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JUL 01 2016

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11 CALIFORNIA INSURANCE COMPANY  
and APPLIED UNDERWRITERS CAPTIVE  
12 RISK ASSURANCE COMPANY, INC.

13 SUPERIOR COURT OF THE STATE OF CALIFORNIA  
14 FOR THE COUNTY OF LOS ANGELES  
15 UNLIMITED JURISDICTION

BS168248

16 CALIFORNIA INSURANCE COMPANY and  
17 APPLIED UNDERWRITERS CAPTIVE RISK  
ASSURANCE COMPANY, INC.,

Case No.

VERIFIED PETITION FOR A  
PEREMPTORY WRIT OF MANDATE  
AND COMPLAINT FOR  
DECLARATORY RELIEF AND  
INJUNCTIVE RELIEF

18 Petitioners and Plaintiffs,

19 vs.

20 DAVE JONES, in his capacity as Insurance  
21 Commissioner of the State of California,

CAL. CIV. PROC. § 1094.5;  
10 C.C.R. § 2509.76

22 Respondent and Defendant.

[REQUEST FOR STAY]

23 SHASTA LINEN SUPPLY, INC.,

24 Real Party in Interest.  
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1           3.     The Program is a loss-sensitive workers' compensation program consisting of  
2 three separate contractual arrangements: (1) a standard workers' compensation policy workers'  
3 compensation insurance policy (without deductibles or similar features) provided to Shasta by  
4 CIC; (2) a separate reinsurance agreement between CIC and AUCRA, an Iowa insurance  
5 company, which was filed with and approved by the CDI and the Iowa Division of Insurance as  
6 an inter-affiliate agreement; and (3) a separate Reinsurance Participation Agreement ("RPA")  
7 between AUCRA and Shasta. By executing the RPA, the participant-insured participates in the  
8 captive reinsurance of the workers' compensation policies by receiving an "allocation" of a  
9 portion of the reinsurance premium and losses of AUCRA, acting as a captive reinsurer. In other  
10 words, the RPA is a captive-insurance arrangement with AUCRA, in which AUCRA acts as a  
11 captive reinsurer and Shasta is the economic owner of the captive vis-à-vis this reinsurance  
12 arrangement (i.e., a "rent-a-captive" arrangement). AUCRA is not party to the workers'  
13 compensation insurance policy issued by CIC to Shasta.

14           4.     The standard workers' compensation insurance policies issued by CIC, the  
15 reinsurance agreement, and the RPA are each separate agreements with separate obligations  
16 between different parties. The failure to comply with any agreement with AUCRA under the  
17 RPA did not relieve and/or impact CIC's obligations under the standard workers' compensation  
18 insurance policy, including CIC's duty to pay claims to employees of Shasta.

19           5.     The Program uses a "segregated-cell" captive arrangement, meaning a separate  
20 underwriting account is kept for each participant. AUCRA is a sponsored captive, sometimes  
21 called a rental captive, meaning it is owned and controlled by parties unrelated to the  
22 insured/reinsured. AUCRA is regulated by the Iowa Division of Insurance, which has granted it  
23 a permitted practice to establish and account for these protected cells.

24           6.     In 2009, Shasta, employing its own insurance broker, decided to enroll in the  
25 Program. Like any traditional captive arrangement, a standard workers' compensation insurance  
26 policy was issued by CIC to Shasta. This standard workers' compensation insurance policy  
27 satisfied Shasta's legal obligation to provide workers' compensation insurance for its employees  
28 pursuant to California Labor Code § 3700. CIC charged and was paid premiums in accordance

1 with its filed and approved rates, and claims were made to and paid by CIC. Further, like any  
2 traditional captive arrangement, a portion of premiums and losses were forwarded ("ceded") by  
3 CIC through a reinsurance agreement with CIC to AUCRA as the reinsurer. AUCRA's  
4 reinsurance agreement with CIC – which discussed the nature of AUCRA's involvement in  
5 facilitating the Program, including the maintenance of segregated cells and the customer-  
6 participant's agreement to make deposits into cells – was filed with, reviewed by and deemed  
7 approved by the CDI. Finally, like any traditional captive arrangement, Shasta entered into a  
8 separate agreement (here, the RPA) with AUCRA in which Shasta agreed to capitalize the  
9 captive protected cell in exchange for a share in the potential profits if its claims experience  
10 turned out favorable. This kind of "fronting" arrangement, in which a "fronting" insurer  
11 admitted to write a line of business in a state, issues a policy to a policyholder, and then reinsures  
12 the risks of that policy to a captive reinsurer affiliated with, or linked to, the insured is common  
13 in the insurance industry.

14 7. After participating in the Program for three years, Shasta became dissatisfied with  
15 the Program costs. Shasta filed a private-party administrative appeal (the "Appeal") under  
16 Insurance Code section 11737(f) ("Section 11737(f)", which permits an insured to file an appeal  
17 with the Commissioner seeking review of a workers' compensation insurance carrier's response  
18 to a "request to review the manner in which the rating system has been applied in connection  
19 with the insurance afforded or offered." Ins. Code § 11737(f) (emph. added).

20 8. Despite the limited scope of a Section 11737(f) proceeding, Shasta sought to  
21 challenge the overall legality of the Program rather than the premium charged to it by CIC and  
22 address issues beyond any "rating system" issue.

23 9. Captive arrangements have long been used approvingly throughout California and  
24 the United States. Risk agreements in such captive arrangements – like the RPA – are not  
25 subject to California rate and/or form filing requirements applicable to workers' compensation  
26 insurance. Such risk sharing agreements would not be subject to such form or rate filing  
27 requirements as these non-insurance agreements between the insured and the reinsurer do not  
28 provide any insurance coverage to the insured and do not change the duties and obligations

1 arising out of the standard workers' compensation policy between the insured and insurer, in this  
2 case, Shasta and CIC.

3 10. The nature of the Program and the RPA were expressly reviewed by the CDI in  
4 connection with multiple financial examinations (in 2006, 2009, and 2013) and in a rating and  
5 underwriting market conduct examination issued in December, 2014. In those examinations, the  
6 CDI described the Program, including the risk sharing features provided by the reinsurer in the  
7 RPA. In those examinations, the CDI never took issue with the fact that the RPA was not filed as  
8 workers' compensation insurance policy form or workers' compensation insurance rate, much  
9 less conclude that that the Program was unlawful or the RPA void. There was absolute  
10 transparency in those examinations. As a matter of fact, the CDI examination noted as of  
11 December 31, 2013 issued on December 15, 2014 stated that:

12 The cooperation and assistance by the officers and employees of the  
13 Company [CIC] during the examination is hereby acknowledged.

14 11. Despite the above and the limited scope of the Appeal, the Commissioner issued  
15 the Order in which it determined that the RPA purportedly altered the rates charged for and  
16 added other obligations not otherwise set forth in the standard workers' compensation insurance  
17 policies issued by CIC (the "CIC Policies"). Based upon these incorrect determinations the  
18 Commissioner concluded that the Program and the RPA constituted a misapplication of CIC's  
19 filed rates in violation of Insurance Code section 11737 and that the RPA constituted a  
20 "collateral agreement" under California Code of Regulations, title 10, section 2268 ("Section  
21 2268"), which was allegedly required to be filed under Insurance Code section 11658.

22 12. The Order should be vacated on each of the following grounds: (1) the  
23 Commissioner and ALJ in the underlying proceeding acted in excess of their powers and  
24 jurisdiction in addressing issues and issuing the remedy imposed in the Order; (2) CIC and  
25 AUCRA were deprived of a fair trial; (3) the Order is unsupported by the findings; (4) the  
26 findings are unsupported by evidence; (5) the Order is contrary to law; and (6) the Order is so  
27 inconsistent with the prior determinations of the Commissioner as to be arbitrary and capricious.  
28

1           13.     Importantly, the powers of a governmental agency are limited by statute and  
2 attempts to act beyond those limits are void. *See Terhune v. Sup. Ct.*, 65 Cal. App. 4th 864, 872-  
3 873 (1998) ("To be valid, administrative action must be within the scope of authority conferred  
4 by the enabling statutes."). Despite this clearly defined limit, the Commissioner addressed issues  
5 well beyond the limited scope of the Appeal and imposed a remedy that is reserved for courts  
6 and is beyond the scope of his statutory powers.

7           14.     By way of example, the AHB is not a court of unlimited jurisdiction. Only  
8 matters specially permitted by statute may be heard by the AHB. Despite the fact that the  
9 underlying Appeal only permitted an appeal by an insured concerning a review of an insurer's  
10 "rating system," both the ALJ and the Commissioner addressed issues and made determinations  
11 concerning non-rate issues, such as the RPA's arbitration agreement and the applicability of  
12 certain "form" filing laws (i.e., Ins. Code § 11658 and Title 10 Section 2268). In addressing  
13 these issues in this limited Appeal, the Commissioner acted in excess of his jurisdiction and  
14 acted in a manner contrary to law. On this ground alone, the Order must be vacated.

15           15.     As another example, the Commissioner voided a contract (the RPA) and required  
16 the payment of monies though the law provides no such power to the Commissioner and though  
17 the RPA at issue concerned an entity (AUCRA) that was not party to and never appeared in the  
18 administrative proceeding. *See Shernoff v. Sup. Ct.*, 44 Cal. App. 3d 406, 409 (1975)  
19 (distinguishing between the powers of the Commissioner and the courts stating, "The  
20 commissioner's disciplinary authority is limited to restraint of future illegal conduct by real  
21 parties in interest, and he possesses no authority to enter money judgment for past injuries. This  
22 latter authority remains in the courts . . ."). On this ground alone, the Order must be vacated.

23           16.     As another example, the Commissioner determined that an unfiled rate is  
24 unlawful and the Commissioner voided *ab initio* the RPA on that basis. This was wrong as a  
25 matter of law. An unfiled rate is not an unlawful rate. An unfiled rate may be lawfully used  
26 unless and until the Commissioner exercises his discretion to disapprove of that rate on the  
27 grounds that it should have been filed. Ins. Code § 11737(a). Even then, a rate may only be  
28 disapproved on a prospective basis and only after the Commissioner himself issues a notice of

1 intent to disapprove of that rate and initiates a rate disapproval proceeding. Ins. Code §11737(d)  
2 & (g). Here, the Commissioner retroactively disapproved the RPA as an unfiled rate. Further, the  
3 Commissioner never issued a notice of intent to disapprove of the RPA under Ins. Code  
4 §11737(d) and (g). Finally, the Commissioner never initiated a rate disapproval proceeding. In  
5 voiding the RPA's payment obligations on the ground that it is an unfiled rate, the Commissioner  
6 acted in excess of his powers and jurisdiction and failed to act in accordance with the law.

7 17. The Commissioner also erred as a matter of law and fact in determining that the  
8 RPA is a "collateral agreement." Insurance regulations define "collateral agreements" as those  
9 that "modif[y] the obligation of either the insured or the insurer." 10 C.C.R. §2268. The RPA  
10 does not qualify. The RPA is separate from the CIC standard workers' compensation insurance  
11 policies; involves a different party than the insurer (e.g., AUCRA instead of CIC); and does not  
12 include any provisions that modify any provisions in the CIC standard workers' compensation  
13 insurance policy (e.g., no provisions specifying that they supersede the CIC Policies). All claims  
14 under the CIC standard workers' compensation policies are adjusted and paid exclusively by  
15 CIC. The RPA would not satisfy Shasta's obligation under Labor Code §3700.

16 18. On further grounds alleged below and to be raised in due course of this action in  
17 briefing and hearing on the Petition, the Order must also be vacated because there was a  
18 prejudicial abuse of discretion in light of the Commissioner's failure to act in accordance with the  
19 law, the Order is unsupported by the findings, the findings are unsupported by the evidence and  
20 the Order is contrary to law. Further, as reflected by the underlying proceedings and evidentiary  
21 record, CIC has also been deprived of a fair trial, which also requires vacation of the Order.

22 19. For the reasons alleged below and those to be discussed in briefing to the Court,  
23 CIC petitions this Court for a peremptory writ of mandate under Section 1094.5 of the California  
24 Code of Civil Procedure and Section 2509.76 of Title 10 of the California Code of Regulations  
25 to seek judicial review and a judgment vacating the June 20, 2016 Decision and Order.

26  
27 **II. PARTIES AND REAL PARTY IN INTEREST**

28 20. Petitioner and Plaintiff CIC is a California insurance company with its principal

1 place of business in Nebraska and a statutory home office in Foster City, California. At all  
2 relevant times, CIC has been authorized to transact insurance in California by the CDI,  
3 including, but not limited to workers' compensation insurance.

