. To prevail, it must still be established that the practice in question is a violation of the Sherman Act.<sup>140</sup> This has proven to be difficult.<sup>141</sup>

The Sherman Act prohibits price-fixing, whether by a buyer or a seller.<sup>142</sup> What the automotive repair industry seeks to prevent is buyer price-fixing, sometimes referred to as “buyer-cartels.”<sup>143</sup> To prevail under the Sherman Act, the automotive repair industry must satisfy the Fifth Circuit’s two-pronged test.

First, the activity must effectively violate the law of mergers.<sup>144</sup> This

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136. *Royal Drug*, 440 U.S. at 211.

137. *Id.* at 206 (“[N]o legislative intention is disclosed to exempt agreements or transactions between insurance companies and entities outside the insurance industry[.]”).

138. *Id.* at 214.

139. 15 U.S.C. §§ 1-7 (2000).

140. *See Proctor*, 675 F.2d at 337 (affirming the lower court’s holding that vertical agreements between the insurance company and its “captured” repair facilities were outside the McCarran Act’s definition of “business of insurance” but nevertheless did not violate antitrust laws).

141. *Cf. Royal Drug*, 440 U.S. at 210 n.5 (stating that, “[i]t is axiomatic that conduct which is not exempt from the antitrust laws may nevertheless be perfectly legal”).

142. *Proctor*, 675 F.2d at 327 n.39.

143. SULLIVAN & GRIMES, *supra* note 8, at 195.

144. *Hardy Bros. Body Shop v. State Farm Mut. Auto. Ins. Co.*, 848 F. Supp. 1276, 1290 (S.D. Miss. 1994) (citing *Union City Barge Lines v. Union Carbide Corp.*, 823 F.2d 129, 138 (5th Cir. 1987)).

can be established by showing a loss of business, price fixing, or an exclusive reciprocal dealing.<sup>145</sup> Second, the activity must otherwise threaten Sherman Act values.<sup>146</sup> Additionally, because most business transactions restrain trade to some extent, courts apply the “rule-of-reason” doctrine to determine the degree of impact and whether the activity is in violation of the Sherman Act.<sup>147</sup>

These requirements are extremely difficult to satisfy and cannot be established by mere allegations.<sup>148</sup> Even if more than mere allegations are established, the repair industry still has an uphill battle. A mere refusal to deal is not an antitrust violation.<sup>149</sup> The automotive repair industry would have to establish that the challenged practice includes some sort of “conscious commitment to a common scheme designed to achieve an unlawful objective.”<sup>150</sup> Further, courts have held that paying the lowest prevailing rate is the “essence of competition.”<sup>151</sup> This makes it extremely difficult for the automotive repair industry to establish that the insurance industry’s creation of a prevailing rate, and use of repair facilities that will only charge that amount, constitutes an antitrust violation.

In light of the challenges the automotive repair industry faces when pursuing relief under a federal antitrust theory, alternative avenues of redress become more alluring. Congress intended that state law regulate the “business of insurance,” not that it be unregulated.<sup>152</sup> Thus, a state law cause of action should be considered to address an unfair insurance practice. In California, Business and Professions Code section 17200 might provide the basis for such a claim.

## VI. A NEW HOPE: CALIFORNIA BUSINESS AND PROFESSIONS CODE §17200

Section 17200 of the California Business and Professions Code is a legislative reenactment of former section 3369 of the California Civil

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145. *Id.*

146. *Id.*

147. *Id.*; see BLACKS LAW DICTIONARY 1360 (8th ed. 2004) (defining “rule of reason” as a doctrine that determines whether a restraint of trade is reasonable based on economic factors).

148. See *Hardy Bros. Body Shop*, 848 F. Supp. at 1290.

149. *Quality Auto Body v. Allstate Ins. Co.*, 660 F.2d 1195, 1200 (7th Cir. 1981).

150. *Edward J. Sweeney & Sons, Inc. v. Texaco, Inc.*, 637 F.2d 105, 111 (3d Cir. 1980), *cert. denied*, 451 U.S. 911 (1981).

151. *Chick’s Auto Body v. State Farm Mut. Auto. Ins. Co.*, 401 A.2d 722, 731-32 (N.J. Super. Ct. Law Div. 1979).

152. *Arroyo-Melecio v. Puerto Rican Am. Ins. Co.*, 398 F.3d 56, 66 (1st Cir. 2005).

code.<sup>153</sup> Section 3369 was enacted in 1872 as a statutory prohibition of the common law tort known as unfair competition.<sup>154</sup> In 1977, the Legislature reenacted section 3369 as section 17200 of the Business and Professions Code as a “catch-all” to the 1941 Unfair Practices Act (hereafter UPA).<sup>155</sup> Both section 3369 and 17200 are commonly referred to as the “unfair competition law” (hereafter 17200).<sup>156</sup>

Unlike the UPA, section 17200 does not prohibit specific acts or practices.<sup>157</sup> As amended, the statute prohibits “unfair competition,” which it defines as “any unlawful, unfair or fraudulent business act or practice . . . .”<sup>158</sup> The California legislature intended this statute to preserve fair business competition.<sup>159</sup> To prevail under a section 17200 claim, the automotive repair industry must establish: (1) that a specific act or practice of an insurance company, or the industry as a whole, is unlawful, fraudulent, or unfair; and (2) the act or practice is not protected by a “safe harbor” provision.<sup>160</sup>

#### A. *17200 v. Federal Antitrust: Any Win Is Still A Win*

Section 17200 is a modest remedy. Unlike the treble damages and attorneys’ fees available to antitrust plaintiffs, section 17200 limits its awards to injunctive relief<sup>161</sup> or restitution or both.<sup>162</sup> However, it is a winning theory, and a small win is better than a loss.

Section 17200 governs anti-competitive business practices as well as injuries to consumers. Its purpose is the preservation of “fair business competition.”<sup>163</sup> The Legislature intended section 17200 as a civil cause of

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153. *Cel-Tech Commc’ns Inc. v. Los Angeles Cellular Tel. Co.*, 973 P.2d 527, 549 (Cal. 1999) (Kennard, J., concurring and dissenting).

154. 2 ROXANE A. POLIDORA ET AL., CALIFORNIA ANTITRUST AND UNFAIR COMPETITION LAW 18 (Daniel J. Morgin ed., 3d ed. 2003); *Cel-Tech*, 973 P.2d at 549 (Kennard, J., concurring and dissenting).

155. CAL. BUS. & PROF. CODE §§ 17000-17440.34 (West Supp. 2009) (This is commonly known as the Unfair Competition Act.).

156. *Cel-Tech*, 973 P.2d at 532 n.2, 540 n.9.

157. *Id.* at 539.

158. CAL. BUS. & PROF. CODE §§ 17200-17208 (West Supp. 2009).

159. *Cel-Tech*, 973 P.2d at 539 (quoting *Barquis v. Merchs. Collection Ass’n*, 496 P.2d 817, 828 (Cal. 1972)).

160. *Cel-Tech*, 973 P.2d at 541-42 (“When specific legislation provides a ‘safe harbor,’ plaintiffs may not use the general unfair competition law to assault that harbor.”).

161. See CAL. BUS. & PROF. CODE § 17204 (West Supp. 2009).

162. § 17203.

163. *Cel-Tech*, 973 P.2d at 539.

action to be used to prevent any business practice that is forbidden by law.<sup>164</sup> However, its broad scope does not end there. Because section 17200 is disjunctive, it establishes three varieties of acts or practices that are considered unfair competition: unlawful, unfair, or fraudulent practices.<sup>165</sup> Thus, it is not limited to just unlawful acts.

The Legislature made clear that section 17200 would deem a practice unfair even if it were not unlawful.<sup>166</sup> This was intended to give courts wide discretion, as “unfair or fraudulent business practices may run the gamut of human ingenuity and chicanery.”<sup>167</sup> Additionally, there is no intent requirement for section 17200 and thus a plaintiff need not establish any malicious intent on the part of the defendant. Given the vast possibilities that a section 17200 claim brings, it is surprising that the repair industry has not sought relief under this theory more often.