4 21. Petitioner and Plaintiff AUCRA is an Iowa insurance corporation with its  
5 principal place of business in Omaha, Nebraska, licensed as an insurance company in Iowa, and  
6 holding a Certificate of Authority from the CDI to act as a reinsurer in California.

7 22. Respondent and Defendant Insurance Commissioner of the State of California  
8 Dave Jones, is named in his official capacity as Insurance Commissioner of the State of  
9 California. The Commissioner is required to follow and apply the California Insurance Code and  
10 the implementing regulations in a consistent and reasonable manner, to abide by the California  
11 Government Code, and to otherwise discharge his duties according to the law, including the  
12 California and United States Constitutions.

13 23. Real party in interest Shasta is a California corporation with its principal place of  
14 business in Sacramento, California.

### 15 16 III. JURISDICTION AND VENUE

17 24. CIC has a right to judicial review of the Order pursuant to Section 1094.5 of the  
18 California Code of Civil Procedure and Section 2509.76 of Title 10 of the California Code of  
19 Regulations. CIC has exhausted all administrative remedies. The Court has jurisdiction over  
20 this action seeking a Writ of Administrative Mandamus pursuant to California Code of Civil  
21 Procedure section 1094.5 and Regulation 2509.76.

22 25. Venue is proper in this Court pursuant to Code of Civil Procedure section 401 in  
23 that this case is being prosecuted against a department of the State of California, and the  
24 Attorney General of California maintains an office in the County of Los Angeles. Venue is also  
25 proper in this Court pursuant to Insurance Code section 12905 in that the Commissioner  
26 maintains an office in the County of Los Angeles.

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IV. FACTUAL ALLEGATIONS

A. The EquityComp® Program

26. The EquityComp® program (the "Program") is a loss sensitive workers' compensation insurance program. Under the Program participants can obtain fully insured workers' compensation insurance coverage that employers are legally required to carry while also providing those same employers with the benefits that participants can obtain through the use of a traditional captive reinsurance company. These types of loss sensitive programs have a long history of being used throughout the United States and California.

27. To participate, Shasta through its broker submitted an Acord Workers' Compensation Application (the "Acord") reflecting an estimated annual payroll of \$2,843,319.

28. Based on the Acord application, an EquityComp® Proposal was submitted to Shasta and its broker which identified two "separate" contractual components of the Program (i) a "standard workers' compensation policy" covering the employers' workers' compensation coverage obligation issued by CIC, and (ii) a "Profit Sharing Plan" issued by AUCRA as reinsurer acting as a captive. The Risk Sharing Plan was described in the Proposal as follows:

Profit Sharing Plan. This Profit Sharing Plan is a reinsurance transaction separate from the guaranteed cost policies. Your risk retention is created by your participation in, and cession of allocated premiums and losses to our facultative reinsurance facility, Applied Underwriters Captive Risk Assurance Company (AUCRA). AUCRA is a subsidiary of Applied Underwriters, Inc., a member of Berkshire Hathaway Inc. Your retention is held in a segregated, protected cell which is not liable for the debts and liabilities of any other AUCRA cell. This Profit Sharing Plan is not a filed retrospective rating plan or dividend plan, and nothing contained herein is to be so construed. This Profit Sharing Plan requires a minimum three year contractual commitment from you with significant penalties for early cancellation.

The Order did not discuss this language or Shasta's estimated annual payroll of \$2,843,319.00.

29. CIC, a licensed California insurer, issues standard workers' compensation insurance policies to participants, such as Shasta. The policy forms and rates used by CIC are filed with and approved by the CDI and the Workers' Compensation Insurance Rating Bureau ("WCIRB"). As demonstrated by evidence submitted in the administrative record, CIC charges

1 and is paid premium and assessments in accordance with its filed and approved rates and state  
2 required assessments. The obligations assumed by CIC under the standard workers'  
3 compensation policy are not affected by or contingent on any contractual or other form of  
4 obligation owed by Shasta to any third party, including AUCRA under the RPA.

5 30. The CIC Policy and the RPA are separate contracts between different parties. The  
6 CIC Policy and the RPA set forth different obligations between different parties. Where the CIC  
7 Policy sets forth the obligations between CIC and Shasta relating to the workers' compensation  
8 insurance coverage provided to Shasta, the RPA sets forth the deposit obligations necessary to  
9 fund losses under the Program and the formula for determining the return of capital and profit-  
10 sharing distribution Shasta receives during and at the end of the Program. In other words, the  
11 RPA sets out the terms of Shasta's participation in AUCRA's captive reinsurance of CIC. The  
12 breach of one agreement does not result in the breach of another. CIC must continue to pay  
13 claims under the CIC Policy even if Shasta were to fail to comply with its obligations under the  
14 RPA. In fact, that is what occurred here, as Shasta has failed to comply with its contractual duty  
15 to provide AUCRA with those capital contributions required under the RPA. Despite this fact,  
16 CIC has continued to administer and pay for claims as required under the separate terms of the  
17 standard workers' compensation policy it issued to Shasta.

18 31. To initiate the Program, a Request To Bind Coverages and Services was executed  
19 by Shasta's president and owner, which provides in part:

20  
21 The initial term of the Agreements will be for three (3) years,  
22 beginning on the Proposed Effective Date. Additional fees apply in  
23 the event of early cancellation. Applicant along with Applicant's  
24 insurance agent was offered for review a Workers' Compensation  
25 Program Summary and Scenarios worksheet (the "Summary") and  
26 was offered the opportunity to participate in a conference call with  
27 Applied's technical representatives to answer any questions about  
28 the Proposal and Summary. Applicant understands the Proposal  
and has had sufficient time to review all of the terms, conditions  
and stipulations regarding the Proposal with Applicant's advisers  
including Applicant's insurance agent. Any and all questions  
concerning the Proposal have been answered to Applicant's full  
satisfaction. Applicant accepts the Proposal including all of its  
terms, conditions and stipulations. (emphasis supplied)

1 The Order did not discuss this disclosure language.

2 32. As expressly set forth in proposal papers provided prior the execution of any  
3 agreements, monthly Program charges are used to pay premiums owed under the CIC Policies as  
4 well as other fees and/or deposits that may be required to be paid under the RPA.

5 33. Participants-insureds, like Shasta, after executing the Request To Bind execute the  
6 RPA, in which it agrees to make deposits into the segregated cell in exchange for participation in  
7 AUCRA's captive reinsurance of CIC and resulting profits or losses. The funds in each cell are  
8 solely for the benefit of each Participant's account. Thereafter, CIC issues its standard workers'  
9 compensation insurance policies to the insured.

10 34. Applied Risk Services, Inc. ("ARS"), a corporate affiliate of CIC, acts as the  
11 billing agent for the Program. ARS receives Program charge payments from Shasta and  
12 allocates those payments to premiums due to CIC and deposits due to AUCRA.

13 35. A portion of premiums paid to CIC under the Program are ceded to AUCRA and  
14 then attributed to Shasta's segregated cell under the RPA. A share of claims are also ceded to  
15 AUCRA under a reinsurance agreement and attributed to Shasta's captive segregated cell under  
16 the RPA. Such ceded premiums, along with any deposits that Shasta may be required to pay, are  
17 used to pay Shasta's ceded claims up to a specified limit. Monthly Program charges vary  
18 depending upon Shasta's actual claims experience, subject to minimum and maximum limits set  
19 forth in the RPA. Depending upon actual claims experience, the final net Program costs could be  
20 more or less than the total premiums due under standard CIC Policies.

21 36. As set forth in the RPA, a participant's final net Program cost is dependent on its  
22 claims experience, and ranges from a minimum to a maximum amount, each of which is fully  
23 disclosed to the participant in the Proposal delivered before the Program is put into place. If the  
24 participant ultimately incurs no claims, then it will pay the minimum. A maximum also caps the  
25 participant's potential net costs under the Program regardless of the number and extent of its  
26 claims.

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1           37.     The Program provides a participant with cost-savings while also creating certainty  
2 for a participant-insured over its maximum out-of-pocket costs relating to the standard workers'  
3 compensation insurance coverage and providing the possible benefit of a capital return.

4           **B.     Shasta and Its Decision to Participate in the Program**

5           38.     Shasta is a laundry and dry cleaning services company that focuses on the linen  
6 rental business. Shasta contracted with other businesses to pick up and deliver linens and  
7 garments, which Shasta washes and irons for re-use. Shasta's target customers include  
8 restaurants, hospitality, hotels and certain medical providers.

9           39.     During the relevant period, Shasta had a staff of more than 60 employees.  
10 Shasta's annual payroll was in the millions of dollars. Shasta was not a small business.

11           40.     At the time the Program was issued to Shasta, its president and part owner was  
12 Thomas Hammer. Mr. Hammer was also a lawyer, a graduate of Boalt Law School, and a former  
13 law partner of Chief Justice of the United States Supreme Court, Earl Warren. During his many  
14 years operating Shasta, Mr. Hammer held a significant number of leadership and board of  
15 director positions outside of Shasta. He was an experienced commercial lawyer and sophisticated  
16 business person.

17           41.     Mr. Hammer was responsible for the finance side of Shasta's operations and  
18 oversaw all financial arrangements, bank loans, and equipment purchases. Mr. Hammer was also  
19 principally responsible for assessing all of Shasta's insurance needs, including workers'  
20 compensation insurance. Mr. Hammer reviewed Shasta's workers' compensation insurance  
21 proposals from the 1960s until his passing in 2014.

22           42.     In 2009, Shasta began its search for workers' compensation insurance coverage  
23 for the year 2010. Mr. Hammer was assisted by Shasta's broker, Jeff Chenu of Pan American  
24 Insurance Services. Mr. Chenu and his agency had served as Shasta's insurance broker for many  
25 years in seeking insurance coverage, including workers' compensation coverage.

26           43.     In December 2009, Mr. Chenu had a meeting with Mr. Hammer to discuss various  
27 options. Mr. Chenu presented five different options, one of which was the Program. Proposals  
28 were also presented by State Compensation Insurance Fund ("SCIF"), Zenith Insurance

1 Company ("Zenith"), Insurance Company of the West ("ICW") and Majestic Insurance  
2 Company. The most expensive option was Zenith, with an annual premium of \$446,541. The  
3 least expensive option was ICW with an annual premium of \$301,091. The proposal for the  
4 Program presented a range of costs that could be paid – the low end of the range made the  
5 Program less expensive than ICW, and the Program's high end was less expensive than the  
6 Zenith quote.

7 44. In 2009, Shasta anticipated an increase in its experience modification factor (a  
8 rating mechanism promulgated by the California Workers' Compensation Rating Bureau based  
9 on claims experience of similarly situated employers) in the following years due to recent poor  
10 claims experience. All else being equal, an increase in an insured's experience modification  
11 factor will mean an increase in that insured's workers' compensation insurance costs. This was a  
12 significant concern for Mr. Hammer.

13 45. Coupled with the uncertainty of rate volatility in the California workers'  
14 compensation marketplace, the Program provided the ability to a participant, such as Shasta, to  
15 have some certainty over its maximum out-of-pocket workers' compensation costs for the  
16 following three years. By way of example, in the case of Shasta, the Program provided a  
17 maximum net cost that effectively approximated the premiums it would have had to pay under  
18 standard CIC Policies for three years, while also providing the potential upside of being out of  
19 pocket less depending on Shasta's claims experience.<sup>1</sup>

20 46. The Program presented a good deal for Shasta to address its concern about the  
21 effect of its increasing experience modification factor on its workers' compensation costs. This  
22 fact was confirmed by Shasta's own expert witness, who testified that Shasta chose the Program  
23 because "there was little or no downside because there was a maximum cost that was  
24

25 \_\_\_\_\_  
26 <sup>1</sup> By way of comparison, the estimated cost of workers' compensation insurance for the 2010 year for Zenith was  
27 \$446,541. Assuming the same payroll, rates and factors over the following years, the estimated cost of workers'  
28 compensation insurance coverage for three years from Zenith would be \$1,339,623, which is in excess of the  
ultimate out-of-pocket costs of approximately \$1,010,000 that would have been borne by Shasta under the Program  
had it paid all Program charges and after a final profit-sharing distribution under the RPA after the Program closed.

1 approximately the same as what a guaranteed cost program would run, and there was some  
2 potential for getting some money back."

3 47. Shasta opted to participate in the Program effective January 1, 2010. The decision  
4 to participate in the Program was made by Mr. Hammer in consultation with Shasta's broker. Mr.  
5 Hammer executed the Program's contracts including the Request To Bind and RPA.

6 48. CIC issued Shasta the standard workers' compensation policy and has complied  
7 fully with all claims payment and other obligations stated in that policy. AUCRA has complied  
8 with the RPA and all funding and other requirements stated therein.

9 **C. Shasta Linen's Experience under the Program**

10 49. As of December 2012, the total cost of the Program as calculated under the RPA  
11 and due and payable by Shasta was \$1,224,991 (This amount is higher than the initial estimated  
12 maximum due to Shasta's higher payroll). Shasta has not paid this full amount. Instead, Shasta  
13 has paid only \$930,000 in Program charges. Despite Shasta's failure to comply with its duties  
14 under the RPA, CIC has continued to perform all duties required of it under the CIC Policies.

15 50. As demonstrated by evidence presented (but rejected by the ALJ), due to the  
16 closure of all claims, Shasta's capital deposit obligations under the Program decreased. Had  
17 Shasta paid the entire \$1,224,991 when due and the Program was closed, Shasta would have  
18 received a return of capital in the past and/or a final profit sharing distribution totaling at least  
19 \$209,000. In other words, Shasta's ultimate net cost under the Program for three years of  
20 workers' compensation coverage, if all payments were made, would have been approximately  
21 \$1,010,000.

22 51. Assuming Shasta had never entered into the RPA and/or its profit-sharing aspects  
23 were simply ignored, the total amount owed by Shasta under the standard workers' compensation  
24 CIC Policies would be \$1,167,489 – approximately \$150,000 more than what Shasta's ultimate  
25 out-of-pocket costs would have been had it complied with its contractually agreed to payment  
26 obligations under the Program.

27 **D. Shasta's Administrative Appeal to the Commissioner under Section 11737(f)**

28 52. On August 27, 2014, Shasta initiated an appeal with the Commissioner's AHB

1 pursuant only to California Insurance Code section 11737(f).

2 53. In the administrative appeal, Shasta challenged the RPA's legality and the  
3 payments due under the RPA. Shasta argued that the RPA was a collateral agreement pursuant to  
4 California Code of Regulations, Title 10, section 2268, and that CIC's failure to file and secure  
5 approval of the RPA violated Insurance Code sections 11735 and 11658. Shasta contended that  
6 it should not have to pay any Program charges.

7 54. CIC argued that the AHB lacked jurisdiction to hear the appeal as Shasta was not  
8 challenging the CIC Policy or rates but Shasta's obligations under the RPA – a separate  
9 agreement with a different entity that was not a party to the Appeal. CIC also contended that,  
10 under the Insurance Code, the Commissioner may only invalidate an unfiled rate prospectively  
11 and only in a specially noticed proceeding brought by the Commissioner himself under Insurance  
12 Code section 11737(d) which was not the basis for Shasta's appeal to the AHB.

13 55. The ALJ submitted a proposed decision on November 20, 2015 and recommended  
14 its adoption as a decision of the Commissioner. In the proposed decision, the ALJ concluded  
15 that the RPA was an unfiled and unapproved collateral agreement that modified the terms of the  
16 CIC standard workers' compensation insurance policies and was therefore void. The ALJ also  
17 determined that Shasta was responsible for additional premiums and fees owed to CIC under its  
18 standard workers' compensation insurance policies which totaled approximately \$230,000.00,  
19 which was in addition to the approximately \$930,000.00 already paid. Ironically, this is in  
20 excess of what Shasta would have paid under the program if it had paid what it owed.

21 56. On January 21, 2016, the Commissioner issued an "Order Adopting Proposed  
22 Decision" in which the Commissioner adopted the November 20, 2105 Proposed Decision.

23 57. On February 5, 2016, CIC filed a Petition for Reconsideration with the  
24 Commissioner addressing the jurisdictional defects in the Proposed Decision and seeking  
25 vacation of the January 21, 2016 Order and rejection of the Proposed Decision.

26 58. On February 17, 2016, Shasta filed its own Petition for Reconsideration with the  
27 Commissioner in which it sought a modification of the Proposed Decision and Order requiring it  
28 to pay premiums and assessments owed under the CIC Policies.





1 alleged herein. The Commissioner's Order was also so inconsistent with prior examinations and  
2 actions as to be arbitrary and capricious.

3  
4 **A. The Commissioner Acted Contrary to the Law and in Excess of His**  
5 **Jurisdiction by Voiding a Contract – a Remedy Unavailable to the**  
6 **Commissioner**

7 66. The Commissioner must act within the powers conferred upon it by law and may  
8 not act in excess of those powers.

9 67. In the Order, the Commissioner declared the RPA void on the grounds that it  
10 constituted a misapplication of rates under Insurance Code section 11737, that it was a collateral  
11 agreement and, therefore, was subject to Insurance Code section 11658's filing requirements.

12 68. No statute or regulation permits the Commissioner to declare a contract void on  
13 the ground that it is unfiled under Section 11658, or is a collateral agreement under Section 2268,  
14 or under Section 11737. To the contrary, as made clear by the Commissioner's newly revised  
15 Title 10, Section 2268, a violation of that section gives rise to only certain administrative  
16 proceedings that have not been initiated here and none of which provide the Commissioner with  
17 the authority to void an agreement that purportedly violates Title 10, Section 2268 or Insurance  
18 Code section 11658.

19 69. Because the Commissioner lacks authority to void a contract on the ground that it  
20 is an unfiled policy form or agreement in violation of the requirements of Section 11658 or  
21 Section 2268, the Commissioner acted in excess of the law in his Order. On this ground alone,  
22 the Order must be vacated.

23  
24 **B. The Commissioner Acted Contrary to the Law and in Excess of His**  
25 **Jurisdiction by Extinguishing the Rights of a Non-Party to the Underlying**  
26 **Administrative Proceeding**

27 70. While CIC was a party to the underlying administrative Appeal, AUCRA was not.  
28 In fact, AUCRA was not named as a party to the Appeal, AUCRA was not joined as a party to

1 the Appeal, AUCRA did not appear in the Appeal, and AUCRA was not represented in the  
2 Appeal. The Order nonetheless purports to rule on the validity and enforceability of the RPA. In  
3 doing so, the Order violates AUCRA's right to due process and constitutes an act in excess and  
4 abuse of the Commissioner's authority.

5 71. A Section 11737(f) appeal only permits an appeal of the decision of an insured's  
6 "insurer" to review the manner in which that "insurer" applied its "rating system" to determine  
7 premium for workers' compensation insurance coverage offered to the insured.

8 72. Here, AUCRA is not Shasta's insurer. The RPA is not an insurance policy. It  
9 provides no insurance coverage to Shasta and certainly would not have satisfied Shasta's  
10 obligation under Labor Code §3700. Instead, Shasta's appeal arose from a decision by CIC and  
11 the Appeal only names CIC as the respondent. Further, Shasta's appeal was served only upon  
12 CIC, not AUCRA. See 10 C.C.R. § 2509.49 (requiring service of copy of the appeal "on the  
13 office designated by each respondent named in the appeal").

14 73. Because AUCRA was not (and, in fact, could not be) a party to the underlying  
15 Section 11737(f) Appeal and/or did not fall within the jurisdiction of the AHB or the  
16 Commissioner in such an Appeal, the Commissioner acted beyond the limits of his role and his  
17 jurisdiction by issuing the Order impacting the rights of this non-party and depriving AUCRA of  
18 fundamental due process. In seeking to address the rights of AUCRA in a proceeding to which it  
19 was not party, to which it was provided no formal notice and to which it was not subject to in the  
20 first instance constituted a violation of AUCRA's due process and deprivation of a fair trial.

21  
22 **C. The Commissioner Acted Contrary to the Law and in Excess of His**  
23 **Jurisdiction by Failing to Provide a Notice of Intent to Disapprove the RPA**  
24 **as an Unfiled Rate and Failing to Initiate a Rate Disapproval Proceeding**

25 74. The Commissioner may disapprove a workers' compensation rate that does not  
26 comply with the rate filing requirements of the California Insurance Code. Ins. Code § 11737(a).

27  
28

1           75.    If the Commissioner decides to exercise his discretion to disapprove of an unfiled  
2 rate, the Commissioner "shall serve notice on the insurer of the intent to disapprove and shall  
3 schedule a hearing to commence within 60 days of the date of the notice." Ins. Code § 11737(d).

4           76.    The Commissioner provided no notice of an intent to disapprove the RPA as an  
5 unfiled rate or schedule and prosecute a hearing to disapprove of any purported unfiled rate.  
6 Instead, the underlying administrative proceeding was initiated by a private party – Shasta –  
7 pursuant to the limited "appeal" process provided under Section 11737(f) and improperly  
8 morphed into a "disapproval" proceeding, without any notice.

9           77.    In limiting the right to initiate a hearing to disapprove of an unfiled rate with the  
10 Commissioner, the California legislature clearly intended to leave the exclusive power to initiate  
11 an unfiled rate disapproval proceeding within the sound discretion of the Commissioner. Unless  
12 and until the Commissioner issues notice of intent to disapprove an unfiled rate and then issues a  
13 disapproval order following a noticed proceeding, an unfiled rate is not an unlawful rate. This  
14 process is intended to provide notice to the insurer and afford the insurer with the ability to  
15 defend its position.

16           78.    Because the Commissioner has not provided notice of an intent to disapprove of  
17 the RPA as an unfiled rate or prosecute a Section 11737(d) proceeding to disapprove the RPA as  
18 an unfiled rate, the Commissioner acted in excess of the law and his powers by issuing his Order  
19 and again depriving CIC and AUCRA of their fundamental due process rights by conducting a  
20 hearing on a matter not noticed.

21  
22           **D.    The Commissioner Acted Contrary to the Law and in Excess of His**  
23                   **Jurisdiction by Retroactively Disapproving the RPA's Payment Obligations**

24           79.    Even if the Commissioner had issued a notice of intent to disapprove the RPA as  
25 an unfiled rate, the Insurance Code only permits the disapproval of that rate on a going-forward  
26 prospective basis for policies issued or renewed after any disapproval order. Ins. Code §  
27 11737(g).

28

1 80. Even if the Commissioner had provided a notice of intent to disapprove of the  
2 RPA's payment obligations as an unfiled rate and initiated a rate disapproval proceeding – none  
3 of which has happened – the Commissioner had no authority to render unlawful the use of those  
4 payment obligations with respect to Shasta as all of the CIC Policies issued to Shasta were issued  
5 and/or renewed and expired prior to the June 20, 2016 Order.

6 81. Because the Insurance Code does not permit the Commissioner to retroactively  
7 disapprove the use of an unfiled rate, the Commissioner acted in excess of the law and beyond  
8 his powers in his Order, which retroactively voided the RPA as an unfiled rate.

9  
10 **E. The Commissioner Acted Contrary to the Law and in Excess of His**  
11 **Jurisdiction by Addressing Non-Rate Issues in the Underlying**  
12 **Administrative Appeal Limited to a Review of an Insurer's Application of a**  
13 **"Rating System"**

14 82. A Section 11737(f) appeal only provides for an appeal to the Commissioner to  
15 review an insurer's response to an insured's "request to review the manner in which the rating  
16 system has been applied in connection with the insurance afforded or offered." Ins. Code §  
17 11737(f). A Section 11737(f) appeal does not permit a customer to raise and seek review of non-  
18 rate issues. That is precisely why a separate statutory scheme is in place to review non-rate  
19 issues.

20 83. Notwithstanding the rate-limited scope of a Section 11737(f) appeal, the  
21 Commissioner examined and reached (erroneous) conclusions of non-rate provisions in the RPA,  
22 such as its provisions regarding dispute resolution, choice of law, and cancellation and  
23 determined whether the RPA fell within the scope of non-rate related statutes and regulations, all  
24 without notice that those issues were being considered.

25 84. Questions over the enforceability of these non-rate provisions and non-rate laws  
26 in the context of this limited private-party Section 11737(f) appeal were not properly before the  
27 ALJ in the Appeal and not properly for consideration by the Commissioner in the Order.

28

1           85.     Because the Order addresses and made determinations concerning non-rate issues  
2 and laws – which fall outside the jurisdiction and scope of a Section 11737(f) appeal – the  
3 Commissioner acted in excess of the law and his powers by issuing an Order reaching  
4 determinations and purporting to impose a remedy based upon a violation of these non-rate  
5 issues depriving CIC and AUCRA of their constitutionally protected due process rights.