#### B. G & C Auto Body: *Opening the Possibilities*

In December of 2007, in *G & C Auto Body Inc. v. Geico General Insurance Co.*,<sup>168</sup> two automotive repair facilities sued several insurance companies alleging the insurance companies engaged in unfair competition, in violation of section 17200.<sup>169</sup> In particular, the plaintiffs alleged that the defendant insurance companies used labor rates that were below the prevailing rate to resolve claims, and that the defendants were steering policyholders away from the plaintiffs’ repair facilities.<sup>170</sup> Under section 17200, the plaintiffs sought both available remedies, restitution and injunctive relief.<sup>171</sup>

In support of their restitution claim, the plaintiffs produced evidence of unpaid accounts receivable that resulted from the defendants’ failure to pay the full labor rates charged by the plaintiffs, and claimed “loss of business caused by the defendants’ steering of customers away from the plaintiffs’

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164. *AICCO, Inc. v. Ins. Co. of N. Am.*, 109 Cal. Rptr. 2d 359, 366 (Ct. App. 2001).

165. *Cel-Tech*, 973 P.2d at 540.

166. *Id.*

167. *People ex. rel. Mosk v. Nat’l Research Co. of Cal.*, 20 Cal. Rptr. 516, 521 (Ct. App. 1962); *see also* *Am. Philatelic Soc’y v. Claibourne*, 46 P.2d 135, 140 (Cal. 1935) (“[A] court of equity is not impotent to frustrate [an unfair act or practice’s] consummation because the scheme is an original one.”).

168. No. C06-04898 MJJ, 2007 WL 4350907 (N.D. Cal. Dec. 12, 2007).

169. *Id.* at \*1.

170. *Id.*

171. *Id.* at \*2.

auto repair shops.”<sup>172</sup> However, the court held against the plaintiffs on their restitution claims because they lacked standing.<sup>173</sup>

The court did not find that the repair facilities were entitled to restitution for the insurance company’s allegedly unfair activities for two reasons. First, restitution requires that a defendant take money or property directly from a plaintiff.<sup>174</sup> Because the insured, not the insurer, is in contractual privity with the repair facility,<sup>175</sup> the repair facility has nothing more than an expectancy interest in obtaining funds from the insurance company.<sup>176</sup> The repair facility’s vested interest in obtaining these funds is from the insured.<sup>177</sup> Thus, a repair facility that has outstanding accounts receivable would have to recover them from the customer, not the insurance company.<sup>178</sup> Second, a repair facility seeking restitution from an insurance company for steering will fail because steering is a loss of business claim.<sup>179</sup> As such, it is a claim for damages, not restitution.<sup>180</sup>

Although the court ruled against the repair facilities on the restitution claims, the battle was only half over. Injunctive relief was still a potential avenue of redress. The defendants claimed that injunctive relief under section 17200 was improper because injury in fact and actual loss of money or property as a result of the unfair practice could not be established.<sup>181</sup> Focusing on the language, “lost money or property,”<sup>182</sup> defendants claimed that this requirement, like the requirement to prevail for a restitution claim, requires a loss of a vested interest.<sup>183</sup> Because contractual privity did not exist between the repair facility and the insurer, the defendants proposed that nothing more than an expectancy interest was lost and therefore injunctive relief was improper.<sup>184</sup> The court disagreed.<sup>185</sup>

As the court explained, the wording of section 17200 makes clear that to be awarded restitution, a vested interest must be lost.<sup>186</sup> Conversely, to

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172. *Id.*

173. *Id.*

174. *Korea Supply Co. v. Lockheed Martin Corp.*, 63 P.3d 937, 947 (Cal. 2003).

175. *See* discussion *supra* Part IV.A; *G & C Auto Body Inc.*, 2007 WL 4350907, at \*2.

176. *G & C Auto Body Inc.*, 2007 WL 4350907, at \*2.

177. *Id.*

178. *Id.* at \*2 n.1.

179. *See Korea Supply Co.*, 63 P.3d at 948.

180. *Id.*

181. *G & C Auto Body Inc.*, 2007 WL 4350907, at \*3.

182. CAL. BUS. & PROF. CODE § 17204 (West Supp. 2009).

183. *G & C Auto Body Inc.*, 2007 WL 4350907, at \*3.

184. *Id.*

185. *Id.* at \*4.