6  
7           **F.     The Order Must Be Vacated as the Order's Issuance was Based upon**  
8           **Prejudicial Abuse of Discretion and CIC was Deprived of a Fair Trial**

9           86.     As will be more fully developed in briefing to the Court, the Order is also flawed  
10 in that it is based upon erroneous statements of law, the Order is unsupported by the findings, the  
11 findings are unsupported by the evidence and the Order is contrary to law. The following is a  
12 list of non-exhaustive examples of defects in the Order. Petitioners reserve their right to raise  
13 other errors at trial.

14           87.     As an initial matter, the Commissioner erred as a matter of law in concluding that  
15 CIC failed to comply with its filed workers' compensation rates, that the RPA altered those rates,  
16 that the RPA was a collateral agreement under Title 10 Section 2268 and that the RPA (and the  
17 Program as a whole) failed to comply with California's workers' compensation rate and form  
18 filing laws.

19           88.     Further, in the Order, the Commissioner concluded that an unfiled rate is an  
20 unlawful rate. This statement is legally incorrect as it conflicts with applicable statutory law.

21           89.     Further, in the Order, the Commissioner incorrectly conflated the "form" and  
22 "rate" filing laws that apply to workers' compensation insurance and ignored key differences to  
23 those laws that impact the regulatory power of the Commissioner. The Commissioner  
24 misinterpreted and patently ignored key provisions within Section 11737 governing the scope  
25 and jurisdiction of the Appeal and the remedies that may be imposed in such an appeal. The  
26 Commissioner incorrectly determined that, within the context of this limited private-party  
27 appeal, he could issue a declaration impacting the rights of entities that were not even a party to  
28 that Appeal, to-wit AUCRA. The Commissioner incorrectly determined that he may consider

1 and rule upon issues beyond the limited scope of the private-party administrative appeal below  
2 and do all of this without providing the notice required under the law, the California and United  
3 States Constitutions and in the context of a non-rate disapproval proceeding.

4 90. In the Order, the Commissioner further incorrectly attempted to rely upon the  
5 equity powers that are instilled with courts, not the Commissioner, to provide itself with  
6 authority to void the RPA and it relies upon an analysis reserved for courts in connection with  
7 their unlimited jurisdiction and power to address issues of purported illegality of contracts and  
8 their enforceability. Further, the Commissioner incorrectly determined that the RPA is void and  
9 not voidable. This was well beyond the limited jurisdiction of the AHB and the Commissioner  
10 does not have the authority to unilaterally expand the limited jurisdiction of the AHB.

11 91. In the Order, the Commissioner also relied upon Insurance Code section 11658.5  
12 as support for its conclusions concerning the illegality of the RPA's arbitration agreement, but  
13 ignored the import of that statute – which supports the enforcement of an arbitration agreement –  
14 and ignored the fact that this statute was not even in effect when Shasta initially agreed to  
15 participate in the Program.

16 92. In the Order, the Commissioner effectively ignored the corporate integrity of CIC  
17 and AUCRA because these entities have common officers and directors. The Order ignores the  
18 fact that CIC and AUCRA are separately licensed and highly regulated insurance companies -  
19 CIC by the CDI and AUCRA by the Iowa Division of Insurance. As highly regulated insurance  
20 companies CIC and AUCRA maintain capital and surplus that their insurance regulators have  
21 determined to be sufficient to satisfy all of their separate obligations, including those arising  
22 under the standard workers' compensation insurance policy CIC issued to Shasta and the RPA  
23 between AUCRA and Shasta. The Commissioner's failure to recognize the separate corporate  
24 integrity of CIC and AUCRA was not supported by the evidence, contrary to law, and an act  
25 beyond the scope of his statutory authority.

26 93. In the Order, the Commissioner incorrectly relied upon other cases in which  
27 courts found collateral agreements though such cases were clearly distinguishable in that they  
28 concerned alleged "collateral agreements" that were in fact secondary or binary agreements

1 between the insured and insurer – which is not the case here, the RPA being between AUCRA  
2 and Shasta and to which CIC is not a party – and did not consider the limits of the California  
3 Insurance Code workers' compensation rate filing laws upon the legal validity of an alleged  
4 unfiled workers' compensation rate. Further, while the Commissioner saw fit to cite various non-  
5 case law authorities to support its conclusion, the Commissioner ignored a California Appellate  
6 decision that made clear that an unfiled rate is not an unlawful rate – the Commissioner wrongly  
7 ignored that decision, which was right on point, based upon a California Rule of Court – rules  
8 inapplicable to the Appeal or the Commissioner's Order.

9 94. In the Order, the Commissioner starkly ignored CDI's decades of regulatory  
10 practice and oversight in not regulating captive fronting arrangements.

11 95. In the Order, the Commissioner ignored the law and the evidence in incorrectly  
12 determining that the RPA – a contract only between Shasta and AUCRA – modified the  
13 "obligation of either the insured or the insurer" under the CIC Policies – contracts between  
14 Shasta and CIC – so as to be a collateral agreement under Title 10 Section 2268. In the Order,  
15 the Commissioner ignores the substantial unrebutted evidence demonstrating that the obligations  
16 of the CIC Policies are not modified by the RPA, and could not be as a result of integration  
17 clauses in the CIC Policy. The Commissioner recognized the integration clauses in the Policy  
18 when he stated in his Order at pages 14 and 15:

19  
20 b. The Guaranteed Cost Policies are the Sole Insurance  
Agreements

21 The guaranteed cost policies issued by CIC in this matter all  
22 contain the same language that the policies are the sole insuring  
23 agreements between CIC and Shasta Linen and go on to state that,  
24 "The only agreements relating to this insurance are stated in this  
policy. The terms of this policy may not be changed or waived  
except by endorsement issued by us to be part of this policy."

25 In addition, a standard form Policy Amendatory  
26 Endorsement-California is attached to each of the policies and  
27 state, "It is further agreed that this policy, including all  
28 endorsements forming a part thereof, constitutes the entire contract  
of insurance. No condition, provision, agreement, or understanding  
not set forth in this policy or such endorsements shall affect such  
contract or rights, duties, or privileges arising therefrom."  
[Emphasis added.] No endorsement is attached, endorsed, or

1 included to the policies adding any provisions or changes relating  
2 to the RPA.

3 Finally, the policies each state on page five, under Part  
4 Six-Conditions, C. Transfer of Your Rights and Duties: "Your  
rights or duties under this policy may not be transferred without  
written consent."

5 96. The Commissioner ignored evidence and testimony demonstrating that the CIC  
6 Policies and RPA are separate contracts between different parties and, as expressly recognized in  
7 the law and in the Order, agreements with a reinsurer are legal. The Commissioner ignored the  
8 fact that the RPA has its own obligations only governing the duties and obligations between  
9 Shasta and AUCRA and that the RPA does not change any duties or obligations owed by CIC  
10 and Shasta under the CIC Policies. The Commissioner also ignored the undisputed evidence  
11 demonstrating that CIC itself charged and was paid premiums in accordance with its filed and  
12 approved rates with the CDI fully rebutting claims that the RPA changed CIC's rates.

13 97. Further, in the Order, the Commissioner concluded that the CDI Financial  
14 Examinations and Market Conduct Examination did not constitute approval of an unfiled  
15 agreement and that there was no evidence that the CDI reviewed the RPA. In so concluding the  
16 Commissioner once again ignored substantial un rebutted testimony and record documentary  
17 evidence confirming that the Program and the RPA were extensively discussed and reviewed by  
18 the CDI in connection with multiple examinations including, but not limited to a power point  
19 presentation explaining exactly how the funds flowed under the Program during the most recent  
20 examination as of December 31, 2013, completed and submitted on December 15, 2014, which  
21 examination was directed to the Commissioner and filed on February 10, 2015. In none of those  
22 examinations did the CDI ever take issue with the non-filed status of the RPA and how the  
23 Program worked. The Commissioner ignored the CDI's own comments in the examination  
24 reports concerning these audits. As the CDI stated in various parts of the latest financial  
25 examination report as of December 31, 2013:

26  
27 "EquityComp is a specialty workers' compensation product with  
28 risk sharing features targeted to medium sized businesses but does  
not include payroll processing services. The EquityComp product



1 is sold with an accompanying Profit Sharing Plan through the  
2 Company's affiliate, [AUCRA]. AUCRA then enters into a  
3 Reinsurance Participation Agreement with the insured in order to  
4 form a segregated protected cell by which the insured shares in a  
5 portion of the premiums and losses under the policy. AUCRA acts  
6 as a facilitator and also bears risk thereon for premiums and losses  
7 between the Company and the insured protected cell.  
8 Approximately 64% of the Company's book of business in 2013  
9 was the EquityComp product." (emphasis supplied)

6 \* \* \*

7 "A risk sharing plan is available for all of the above types of  
8 workers' compensation policies offered which provides a profit  
9 sharing distribution for policyholders who have good loss  
10 experience. Risk sharing components are accounted for through  
11 segregated cell accounts and reinsured with the Company's  
12 affiliated captive company, AUCRA." (emphasis supplied)

11 \* \* \*

12 "Master Facultative Reinsurance Agreement: The Company is a  
13 party to a Facultative Reinsurance Agreement with Applied  
14 Underwriters Captive Risk Assurance Company, Inc. (AUCRA),  
15 where premiums and losses of the profit sharing workers'  
16 compensation policies are ceded to AUCRA under a segregated  
17 cell arrangement."

15 This examination report was an exhibit to the proceedings before the ALJ and  
16 Commissioner. Contrary to the Commissioner's conclusions, the CDI had a thorough  
17 understanding of the Program, including the RPA. There was absolute transparency of the  
18 Program to the CDI.

19 98. The Commissioner further fails to even address the fact that the CDI conducted an  
20 examination in 2013 with the express purpose of reviewing CIC's rating and underwriting  
21 practices for compliance with all applicable laws, including those impacted by the Program and  
22 the RPA. As stated in the CDI's own examination report:

23  
24 "Applied Underwriters, Inc. offers workers' compensation  
25 insurance to large business through EquityComp®. EquityComp®  
26 is designed for mid-size to larger business and provides customers  
27 with flexible risk retention options. EquityComp® targets larger,  
28 more financially stable companies relative to SolutionOne®;  
however Applied does not process payroll for EquityComp®  
clients. To maintain the integrity of the business model, Applied  
Underwriters, Inc. utilizes a specialized captive insurance  
reinsurance facility through which customers directly participate in

1                    losses. Applied's captive reinsurance facility acts to collateralize  
2                    and secure reinsurance amounts related to EquityComp® and  
3                    facilitate real-time matching of premium to exposure." (emphasis  
4                    supplied)

5                    99.     In none of the CDI's examinations, did the CDI suggest, or question, much less  
6                    determine, that the Program was unlawful or take issue with the non-filed status of the RPA. By  
7                    reversing course in the Order, the Commissioner has acted arbitrarily and capriciously by taking  
8                    action directly at odds with the conclusions in its own examination reports.

9                    100.    The Commissioner accepted the 2013 CIC Examination Report and it was filed  
10                   with the CDI on February 10, 2015. As noted in Paragraph 10, supra, the CDI Examination  
11                   acknowledged the full cooperation of the officers and employees of CIC during the course of the  
12                   examination.

13                   101.    In the Order, the Commissioner further concluded that the RPA sets forth a non-  
14                   renewal penalty. This characterization is misleading and unsupported by the evidence. In  
15                   addition to the fact that this provision did not modify any obligation arising out of the CIC  
16                   Policies, the Commissioner ignored extensive un rebutted evidence demonstrating that there is no  
17                   such non-renewal "penalty," but rather a mechanism for requiring the payment of additional  
18                   deposits to ensure payment of claims.

19                   102.    The Commissioner in the Order admitted that the CIC Policies contained the  
20                   cancellation provision and "Short Rate Cancellation" Notice required by the Insurance Code.  
21                   (See Order at pp. 13-14)

22                   103.    The Commissioner further ignored extensive un rebutted evidence that such  
23                   additional deposits were akin to collateral calls that may be called on a participant/insured in any  
24                   loss sensitive participating plan to ensure payment of claims. The Commissioner also deemed not  
25                   worthy of noting that these additional deposits would be returned when all claims were closed  
26                   and that the Program was closed and did not change the ultimate cost of the Program as  
27                   represented to as Shasta.