186. *Id.* at \*2, \*4.

be awarded injunctive relief, all that is necessary is lost income; a showing of wrongful acquisition by the defendant is not necessary.<sup>187</sup> Therefore, the court found no reason to bar the plaintiffs' injunction claims.<sup>188</sup> However, because the plaintiffs only sought an injunction requiring the defendants to stop making defamatory statements, the victory was nominal.

Although the pecuniary results of this case favored the insurance companies, the court left open the possibility of injunctive relief. This may help end the myriad of unlawful, fraudulent, and unfair insurance industry practices that cause lost income to the automotive repair industry.

The following parts analyze potential insurance industry practices that are candidates for section 17200 claims. The list is by no means exhaustive.

### C. Unlawful Practices

When determining whether a practice is "unlawful," section 17200 "borrows" violations from other laws, and makes them independently actionable.<sup>189</sup> "Virtually any law—federal, state, or local—can serve as a predicate for a section 17200 action."<sup>190</sup> Although the "unlawful" prong is broad, it is not limitless.

First, the underlying illegality to which section 17200 is anchored, must be sufficiently proved.<sup>191</sup> Second, the alleged unfair practice must not be protected by any "safe harbor."<sup>192</sup> For example, if the legislature has specifically stated that an act or practice is legal, a plaintiff may not plead around that immunity via section 17200.<sup>193</sup> However, the safe harbor must actually bar a 17200 action or clearly permit the allegedly unfair conduct.<sup>194</sup> Thus, if a statute does not expressly allow the conduct, it is not within the safe harbor. Last, the alleged unfair act must actually cause the plaintiff to have lost money or property.<sup>195</sup> Accordingly, if an automotive repair

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187. *Id.* at \*4.

188. *Id.*

189. *See* *Cel-Tech Commc'ns, Inc. v. Los Angeles Cellular Tel. Co.*, 973 P.2d 527, 539-40 (Cal. 1999) (Kennard, J., concurring and dissenting); *Farmers Ins. Exch. v. Superior Court*, 826 P.2d 730, 734 (Cal. 1992).

190. *Stevens v. Superior Court*, 89 Cal. Rptr. 2d 370, 375 (Ct. App. 1999).

191. *POLIDORA ET AL.*, *supra* note 154 at 18.

192. *Id.* at 18-19.

193. *Cel-Tech*, 973 P.2d at 541; *see also* *Rubin v. Green*, 847 P.2d 1044, 1047 (Cal. 1993) (dismissing the plaintiff's section 17200 claim, seeking injunctive relief, because the defendant's actions were immune from suit due to independent statute).

194. *Cel-Tech*, 973 P.2d at 541.

195. *Californians For Disability Rights v. Mervyn's, LLC*, 138 P.3d 207, 209 (Cal. 2006)

facility can establish that an insurance practice violates a law, is not protected by a safe harbor, and has actually caused that repair facility to lose money or property, an injunction will be appropriate under section 17200.

### 1. Steering

In the automotive repair industry, “steering” is defined as an insurance industry practice of “directing first party insureds and/or third party claimant[s] to or away from specific repair facilities.”<sup>196</sup> The California Code of Regulations makes this practice illegal.<sup>197</sup> If an automotive repair facility can establish that steering has occurred, that repair facility has a valid section 17200 claim.

### 2. Defamation

Defamation and steering are closely related. Very often an insurance company will deter a policyholder from going to a specific repair facility by making false statement.<sup>198</sup> Because defamation is independently illegal, it too can be used to anchor a section 17200 claim.<sup>199</sup>

### 3. Arbitrary Capping

If it can be established that an insurance company has arbitrarily or unreasonably<sup>200</sup> capped paint materials, labor rates, hazardous waste cost, undercoating, or any other cost incurred, section 17200 will be a valid cause of action. Although not prohibited by any specific law, arbitrary capping is illegal.<sup>201</sup>

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(stating that after the passage of proposition 64, actual injury to the plaintiff was required for standing).

196. BRUCE CORNBUM, *DICTIONARY: AUTO BODY REPAIR LAW* 85 (2003).

197. CAL. CODE REGS. tit. 10, § 2695.8(e) (2008) (“No insurer shall: (1) require that an automobile be repaired at a specific repair shop; or, (2) suggest or recommend that an automobile be repaired at a specific repair shop . . .”).