28                   104.    In the Order, the Commissioner also concluded that CIC made misrepresentations  
to the Commissioner concerning the Program and reinsurance and that the Program was

1 misleading. But the Commissioner thereafter fails to cite to a single instance where CIC made  
2 any such misrepresentation or any citation to the administrative record in Shasta to support this  
3 conclusion. Further, the Commissioner failed to act in accordance with the law in even  
4 addressing such issues in the context of the limited private-party administrative appeal provided  
5 by Section 11737(f).

6 105. In the Order, the Commissioner further concluded that no profit sharing  
7 distributions have been made under the Program. This conclusion is simply untrue and  
8 unsupported by any evidence as the Commissioner himself admits in the Order. The  
9 Commissioner's conclusion that no profit sharing distributions have been made is unsupported by  
10 any evidence and the Commissioner's decision to issue such an unsupported conclusion –  
11 especially where such a conclusion was irrelevant to the questions presented in the underlying  
12 appeal – was an egregious error.

13 106. In the Order, the Commissioner contended that the Program was not a "fronting  
14 arrangement" (a term oft used with respect to captive arrangements) and that there was no  
15 evidence supporting this fact. The Commissioner, however, dismissed outright testimony  
16 provided by experts for both CIC and Shasta confirming that the Program was a "fronting  
17 arrangement" captive arrangement. The Commissioner further disregarded the comments of its  
18 own agency as reflected in multiple examination reports in which the CDI confirmed the captive  
19 arrangement of the Program.

20 107. In the Order, the Commissioner concluded that the Program was a non-linear  
21 retrospective rating plan based upon its determination that this statement was made in a patent  
22 application filed by Applied Underwriters, Inc., a non-party to the Appeal. This determination,  
23 however is unsupported by the evidence. No such statement was made by Applied Underwriters,  
24 Inc. While the Program, "in effect," could provide an insured with the ability to participate in a  
25 workers' compensation plan like a non-linear retrospective rating plan, the Program is structured  
26 as a segregated cell captive arrangement – an arrangement for which the CDI had vetted and  
27 which complied with the law.

28

1           108. In the Appeal, the ALJ erred in refusing to consider evidence demonstrating the  
2 successful working of the Program and that it delivered precisely what the Program promised.  
3 Additionally, the Order is completely devoid of any favorable evidentiary inferences and/or  
4 determinations and instead only includes evidence and makes every inference contrary to the  
5 positions held by CIC. For instance, while the Order suggests that Shasta was somehow duped  
6 into entering into the Program and/or the Program did not provide an economical option for  
7 Shasta, the Commissioner failed to mention that Shasta was a long on-going and substantial  
8 business operation, that the proposal for the Program was reviewed by an experienced  
9 commercial attorney who as the owner of Shasta had for many years reviewed workers'  
10 compensation proposals for Shasta, that the attorney was assisted by Shasta's controller who also  
11 regularly reviewed workers' compensation proposals, and that both were assisted by an  
12 independent professional insurance broker and the execution of certain disclosure documents  
13 including the Request to Bind. Further, the Commissioner did not consider substantial testimony  
14 demonstrating Shasta's reasoning for entering into the Program, that Shasta was concerned about  
15 expected experience modification factors that would apply to workers' compensation insurance  
16 rates causing an increase in premium and that the Program provided an ideal mechanism for  
17 Shasta to obtain the workers' compensation insurance it required while recouping monies if  
18 claims costs remained low. In the words of Shasta's own expert, "[F]rom a risk management  
19 perspective, especially, you know, if the maximum is no more or approximately the same as the  
20 guaranteed cost and there's the potential for getting something back, then yeah, and it mitigates  
21 my experience mod problem, then yeah, that sounds like the best available deal." It was the best  
22 available deal and would have been successful if Shasta paid what it owed and contractually  
23 agreed to pay. To suggest that Shasta was duped is just not the case. This was a deliberate  
24 calculated business decision based upon a review of various workers' compensation options in  
25 consultation with Shasta's broker.

26           109. The underpinning of the Commissioner's Order is that the RPA was a collateral  
27 agreement that changed the terms and conditions of the CIC Policies. The Commissioner in his  
28 Order ignored the substantial un rebutted evidence that every single workers' compensation claim

1 brought by an injured Shasta employee under the CIC Policies was adjudicated exclusively in  
2 California before the California Workers' Compensation Appeals Board. No such claims were or  
3 could be made under the RPA.

4 110. Moreover, the Commissioner's claim that the RPA is a collateral agreement that  
5 changed the terms and conditions of the CIC Policy is belied by the very language in his Order.  
6 The Commissioner's Order states that "every guaranteed cost policy must contain statutorily-  
7 required dispute resolution and cancellation language." (Order at pp. 12-13). The Commissioner  
8 acknowledged that the CIC Policies contain the required language. (Id.). The best evidence that  
9 the CIC Policies contained that language is that the Appeal upon which the Commissioner issued  
10 his Order was brought by Shasta pursuant to the dispute resolution process in the CIC Policies  
11 under Ins. Code §11737(f) and not by arbitration under the RPA.

12 111. Additionally, the Commissioner has failed to act in accordance with the law and  
13 acted capriciously and arbitrarily in disapproving of the RPA and Program though the CDI had  
14 examined all aspects of the RPA and the Program in connection with multiple examinations and  
15 review of forms, including reinsurance agreements, and, therefore, the CDI has approved,  
16 expressly and implicitly, the RPA and the Program; therefore, the Commissioner should be  
17 estopped from retroactively disapproving of the Program or purporting to void the RPA.

18 112. For each of the reasons stated in paragraphs 1 through 111 above and for  
19 additional reasons to be raised and discussed in connection with briefing and hearing to the  
20 Court, the Commissioner's Order constitutes a prejudicial abuse of discretion as the rulings  
21 stated therein were issued in excess of the law, in excess of the jurisdiction and powers of the  
22 Commissioner, the Order is unsupported by the findings and the findings are unsupported by the  
23 evidence.

24 113. All administrative remedies have been exhausted and/or were unavailable to CIC  
25 and/or AUCRA. CIC and AUCRA lack a "plain, speedy, adequate remedy, in the ordinary  
26 course of law."  
27  
28

1 114. CIC and AUCRA are therefore entitled to a writ of mandamus under Code of  
2 Civil Procedure section 1094.5 that directs the Commissioner to set aside his Order for each of  
3 the reasons set forth above and those reasons to be raised at hearing.

4  
5 **VI. SECOND CAUSE OF ACTION**

6 (Declaratory Relief: CCP Section 1060)

7 115. CIC and AUCRA reallege and incorporate paragraphs 1 through 114 herein by  
8 reference.

9 116. An actual controversy has arisen and now exists between the parties concerning  
10 the Commissioner's powers and jurisdiction as they concern the regulation and approval and/or  
11 disapproval of workers' compensation insurance forms and rates, specifically, California  
12 Insurance Code sections 11658, 11735, 11737 and 10 C.C.R. § 2268.

13 117. Plaintiffs contend that the Order determined issues and set forth a remedy that  
14 was beyond the scope of the limited issues permitted to be addressed in that appeal and the  
15 jurisdiction of the AHB and/or the Commissioner. By statute, the Commissioner himself must  
16 issue a notice of intent to disapprove an allegedly unfiled workers' compensation insurance rate –  
17 which did not happen here. Also by statute, the Commissioner can only require the discontinued  
18 use of a disapproved workers' compensation insurance rate on a going forward basis – yet here,  
19 the Commissioner retroactively invalidated the RPA on the ground that it affected rates and was  
20 unfiled.

21 118. Plaintiffs further contend that the Commissioner has issued the Order in which the  
22 Commissioner has set forth incorrect interpretations of the laws concerning workers'  
23 compensation rates and forms. Specifically, in the Order, the Commissioner has determined that:

- 24 - The Commissioner has jurisdiction and/or power to address  
25 non-rate issues in a Section 11737(f) proceeding, though  
26 such a proceeding only concerns "rating system" issues.  
27 - The Commissioner has jurisdiction and/or the power to  
28 void a contract on the ground that a contract violates  
Insurance Code section 11658 though there is no statute

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that provides the Commissioner with the power of voiding a contract or requiring monetary remuneration.

- The Commissioner has jurisdiction and/or the power to void a contract on the ground that the contract constitutes an unfiled workers' compensation rate though the relevant workers' compensation rates only permit the prospective disapproval of an unfiled rate.
- The Commissioner has jurisdiction and/or the power to void a contract on the ground that the contract constitutes an unfiled workers' compensation rate though the Commissioner provided no notice of intent to disapprove of that rate or initiated a rate disapproval proceeding as required under Insurance Code section 11737.
- The Commissioner has determined that an unfiled workers' compensation rate is an unlawful rate ab initio.

119. The Commissioner has designated the Order precedential and as such the Commissioner intends the legal and factual conclusions therein to be cited as precedent.

120. CIC and AUCRA disagree with each of these determinations on the grounds that they are contrary to the law and fact and are in conflict and/or in excess of statutory authority.

121. Further, in setting forth statements of law and designating the Order precedential with the purpose of applying such statements of law in other matters, the Order constitutes an underground regulation in violation of California law, and has been applied in manner that violates the California and Federal constitutions.

122. Upon information and belief and based upon the Order, the Commissioner contends in all respects to the contrary of Petitioners' contentions regarding the interpretation, meaning and application of the above-referenced statutes and applicable regulations, the Commissioner disputes that he did not proceed in the manner required by law in interpreting and applying the above-referenced laws and the Commissioner contends his interpretation and application of the above-referenced regulations is consistent with all applicable laws.



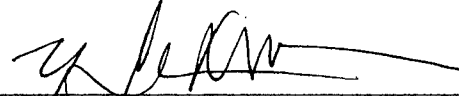


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- 2. For a declaration concerning the powers and jurisdiction of the Commissioner with regards to his ability to regulate and void an unfiled workers' compensation rate or form;
- 3. For an injunction enjoining and an order staying enforcement of the Order;
- 4. Recovery of attorneys' fees; and
- 5. For such other or further relief as the Court may deem just and proper.

DATED: 7/1/16

HINSHAW & CULBERTSON LLP

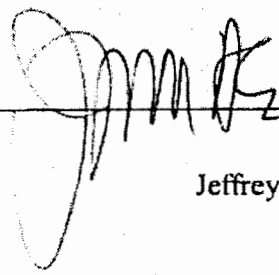
By:   
SPENCER Y. KOOK  
RICHARD DE LA MORA  
TRAVIS R. WALL  
Attorneys for Petitioners and Plaintiffs  
CALIFORNIA INSURANCE COMPANY  
and APPLIED UNDERWRITERS CAPTIVE  
RISK ASSURANCE COMPANY, INC.

VERIFICATION

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I, Jeffrey Silver, Esq., am the Secretary and General Counsel of California Insurance Company and Applied Underwriters Captive Risk Assurance Company, Inc. I have read the above Petition for Writ of Administrative Mandamus and Complaint for Declaratory Relief. The facts alleged in the above petition are true to the best of my own knowledge. This verification does not address the legal conclusions.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this verification is executed on 30th day of June 2016 at Omaha, Nebraska.



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Jeffrey Silver

# **Exhibit A**

**BEFORE THE INSURANCE COMMISSIONER  
OF THE STATE OF CALIFORNIA**

In the Matter of the Appeal of:

SHASTA LINEN SUPPLY, INC.

Appellant,

From the Decision of the

CALIFORNIA INSURANCE COMPANY,

Respondent.

File AHB-WCA-14-31

**DECISION & ORDER**

**I. Introduction**

Shasta Linen Supply, Inc. (Shasta Linen) appeals California Insurance Company's (CIC) decision rejecting Shasta Linen's claims that CIC failed to adhere to its rate filings and sold an unfiled and unapproved insurance program titled EquityComp.

For the reasons set forth below, the Insurance Commissioner of the State of California ("Insurance Commissioner") finds that CIC's EquityComp program and the accompanying Reinsurance Participation Agreement (RPA) constitute a misapplication of the filed rates of CIC in violation of California Insurance Code section 11737. Further, the Commissioner finds that CIC's EquityComp program and the accompanying RPA constitute a collateral agreement pursuant to California Code of Regulations, title 10, section 2268, and CIC's failure to file and secure approval of EquityComp and the RPA, in violation of Insurance Code section 11658, renders the RPA void as a matter of law.

## **II. Statement of Issues**

1. Does CIC's EquityComp program constitute a misapplication of the filed rates of CIC in violation of California Insurance Code section 11737?

2. Does CIC's EquityComp program's RPA constitute a collateral agreement modifying the rates and obligations of either the insured or insurer, and is it void as a matter of law since the RPA was not filed with the Workers' Compensation Insurance Rating Bureau and the Department of Insurance before its use in the State of California, pursuant to Insurance Code section 11658 and California Code of Regulations, title 10, sections 2268 and 2218?