198. *See Industry Profile Report*, BODY SHOP BUS., May 2007, at 52.

199. CAL. CIV. CODE §§ 44-46 (West Supp. 2009).

200. *Id.* (stating that capping must be arbitrary or otherwise unreasonable to be illegal).

201. Letter from Cindy A. Ossias, Senior Staff Counsel, Ca. Dep’t of Ins. (DOI) to Eugene Crozat, President of G & C Autobody (Nov. 2, 1995) (“The Department’s position is this: the practice of arbitrarily capping or limiting costs is illegal.”) (on file with author).

#### D. *Unfair Practices*

In general, the “unfairness” prong of section 17200 has been used to enjoin deceptive or sharp business practices.<sup>202</sup> This “allows plaintiffs to attack business practices that are not expressly proscribed by any established law.”<sup>203</sup> This prong has been left intentionally broad, allowing courts wide discretion to prohibit new schemes of unfair practice.<sup>204</sup> In determining what is “unfair,” an inherently ambiguous and troublesome concept, courts had previously looked to whether the business practice offended an “established public policy” or whether the practice was “immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers.”<sup>205</sup> Also, the interest of the defendant’s conduct was weighed against the harm to the alleged victim.<sup>206</sup> However, this definition provided little guidance to courts and businesses. In 1999, in *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.*, the California Supreme Court decided to rework the “unfairness” prong.<sup>207</sup> The court held that in the context of section 17200, a practice is “unfair” if it appears to be the early development of an antitrust violation, violates the spirit of antitrust legislation, or the practice is otherwise anticompetitive.<sup>208</sup> Thus, the unfairness prong of section 17200 is ideal for prosecuting insurance industry practices that would have been antitrust violations, but for the McCarran Act.

#### 1. Capping and Preemptive Refusals to Pay for Operations

The only relationship that an insurance company and a repair facility have is a non-contractual, arm’s-length relationship that allows the insurance company to “reasonably adjust any written estimates prepared by the repair shop[.]”<sup>209</sup> The term “adjust” presupposes something already in

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202. *Klein v. Earth Elements, Inc.*, 69 Cal. Rptr. 2d 623, 625 (Ct. App. 1997).

203. WILLIAM L. STERN, *BUS. & PROF.C. § 17200 PRACTICE § 1:3*, at 1-2 (Rutter Group 2008).

204. *Schnall v. Hertz Corp.*, 93 Cal. Rptr. 2d 439, 446 (Ct. App. 2000).

205. *State Farm Fire & Cas. Co. v. Superior Court*, 53 Cal. Rptr. 2d 229, 235 (Ct. App. 1996) (citing *People v. Casa Blanca Convalescent Homes, Inc.*, 206 Cal. Rptr. 164, 177 (Ct. App. 1984)).

206. *Id.*

207. 973 P.2d 527, 543 (Cal. 1999).

208. *Id.* at 544.

209. CAL. CODE REGS. tit. 10, § 2655.8(f)(3) (2008).

existence. Thus, the common insurance industry practice of preemptively refusing to pay for particular operations<sup>210</sup> or “capping”<sup>211</sup> is unfair.

A preemptive “adjustment” is not an adjustment at all, it is an attempt to fix cost and it is therefore an incipient antitrust violation. This unfairness is further supported by the fact that any adjustment must be fair and reasonable.<sup>212</sup> A preemptively denied operation is neither fair nor reasonable, as it is arbitrary.<sup>213</sup>

## 2. Prevailing Rates

The insurance industry practice of creating a prevailing rate is also unfair, as it hinders competition. Because repair facilities are tethered to this artificial prevailing rate, the repair industry is incapable of unfettered competition. Superior repair facilities struggle to provide greater quality repairs and service while mediocre and substandard facilities thrive. Also, in its creation of the prevailing rate, insurance companies do not categorize repair facilities into those that comply with various laws<sup>214</sup> and those that do not.<sup>215</sup> This is unfair because it hinders competition by benefiting repair facilities that have cut cost through non-compliance with the law.