## **III. Contentions of the Parties**

Shasta Linen contends CIC violated numerous Insurance Code provisions, as well as the California Code of Regulations, by failing to file the EquityComp program and the RPA with the Workers' Compensation Insurance Rating Bureau (WCIRB)<sup>1</sup> and the Insurance Commissioner. Specifically, Shasta Linen asserts the RPA constitutes a collateral agreement pursuant to California Code of Regulations, title 10, sections 2268 and 2218, and as such must be filed and approved by the Insurance Commissioner prior to use.<sup>2</sup> Shasta Linen argues CIC's failure to file the RPA violates Insurance Code sections 11658 and 11735, as well as Part 2, Section V of the Miscellaneous Regulations for the Recording and Reporting of Data.<sup>3</sup> Shasta Linen also contends CIC violated Insurance Code section 381 by failing to specify, in Shasta Linen's workers' compensation insurance policy, the basis and rates upon which the final premium is to

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<sup>1</sup> The WCIRB is a rating organization licensed by the Insurance Commissioner under Insurance Code sections 11750 et seq. to assist the Commissioner in the development and administration of workers' compensation insurance classification and rating systems. The WCIRB serves as the Commissioner's designated statistical agent for the purpose of gathering and compiling experience data developed under California's workers' compensation and employers' liability insurance policies. (Ins. Code § 11751.5).

<sup>2</sup> Appellant's Post-hearing Opening Brief, 4:7-17.

<sup>3</sup> Provisions of the Miscellaneous Regulations for the Recording and Reporting Data are part of the Insurance Commissioner's Regulations, codified in California Code of Regulations, title 10, section 2354.

be determined and paid.<sup>4</sup> Lastly, Shasta Linen asserts CIC violated Insurance Code section 11658.5, by failing to inform Shasta Linen of its right to negotiate the policy's dispute resolution provisions and by failing to secure written receipt of such disclosure prior to issuance of the policy.<sup>5</sup> Shasta Linen urges the Commissioner to bar CIC from enforcing the terms of EquityComp and the RPA, including the mandatory arbitration provisions. Shasta Linen also requests the Commissioner order CIC to return all monies contributed to Shasta Linen's cell account, except for those used to settle workers' compensation claims, as well as all fees collected and disbursed to Applied Underwriters, Inc. and Applied Underwriters Captive Risk Assurance Company.<sup>6</sup>

CIC initially asserts the California Department of Insurance (CDI) lacks jurisdiction over Shasta Linen's appeal. Specifically, CIC argues: (1) appeals filed under Insurance Code section 11737, subdivision (f) may only determine "whether CIC has properly applied its [rate] filings to determine how much premium to charge" and may not address the potential illegality of the rate filing;<sup>7</sup> (2) the RPA is between AUCRA and Shasta Linen, and relief in this forum is not possible;<sup>8</sup> (3) whether the RPA is an unlawful collateral agreement in violation of the Insurance Commissioner's Regulations is beyond the scope of the CDI's jurisdiction;<sup>9</sup> and (4) only the Insurance Commissioner may initiate a hearing to disapprove an unfiled rate.<sup>10</sup>

With regard to the merits of Shasta Linen's claims, CIC argues the RPA is not a collateral agreement because it does not change the cost of insurance under the CIC policy, does not impact insurance rates, and does not modify the terms of the CIC insurance policy issued to

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<sup>4</sup> Appellant's Post-hearing Opening Brief, 5:7-13.

<sup>5</sup> Appellant's Post-hearing Opening Brief, 5:15-23.

<sup>6</sup> Appellant's Post-hearing Opening Brief, 6:1-3; 26:3-12.

<sup>7</sup> Respondent's Post-hearing Opening Brief, 21:13-22:7.

<sup>8</sup> Respondent's Post-hearing Opening Brief, 22:8-18.

<sup>9</sup> Respondent's Post-hearing Opening Brief, 23:8-14.

<sup>10</sup> Respondent's Post-hearing Opening Brief, 23:21-24:6.

Shasta Linen.<sup>11</sup> Lastly, with regard to potential remedies, CIC contends the CDI may not void Shasta Linen's RPA. Instead, CIC argues that if the Commissioner finds that the RPA violates the Insurance Code or its applicable Regulations, the Commissioner may issue only a prospective order to cease use of the RPA, and is not permitted to void Shasta Linen's RPA.<sup>12</sup>

#### **IV. Procedural History**

On August 29, 2014, Shasta Linen filed an appeal with the Department of Insurance, Administrative Hearing Bureau (AHB) in response to CIC's July 31, 2014 decision rejecting Shasta Linen's Complaint and Request for Action. On September 5, 2014, the Chief Administrative Law Judge issued an Appeal Inception Notice and assigned the matter to Administrative Law Judge (ALJ) Kristin L. Rosi.

On October 31, 2014, the ALJ conducted a telephonic status conference with all parties. During the conference, the parties agreed to a discovery timetable and to the statement of the issue as identified above. The ALJ set the matter for an evidentiary hearing commencing March 9, 2015.

At the hearing, Craig E. Farmer, Esq., of Farmer, Smith & Lane, LLP, appeared on behalf of Shasta Linen. Spencer Y. Kook, Esq. and Richard De La Mora, Esq., of Hinshaw & Culbertson, LLP, appeared on behalf of CIC. The parties submitted documentary evidence and presented witnesses. The evidentiary record includes witness testimony and all exhibits admitted into evidence as identified in the parties' Exhibit Lists.

On March 17, 2015, CIC's General Counsel and co-author of the EquityComp program, Jeffrey Silver, invoked the attorney-client privilege and refused to answer any questions regarding EquityComp's creation or the RPA's terms. In order to create a more complete

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<sup>11</sup> Respondent's Post-hearing Opening Brief, 26:1-28:6; 30:15-31:7; 37:19-41:4.

<sup>12</sup> Respondent's Post-hearing Opening Brief, 41:6-42:3.

evidentiary record, on March 23, 2015, the ALJ convened a conference to discuss the presentation of an additional witness. During this conference, CIC agreed to present a witness able to testify about the EquityComp program and the RPA. In response to a joint request by the parties, on March 26, 2015, the ALJ issued an Order continuing the evidentiary hearing to May 21 and May 22, 2015.

On April 30, 2015, the ALJ ordered additional evidence from both parties. Specifically, the ALJ ordered copies of CIC's Annual Statements, the total number of EquityComp participants, the total number of EquityComp participants who received refunds at the conclusion of the program, a list of complaints and grievances filed regarding the program, the percentage of EquityComp participants with open claims at the conclusion of the program, and an EquityComp loss ratio sensitivity analysis for 2013 and 2014. The ALJ also ordered copies of Shasta Linen's corporate tax returns, the total amounts paid in workers' compensation premium and losses for policy years 2013 and 2014, and the most recent experience rating modification.

On May 8, 2015, CIC filed an Objection and Request for a Continuance in response to the ALJ's Order for Additional Evidence. CIC objected to the production of additional evidence arguing: (1) the ALJ lacks authority and jurisdiction to issue such an order; (2) the information is irrelevant; and (3) the information is confidential to third-party participants.

On May 18, 2015, the ALJ overruled CIC's objections and ordered CIC to comply with the April 30, 2015 Order. On May 19, 2015, CIC informed the ALJ it would not comply with the ALJ's Additional Evidence Order. At the hearing on May 21, 2015, CIC called Patrick Watson to testify in response to the ALJ's request for a person most knowledgeable regarding EquityComp and the RPA.

On July 24, 2015, the parties filed concurrent opening briefs and on August 10, 2015, the



parties filed their concurrent reply briefs.

On August 11, 2015, CIC requested the ALJ take official notice of the Summary Denial issued in *Sportsmobile West, Inc.*, AHB-WCA-06-7 and the Notice of Hearing and Order to Show Cause filed by the CDI against Zurich American Insurance Company of Illinois on February 27, 2012. On that same date, CIC also requested permission to file a supplemental declaration by Ellen Gardiner, pursuant to California Code of Regulations, title 10, section 2509.66. On August 24, 2015, Shasta Linen filed objections to CIC's additional evidence and request for official notice. On September 16, 2015, the ALJ rejected CIC's request to file additional evidence. On that same date, the ALJ granted, in part, and rejected, in part, various requests for official notice and ordered the record closed.

On October 29, 2015, the ALJ reopened the record to accept the parties' executed Stipulated Protective Order. By that same Order, the ALJ reclosed the record.

On November 20, 2015, the ALJ submitted her Proposed Decision and Order, which was adopted by Order of the Commissioner on January 21, 2016.

CIC filed its Petition of Reconsideration dated February 5, 2016, and Shasta Linen also filed a Petition for Reconsideration dated February 17, 2016.

On March 22, 2016, the Insurance Commissioner issued an Order Granting Reconsideration and Notice of Non-Adoption of Proposed Decision.

## **V. Findings of Fact**

A review of the record found, by a preponderance of evidence, the following material facts, that are adopted herein.<sup>13</sup>

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<sup>13</sup> References to the transcript of the evidentiary hearing are "Tr." followed by the page number(s) and, where line references are used, a ":" followed by the line number(s). Thus, a reference to Tr. 35:14-18 is to page 35, lines 14-18 of the transcript. Exhibits are referred to by the numbers assigned to them in the parties' Exhibit Lists.

## **A. Shasta Linen**

### **1. Company History**

Shasta Linen is a privately-held family-owned California corporation in the linen rental business.<sup>14</sup> Founded in 1948, Shasta Linen originally operated as a laundry and dry cleaning service. In the 1950s, the company ceased operating as a laundry and dry cleaning service and entered into the linen rental business. Shasta Linen's customers include restaurants, hotels, surgery centers and doctor's offices.<sup>15</sup>

Shasta Linen employees pick up soiled linens and garments from their customers and transport them back to Shasta's Sacramento laundry facility. There, the linens are counted, sorted, washed, dried and pressed.<sup>16</sup> Shasta Linen employees then return the cleaned linens to the customers. The laundry facility employs approximately 63 people who work five days a week.<sup>17</sup>

Prior to December 2014, Shasta Linen had two owners; Tom Hammer, President, and Gordon Macauley, Vice-President. Mr. Hammer and Mr. Macauley each owned 50% of the corporation. In December 2014, Mr. Hammer passed away and his 50% share was divided between his daughter, Noel Richardson, the current President of Shasta Linen, and his surviving spouse, Phyllis Hammer. Ms. Richardson received 20% of the corporate stock and Mrs. Hammer received the remaining 30%.<sup>18</sup>

### **2. 2009 Purchase of EquityComp Program**

For decades, Shasta Linen employed Sacramento Valley Insurance Services (SVIS) as its

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<sup>14</sup> Tr. 106:23-107:2.

<sup>15</sup> Tr. 107:12-16.

<sup>16</sup> Tr. 108:5-11.

<sup>17</sup> Tr. 108:23-25.

<sup>18</sup> Tr. 100:7-9.

insurance broker.<sup>19</sup> In each of these years, SVIS secured Shasta Linen's workers' compensation insurance through a guaranteed cost policy. From 2002 through 2008, Shasta Linen's experience modification ranged from 66% to 80%, demonstrating that Shasta Linen had a more favorable loss experience than other businesses in its industry.<sup>20</sup>

In 2009, Shasta Linen anticipated an increase in its experience modification factor due to several earlier claims. In late 2009, Shasta Linen's broker presented the EquityComp program as an alternative to the traditional guaranteed cost policy and as a means to counter the effects of an increase in experience modification. At that same time, the broker presented quotes from other insurers offering guaranteed cost policies.<sup>21</sup> The quotes were presented in descending cost order with Zenith Insurance Company quoting an annual premium of \$446,541 and Insurance Company of the West (ICW) quoting an annual premium of \$301,091. The broker placed EquityComp on the line below ICW, with a note that stated "see attached."<sup>22</sup> Attached to the rate quotes was a Program Proposal and a Rate Quote from Applied Underwriters' ("AU") EquityComp program. The EquityComp rate quote indicated a minimum single-year premium of \$107,541 and a maximum premium of \$322,623.<sup>23</sup> The broker did not present Shasta Linen with a copy of the Reinsurance Participation Agreement nor had the broker read the RPA at the

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<sup>19</sup> SVIS was subsequently acquired by Pan American Underwriters, a wholly-owned subsidiary of Ascension Insurance Services. (Exh. 271-9).