## 3. Interference with A Contractual Relationship

As stated earlier, a repair facility and an insurance company are not in contractual privity with each other.<sup>216</sup> The repair facility is contractually bound only to the insured, and has agreed with the insured to repair his vehicle to its pre-accident condition. However, it is common insurance industry practice to continuously bombard the repair facility with demands to lower repair cost such as cutting out operations that the repair facility deems necessary, or using aftermarket or used parts as opposed to new parts. This practice interferes with the repair facility’s ability to properly

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210. For example, repair facilities are often not allowed to charge for undercoating, corrosion protection, priming and sanding operations, welding repairs, hazardous waste removal, or detailing operations even if these operations are performed.

211. *See supra* note 31.

212. CAL. INS. CODE § 790.03 (West 2005).

213. *See* BLACK’S LAW DICTIONARY 112 (8th ed. 2004) (defining arbitrary as “founded on prejudice or preference rather than reason or fact”).

214. *See supra* note 68 and accompanying text.

215. The California Insurance Code only requires that an insurance company’s survey be submitted to the Department of Insurance, it does not have any requirements as to the types of repair facilities that can be included in the survey. CAL. INS. CODE § 758 (West 2005).

216. *See* discussion *supra* Part IV.A.

and profitably repair the insured's vehicle. Moreover, an insurance company is not in the business of repairing vehicles.<sup>217</sup> It is the repair facility's duty to ensure that the insured's vehicle is repaired to its pre-accident condition, not the insurer. Because the insurance company is not a party to the repair contract—only the insured and the repair facility are—the insurance company bears no liability for the quality or the safety of a vehicle's repair. This practice is unfair, as it places liability on the repair facility for repairs done to the insurer's vehicle which were not done to repair facility specifications.

#### *E. Fraudulent Practices*

Unlike common law fraud, "fraudulent practices" are deemed unfair if the "public is likely to be deceived."<sup>218</sup> Thus, a section 17200 violation can be established even if "no one was actually deceived, relied upon the fraudulent practice, or sustained any damage."<sup>219</sup> The most glaring fraudulent insurance practice revolves around the industry's use of captured repair facilities.

Using a myriad of tactics, insurance companies encourage insureds to take their vehicles to captured repair facilities. An insurance company will discourage an insured from using non-captured repair facilities by informing the insured that the particular repair facility the insured has in mind is not in the directory and that the work cannot be guaranteed.<sup>220</sup> What the insurance company is not telling the insured is that the repair facility, in exchange for referrals, has previously agreed not to perform certain tasks to the insured's vehicle, irrespective of what the proper repair procedure dictates.<sup>221</sup> This is deceptive because the insured is led, or likely to be led, to believe that the captured repair facility is of a high caliber when in reality it is only the lowest bidder. Thus, the insurance company and the captured repair facility benefit to the detriment of the insured and the non-captured repair facility that has lost the business. This fraudulent practice is unfair.

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217. To repair and or diagnose a motor vehicle requires registration with the Bureau of Automotive Repair. See CAL. BUS. & PROF. CODE § 9880.1(a) (West Supp. 2009).

218. *State Farm Fire & Cas. Co. v. Superior Court*, 53 Cal. Rptr. 2d 229, 235 (Ct. App. 1996) (disapproved on other grounds in *Cel-Tech Commc'ns, Inc. v. Los Angeles Cellular Tel. Co.*, 973 P.2d 527 (Cal. 1999)).

219. *Id.*

220. *E.g.*, *Workman v. State Farm Mut. Auto. Ins. Co.*, 520 F. Supp. 610, 613 (N.D. Cal. 1981).

221. *E.g.*, *Proctor v. State Farm Mut. Auto. Ins. Co.*, 675 F.2d 308, 316 (D.C. Cir. 1982).

*F. Injunctive Relief: Is It Appropriate?*

With a valid claim established, the repair facility must convince a court that injunctive relief is appropriate. This may be a difficult task, as courts are reluctant to issue injunctions that are “broad, vague, or generally phrased . . . .”<sup>222</sup> The repair industry must carefully craft a desired injunction or face losing this opportunity. Courts have wide discretion when determining whether injunctive relief is appropriate.<sup>223</sup> When determining whether injunctive relief is appropriate, courts consider: (1) whether there is an adequate remedy at law;<sup>224</sup> (2) the hardship to the plaintiff absent the injunction versus the hardship to the defendant in complying with the injunction;<sup>225</sup> and (3) the feasibility of enforcing the injunction.<sup>226</sup>

*1. Adequate Remedy at Law*

A repair facility will face difficulty attaining an injunction if it has an adequate remedy at law.<sup>227</sup> However, repair facilities need not establish that no legal remedy at law exists, only that it “has [no] plain, speedy, adequate, and complete remedy at law.”<sup>228</sup> Overcoming this burden should not be difficult for practices that are solely unfair or fraudulent. These practices are prohibited only by section 17200, which limits those who prevail to equitable remedies.<sup>229</sup> Therefore, the repair industry should easily be able to establish that injunctive relief is appropriate for unfair and fraudulent practices, as no adequate remedy at law exists.

A repair facility may face challenges obtaining an injunction if it claims that an insurance company has violated section 17200 by engaging in an unlawful practice. Many unlawful practices have adequate legal

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222. See ROBERT I. WEIL ET AL., CAL. PRAC. GUIDE: CIV. PRO. BEFORE TRIAL ¶ 9:544 (Rutter Group 2008).

223. See, e.g., *Cortez v. Purolator Air Filtration Prods. Co.*, 999 P.2d 706, 717 (Cal. 2000).

224. See, e.g., *Fortner v. Wilson*, 216 P.2d 299, 301 (Okla. 1950) (“[E]quity will not force specific performance where plaintiff had an adequate remedy at law.”).

225. *Garcia v. Sanchez*, 772 P.2d 1311, 1316 (N.M. Ct. App. 1989) (denying injunctive relief after “[b]alancing the equities between the parties, by balancing the value of the trees to the defendant against the character of the properties involved and the nature of the harm sustained by the plaintiff”).

226. See, e.g., *Grossman v. Wegman’s Food Mkts., Inc.*, 350 N.Y.S.2d 484, 485-86 (App. Div. 1973) (“[C]ourts of equity are reluctant to grant specific performance in situations where such performance would require judicial supervision over a long period of time.”).

227. See *Fortner*, 216 P.2d at 301.

228. *Suchan v. Rutherford*, 410 P.2d 434, 438 (Idaho 1966).

229. See CAL. BUS. & PROF. CODE § 17203 (West Supp. 2009).

remedies, which will prevent a repair facility from obtaining an injunction. However, repair facilities have obtained injunctions for unlawful conduct pursuant to section 17200.<sup>230</sup>

## 2. Balancing the Competing Interests

If a repair facility can establish that an adequate remedy at law does not exist, a court will compare the hardship to the automotive repair facility absent an injunction to the hardship the insurance company will face in complying with the injunction.<sup>231</sup> For many potential claims, this balance should weigh in favor of the repair facility.

The hardship the insurance industry faces if it is enjoined from practices such as steering, preemptively refusing to pay for specific operations, or conveying to insureds that non-captured repair facilities are of lesser quality, is the loss of its ability to suppress repair costs. Any increase in costs will be recouped by increasing premiums. Although these hardships may appear to do more harm than good, as they could increase the premiums of all insured drivers, as discussed in Parts III and IV, increased insurance premiums will benefit society.

Enjoining the insurance industry from engaging in unfair, fraudulent, and unlawful business practices will greatly benefit repair facilities and society. Without arbitrary caps on materials and labor, the repair industry will be able to profitably repair vehicles to industry standards, which will allow it to better train its technicians, and adequately compensate its employees. Better trained technicians lead to safer vehicles, and safer vehicles logically lead to fewer accidents. Further, without a prevailing rate survey compiled solely by the insurance industry, repair facilities will be incentivized to comply with environmental laws, OSHA standards, and carry adequate Workers' Compensation Insurance.<sup>232</sup>

While enjoining the insurance industry from engaging in practices that violate section 17200 may have a negative affect on the insurance industry, it will greatly benefit the repair industry and society as a whole. This factor should weigh in favor of the repair industry.

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230. *See, e.g., G & C Auto Body Inc. v. Geico Gen. Ins. Co.*, No. C06-04898 MJJ, 2007 WL 4350907 (N.D. Cal. Dec. 12, 2007) (finding that “the sole remedy available to the plaintiffs in connection with their Section 17200 claim is injunctive relief” and enjoining the defendant “from making defamatory remarks about the plaintiffs’ workmanship and business practices”).