<sup>20</sup> Exh. 65. The WCIRB promulgates experience ratings for each qualified employer pursuant to the rules set forth in the California Workers' Compensation Experience Rating Plan (ERP). Experience rating utilizes a policyholder's past claims experience to forecast future losses by measuring the policyholder's loss experience against the loss experience of policyholders in the same classification to produce a prospective premium credit, debit or unity modification. (Ins. Code § 11730, subd. (c)). The rules governing the reporting of loss data are found in the California Workers' Compensation Uniform Statistical Reporting Plan (USRP). Provisions of the ERP and USRP, including the Standard Classification System, are part of the Insurance Commissioner's regulations, codified at title 10, California Code of Regulations, section 2352.1.

<sup>21</sup> Exh. 271-14; Exh 272-22.

<sup>22</sup> Exh. 272-22. The Commissioner notes for the record that the broker named Applied Underwriters as the insurance carrier. The broker made no mention of CIC anywhere in his presentation.

<sup>23</sup> Exh. 201-3.

time he presented the program.<sup>24</sup>

After reviewing the premium and claim amount tables in AU's marketing materials, Shasta Linen agreed to enroll in the three-year EquityComp program.<sup>25</sup> In December 2012, the final month of the three-year program, Shasta Linen received a monthly bill for \$77,593.66.<sup>26</sup> By that time, Shasta Linen had already paid \$934,466.60 in EquityComp costs over the three years and its captive cell held approximately \$200,000.<sup>27</sup> In January 2013, one month after the program ended and the workers' compensation insurance policy expired, Shasta Linen received a bill for an additional \$166,619.75.<sup>28</sup> Shasta Linen has not paid the additional \$244,213.31 arguing that such payments exceed the guaranteed cost policy's quoted amount, were not fully explained and are inconsistent with the guaranteed cost policy.<sup>29</sup> CIC continues to compound interest on these unpaid charges each month. In January 2014, CIC calculated Shasta Linen's final payment at \$290,524.58.<sup>30</sup>

## **B. CIC and Its Affiliated Entities**

### **1. Organizational Structure**

CIC California Insurance Company is a licensed property and casualty insurance company, domiciled in California and licensed to transact business in 26 states. CIC is wholly-owned by North American Casualty Company, a non-insurer, which is in turn wholly-owned by Applied Underwriters, Inc. (AU), a Nebraska corporation.<sup>31</sup> AU is an indirect subsidiary of Berkshire Hathaway Inc. AU is also the parent company for Applied Underwriters Captive Risk

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<sup>24</sup> Exh. 271-26. The broker had never enrolled a client in EquityComp prior to enrolling Shasta Linen.

<sup>25</sup> The guaranteed cost policy had an effective date of January 1, 2010. Shasta Linen did not enroll in EquityComp until January 5, 2010.

<sup>26</sup> Exh. 213-23.

<sup>27</sup> Tr. 819:8-11; Tr. 232:3-7; Exh. 31-2.

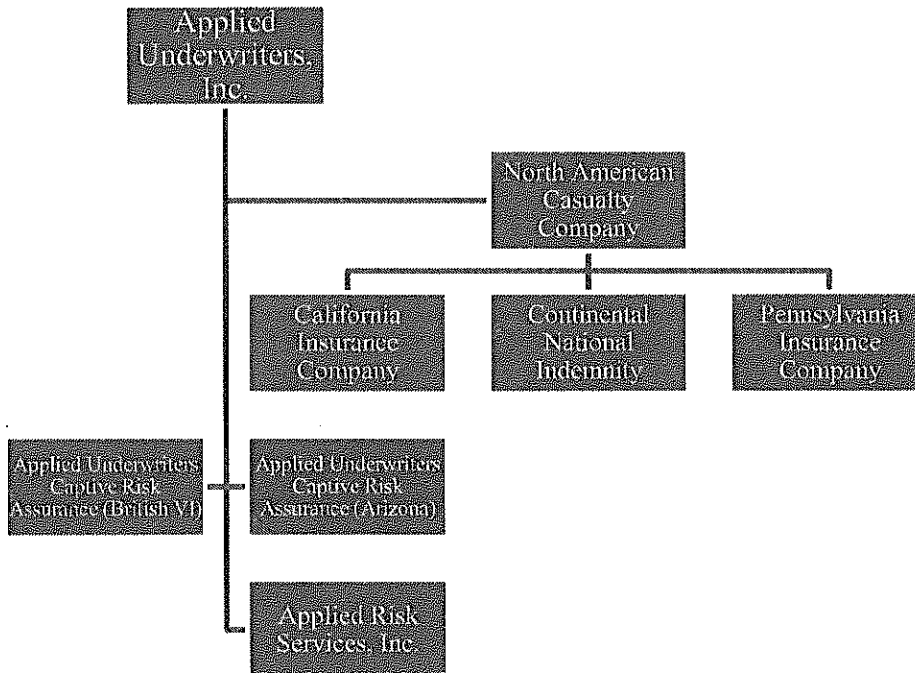
<sup>28</sup> Exh. 214-1.

<sup>29</sup>  $\$77,593.66 + \$166,619.75 = \$244,213.31$ .

<sup>30</sup> Exh. 214-16.

<sup>31</sup> Exh. 234-5; Tr. 1150:6-16.

Assurance Company, BVI (AUCRA) and Applied Risk Services (ARS). The following flow chart provides the organizational structure relevant to this proceeding:



AU is a financial service corporation that provides payroll processing services and underwrites workers' compensation insurance through its affiliated insurance companies to small and medium-sized employers. AU manages all of CIC's underwriting, investment, administrative, actuarial and claim services through a Management Services Agreement.<sup>32</sup> AU also administers the EquityComp program on behalf of CIC. All EquityComp documents presented and signed by Shasta Linen bear the name and logo of Applied Underwriters, Inc. EquityComp is a registered trademark of AU and all AU employees work on CIC issues.<sup>33</sup>

AUCRA is an insurance company organized under the law of the British Virgin Islands and domiciled in Iowa.<sup>34</sup> AUCRA's sole purpose in the Berkshire Hathaway family is to serve

<sup>32</sup> Exh. 274-7.

<sup>33</sup> Exh. 203-1; Tr. 706:23-707:4.

<sup>34</sup> Tr. 620:2-3.

as CIC's reinsurance arm.<sup>35</sup> It does not reinsure any other entities or perform any other functions.

Applied Risk Services (ARS) is the billing agent for EquityComp and serves as CIC's service agent.<sup>36</sup> Under an Agency Agreement, ARS receives premium from policyholders and pays commissions to brokers on behalf of CIC. For this service, CIC reimburses ARS for the paid commissions. ARS and CIC are also parties to a Claims Services Agreement wherein ARS pays losses and loss adjustment expenses on CIC policies.<sup>37</sup> CIC reimburses ARS for all losses and allocated loss adjustment expenses incurred on CIC claims.

The Boards of Directors for CIC, AU, and AUCRA are identical in composition.<sup>38</sup> Mr. Silver, CIC's and AU's General Counsel, serves on each of these Boards, as well as on the Board of ARS. Ms. Gardiner, AU's Chief Actuary, is an officer of all the entities involved in this litigation, namely, AU, CIC and AUCRA.

CIC is also a party to an intercompany pooling agreement<sup>39</sup> with its affiliated Berkshire Hathaway carriers. In 2010, the pooling agreement included CIC and Continental National Indemnity Company (CNI), with CIC assuming an 85% share and CNI assuming the remaining 15%.<sup>40</sup> In 2011, the pooling agreement expanded to include Illinois Insurance Company (IIC). CIC remained the lead company with an 80% share, while CNI assumed 15% and IIC assumed 5%. In 2013, affiliate Pennsylvania Insurance (PIC) was added to the pooling arrangement. As a result, CIC's share reduced to 75%.

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<sup>35</sup> Tr. 1154:3-15.

<sup>36</sup> Tr. 1154:17-23; Exh. 234-6.

<sup>37</sup> Exh. 274-8.

<sup>38</sup> Tr. 1153:2-4; Tr. 863:1-3.

<sup>39</sup> In pooling arrangements, entities share exposures to possible loss. Casualty Actuarial Society, Foundations of Casualty Actuarial Science, (4<sup>th</sup> ed. 2001), pp. 49-50.

<sup>40</sup> CIC's 2010 Annual Statement, Management Discussion and Analysis. CIC's Annual Statements are available on the California Department of Insurance's website. The Commissioner takes Official Notice of CIC's Annual Statements from 2008 through 2014.

## 2. CIC's Workers' Compensation Policies

CIC offers workers' compensation insurance through a guaranteed cost policy and a profit-sharing program. Each program is relevant to the underlying issue and described below.

### a. Guaranteed Cost Policy

A great majority of California employers receive workers' compensation insurance coverage through guaranteed cost policies.<sup>41</sup> Under a guaranteed cost policy, the insured company pays a fixed annual premium for the policy term, regardless of subsequent loss experience. The fixed premium is the sum of the average losses and the basic fees. Average losses take into account the base rate for each classification assigned to the policy and the employer's experience modification factor. The fees are the estimated costs of providing the insurance; that is sales, underwriting, profit and other fixed costs. Thus, a company with average losses of \$500,000, may be charged \$750,000 in premium; \$500,000 to cover expected loss payments and \$250,000 in basic fees.

Every guaranteed cost policy must adhere to the Insurance Code and its applicable Regulations. All rates charged in a guaranteed cost policy must be filed with the WCIRB and approved by the Insurance Commissioner prior to use. In addition, every guaranteed cost policy must contain statutorily-required dispute resolution and cancellation language.<sup>42</sup>

CIC's guaranteed cost policies contain standard language approved by the Insurance Commissioner. For example, each policy states CIC's rates are filed with the Commissioner and open to public inspection. CIC warrants that it adheres to a single uniform experience rating plan and applies such experience rating to each policy.<sup>43</sup> In addition, CIC's guaranteed cost

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<sup>41</sup> Tr. 310:4-6.

<sup>42</sup> Ins. Code § 11650 et seq.

<sup>43</sup> Exh. 209-17.

policies notify employers of the dispute resolution process provided under California Insurance Code section 11737, subdivision (f). CIC's Policyholder Notice provides that:

If you are aggrieved by our decision adopting a change in a classification assignment that results in increased premium, or by the application of our rating system to your workers' compensation insurance, you may dispute these matters with us. If you are dissatisfied with the outcome of the initial dispute with us, you may send us a written Complaint and Request for Action as outlined below.

You may send us a written Complaint and Request for Action requesting that we reconsider a change in a classification assignment that results in an increased premium and/or requesting that we review the manner in which our rating system has been applied in connection with the insurance afforded or offered you. Written Complaints and Requests for Action should be forwarded to: California Insurance Company, P.O. Box 281900, San Francisco, CA 94128-1900, Phone No. (877) 234-4450; Fax No. (415) 508-0374.<sup>44</sup>

Pursuant to California Code of Regulations, title 10, section 2509.44, CIC must acknowledge the complaint within 30 days and indicate whether the complaint will be reviewed. If CIC agrees to review the complaint, it must issue a decision within 60 days of the acknowledgment letter. An insured dissatisfied with CIC's decision may appeal to the Insurance Commissioner. The policy's dispute resolution provision does not provide for binding arbitration or any other alternative dispute methods.

CIC's guaranteed cost policies also include a cancellation provision and a "Short Rate Cancellation" Notice, as required by the Insurance Code.<sup>45</sup> Part 5, subsection E of the CIC policy provides that following cancellation, the final premium will be determined as follows:

1. If we cancel, final premium will be calculated pro rata based on the time the policy was in force. Final premium will not be less than the pro rata share of the minimum premium.

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<sup>44</sup> Exh. 208-15.

<sup>45</sup> Exh. 208-93; See also Ins. Code § 481, subd. (c).



2. If you cancel, the final premium will be more than pro rata; it will be based on the time this policy was in force, and increased by our short rate calculation table and procedure. Final premium will not be less than the minimum premium.<sup>46</sup>

The Short Rate penalty is a percentage of the full-term premium based on the number of days of coverage in the canceled policy.<sup>47</sup> The Short Rate Calculation Table in CIC's guaranteed cost policies quotes subsection E and provides a formula for determining the early cancellation penalty. For example, an employer who pays an annual premium of \$300,000 and cancels its policy after 100 days will owe \$114,000; \$82,192 in actual earned premium and \$31,808 in penalties.<sup>48</sup> After expiration of the policy, an employer may change insurance carriers without penalty.