231. *See Garcia v. Sanchez*, 772 P.2d 1311, 1316 (N.M. Ct. App. 1989).

232. The current practice is not to account for regulatory compliance when compiling data for the prevailing rate surveys. *See supra* note 85 and accompanying text. Therefore, repair facilities that carry a higher operating cost due to compliance with these laws are essentially punished by having their rates averaged with shops that do not comply.

### 3. Enforceability

The repair industry must be able to “narrowly and discretely define[]” an insurance industry practice “so that an injunction can appropriately be crafted[.]”<sup>233</sup> Courts will not impose an injunction if it obliges the defendant to perform continuously, to the point of making enforcement impossible, or requires constant and long lasting supervision by the court and supplemental proceedings to ensure the defendant is in compliance with the reoccurring duties.<sup>234</sup> Accordingly, when crafting its desired injunction, the automotive repair industry must clearly identify the practice in question, and ensure that what it is asking the insurance company to do, or refrain from doing, can be performed quickly and without constant court intervention.

Formulating an injunction for an insurance practice such as defamation should be relatively straightforward. A simple demand that an insurance company refrain from making defamatory remarks to insureds about an automotive repair facility may be all that is needed.<sup>235</sup> Other insurance industry practices may not be as easy to formulate. A court would not likely grant an injunction that enjoined an insurance company from “arbitrarily capping” paint materials. An injunction this vague would likely cause the insurance company and the repair facility to constantly fight over the meaning of what is “arbitrary.” This would require the court to essentially police its previous ruling; a task courts are not willing to perform. However, an injunction preventing an insurance company from capping materials before viewing the vehicle, or before the repair facility has written its estimate is a much more objective demand.

### 4. Crafting the Injunction

Formulating an injunction to deal with the prevailing rate survey may be quite a feat. The insurance industry cannot be enjoined from conducting the survey altogether, as the collection of data is not an unfair practice. Additionally, an outright prohibition of the survey would likely violate the policy behind the McCarran Act, which intends the insurance industry to share data.<sup>236</sup> Controlling the manner in which the surveys are conducted,

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233. Sharon J. Arkin, *The Effective Use of California's Unfair Competition Law to Redress Managed Care Abuses*, 22 WHITTIER L. REV. 467, 503 (2000).

234. *Suchan v. Rutherford*, 410 P.2d 434, 440 (Idaho 1966).

235. An injunction preventing defamatory remarks may also aid in ending some forms of steering, as defamatory statements about non-captured repair facilities is a subtle form of steering.

236. *See supra* text accompanying notes 18-19.

2009]

*BUYER POWER ABUSE IN AUTO-REPAIR*

531

compiled, or collected would also prove problematic, as it would turn the court into an auditing agency.

One possible solution would be to require an insurance company to allow a repair facility representative to participate in the creation, formulation, and collection of the surveys. The extent to which the representative would partake in the surveys would have to be carefully laid out in the injunction, otherwise the injunction may be rejected or useless to the repair industry. Additionally, the injunction would have to be crafted in a manner that that would not overburden the court with constant interpretations of the injunction or force it to monitor its success. If crafted correctly, an injunction similar to this could turn the prevailing rate surveys from a device used to artificially suppress repair cost, to a tool that would accurately reflect the cost of repairing a vehicle, and provide the insurance industry with the data it needs to accurately underwrite risk.

## VII. CONCLUSION

The automotive repair industry and the automotive insurance industry are in a competitive vertical relationship. Although Congress has, to a large degree, granted the insurance industry the freedom to operate without the threat of federal antitrust liability, competition (and the efficiency and fairness that it serves) is undermined when the insurance industry engages in unfair practices. However, relief from unfair insurance industry practices may be difficult to find along an antitrust path. State law remedies must be used to check the insurance industry's tendency to grasp more than it is given. Carefully crafted injunctions pursuant to section 17200 may provide that check. Section 17200 can be used as a tool to balance the competing interests of the automotive repair industry and the automotive insurance industry, which will ultimately benefit consumers.

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