CIC's guaranteed cost policies also set a minimum and estimated annual premium based on an employer's payroll estimates, experience modification factor, and CIC's rates per \$100 of payroll for each applicable classification. After estimated taxes and fees, the guaranteed cost policies provide an employer with an annual premium estimate. The final premium due is calculated using actual payroll amounts assigned to a specific classification of the policy and the employer's experience modification factor. The final premium is not impacted by the actual losses incurred during that same policy period.

**b. The Guaranteed Cost Policies are the Sole Insurance Agreements**

The guaranteed cost policies issued by CIC in this matter all contain the same language that the policies are the sole insuring agreements between CIC and Shasta Linen and go on to state that, "The only agreements relating to this insurance are stated in this policy. The terms of

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<sup>46</sup> Exh. 208-87.

<sup>47</sup> The short-rate penalty discourages employers from switching insurers mid-policy year.

<sup>48</sup> Exh. 208-20 to 208-22.

this policy may not be changed or waived except by endorsement issued by us to be part of this policy.”<sup>49</sup>

In addition, a standard form Policy Amendatory Endorsement—California is attached to each of the policies and state, “It is further agreed that this policy, including all endorsements forming a part thereof, constitutes the entire contract of insurance. No condition, provision, agreement, or understanding not set forth in this policy or such endorsements shall affect such contract or rights, duties, or privileges arising therefrom.”<sup>50</sup> [Emphasis added.] No endorsement is attached, endorsed, or included to the policies adding any provisions or changes relating to the RPA.

Finally, the policies each state on page five, under Part Six—Conditions, C. Transfer of Your Rights and Duties: “Your rights or duties under this policy may not be transferred without our written consent.”

**c. EquityComp**

In conjunction with AU, CIC offers a “profit-sharing” loss sensitive program titled EquityComp. Loss sensitive programs are ones in which the premium for the policy year is impacted by the actual cost of claims incurred during the policy year.<sup>51</sup> By definition, loss sensitive plans are “profit-sharing.”<sup>52</sup> Generally, carriers market loss sensitive programs exclusively to large employers.<sup>53</sup> In fact, many jurisdictions restrict the sale of loss sensitive programs to employers whose annual premiums exceed \$500,000. Large employers are typically better able to cope with loss and experience modification variations and are in a better position to control claims costs. Also, given the sophistication of larger companies, these employers are

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<sup>49</sup> Exhibits 208, 209, and 210.

<sup>50</sup> *Ibid.*

<sup>51</sup> Tr. 595:9-14.

<sup>52</sup> Tr. 604:9-14.

<sup>53</sup> Tr. 310:10-16; see also ALJ Exh. 1.

better able to evaluate the cost effectiveness of the types of insurance policies available.<sup>54</sup> In essence, large employers are more prudent shoppers and can evaluate whether their costs match with an insurer's quote.<sup>55</sup> Loss sensitive programs are issued as endorsements to guaranteed cost policies and require the Insurance Commissioner's approval.<sup>56</sup>

EquityComp's profit-sharing plan is reflected in a Reinsurance Participation Agreement.<sup>57</sup> Neither CIC nor its affiliated entities filed or sought approval for the RPA or the EquityComp program.<sup>58</sup> The EquityComp program, and its accompanying Reinsurance Participation Agreement, is discussed in Section C, *infra*.

### 3. Financial Statements, Ratios and Market Share

CIC is primarily a workers' compensation insurance carrier. Approximately 98 percent of its book of business is written in California workers' compensation.<sup>59</sup> EquityComp currently generates 80 percent of CIC's policy premium.<sup>60</sup> That percentage has steadily increased since the program's inception in 2008.

- In 2009, CIC's net earned premium totaled \$71,512,000 with incurred losses and loss adjustment expenses (LAE) equaling \$55,615,000.<sup>61</sup> This resulted in a net loss ratio of 77.7% and a combined ratio of 109.7%.<sup>62</sup> Accordingly, CIC had a negative net income of \$4,419,116.<sup>63</sup>

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<sup>54</sup> Tr. 310:17-23.

<sup>55</sup> Tr. 311:4-11.

<sup>56</sup> Tr. 875:2-4; An endorsement to an insurance policy "is an amendment to or modification of an existing policy of insurance" that "may alter or vary any term or condition of the policy" and that "may be attached to a policy at its inception or added during the term of the policy." *Adams v. Explorer Ins. Co.* (2003) 107 Cal.App.4<sup>th</sup> 438.

<sup>57</sup> Tr. 621:2-16.

<sup>58</sup> Tr. 1169:18-20.

<sup>59</sup> Tr. 1155:24-1156:4.

<sup>60</sup> Tr. 865:19-22. Mr. Silver's testimony contradicted that of Ms. Gardiner on this issue. The Commissioner credits Ms. Gardiner's testimony on this issue, as Ms. Gardiner serves as the chief underwriter for AU and CIC.

<sup>61</sup> CIC's 2010 Annual Statement, Statement of Income.

<sup>62</sup> The net loss ratio is the sum of incurred losses and incurred loss adjustment expenses divided by earned premium. These amounts are found on lines 1 through 3 of CIC's Statement of Income.

<sup>63</sup> CIC's 2010 Annual Statement, Five-Year Historical Data.

- In 2010, CIC's net earned premium increased to \$87,444,676, while its incurred losses and LAE dramatically decreased to \$17,151,456. As a result of the significant decrease in losses, CIC net loss ratio dropped to 19.6% and its combined ratio declined to 54%.<sup>64</sup> This resulted in net income of \$28,516,390.
- In 2011, CIC's net earned premium rose 34 percent to \$117,505,149 with incurred losses and LAE's of \$34,725,831. That year, CIC's net loss ratio equaled 29.5% and its combined loss ratio equaled 55.7%.<sup>65</sup> CIC's net income for 2011 also increased to \$36,573,942.<sup>66</sup>
- In 2012, CIC saw a 16 percent earned premium increase with net earned premium totaling \$135,598,473. CIC's losses and LAE equaled \$17,116,000, for a net loss ratio of 12.6% and a combined ratio of 43.2%.<sup>67</sup> CIC's net income in 2012 equaled \$47,582,838.
- In 2013, CIC's net earned premium increased another 37 percent to \$186,034,034. CIC's losses and LAE totaled \$59,854,816, for a net loss ratio of 32.1%. After underwriting expenses, CIC combined ratio equaled 61.8%.<sup>68</sup> CIC recorded net income of \$48,928,910 for 2013.
- In 2014, CIC's net earned premium rose another 29 percent to \$240,474,973. CIC's incurred losses and LAE's for that year equaled \$72,484,214, for a net loss ratio of 30.1%.<sup>69</sup> CIC's combined ratio for 2014 totaled 60% and CIC reported a net income of \$65,540,948.

<sup>64</sup> CIC's 2010 Annual Statement, Statement of Income & Five-Year Historical Data.

<sup>65</sup> CIC's 2011 Annual Statement, Management's Discussion and Analysis, p. 4.

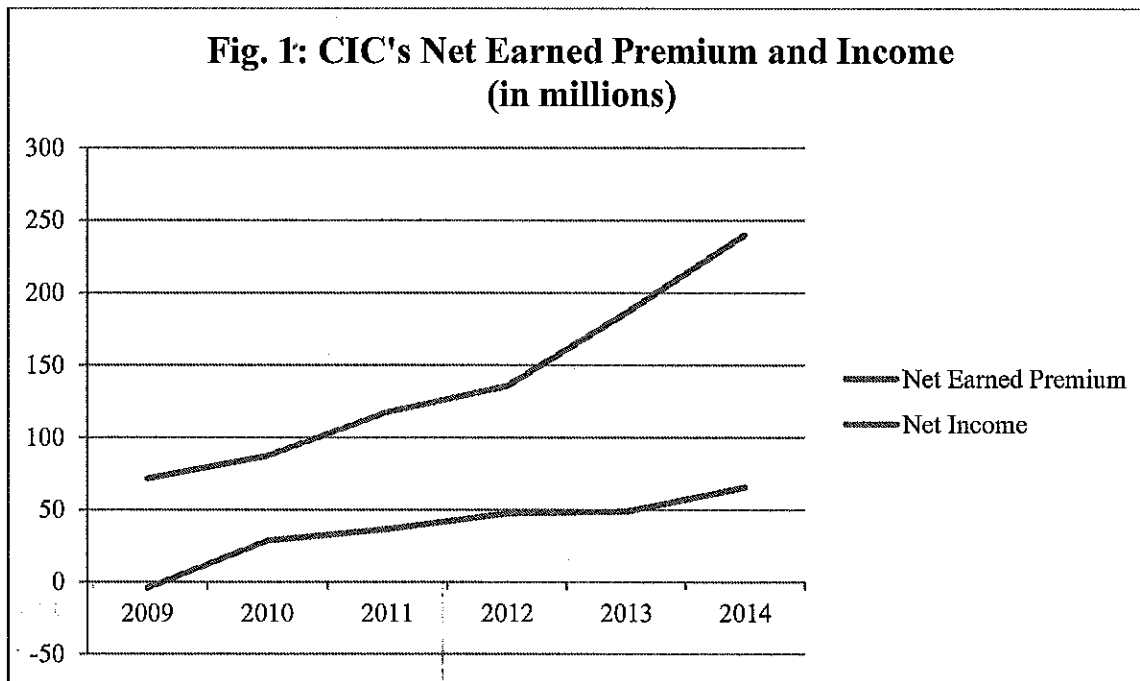
<sup>66</sup> CIC's 2013 Annual Statement, Five-Year Historical Data.

<sup>67</sup> CIC's 2012 Annual Statement, Management's Discussion and Analysis, p. 4.

<sup>68</sup> CIC's 2013 Annual Statement, Management's Discussion and Analysis (Amended), p. 5.

<sup>69</sup> CIC's 2014 Annual Statement, Management's Discussion and Analysis, p. 4.

In sum, CIC's profits since EquityComp's 2008 inception equal \$227,713,912. The following chart illustrates CIC's increase in net earned premium and net income:

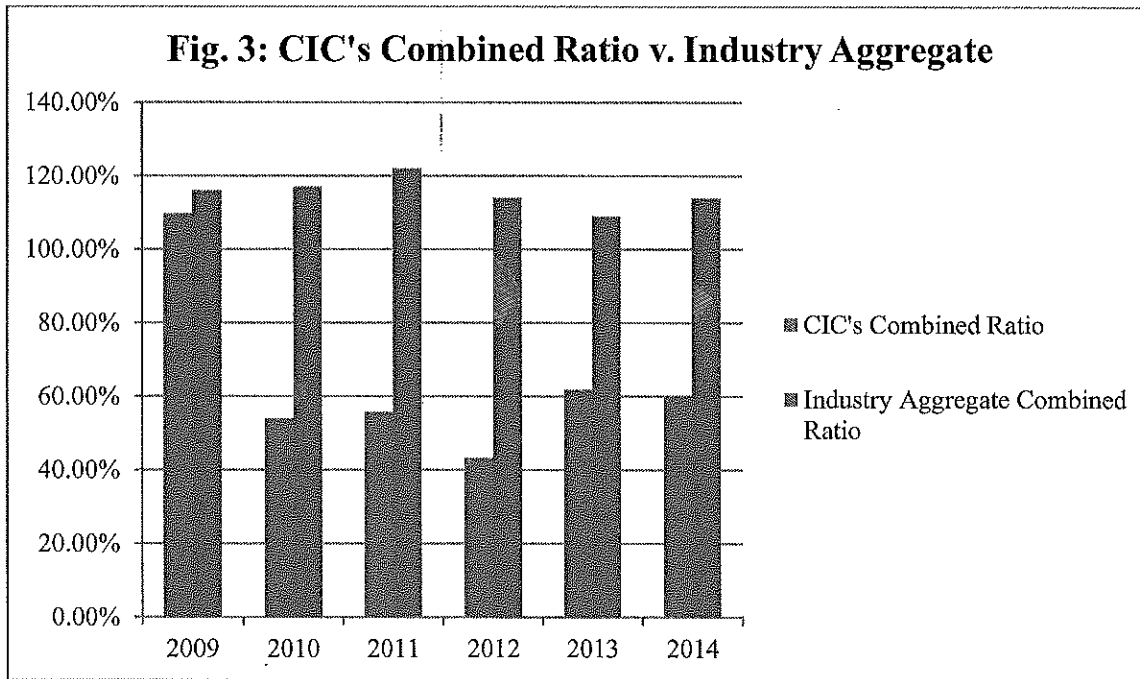
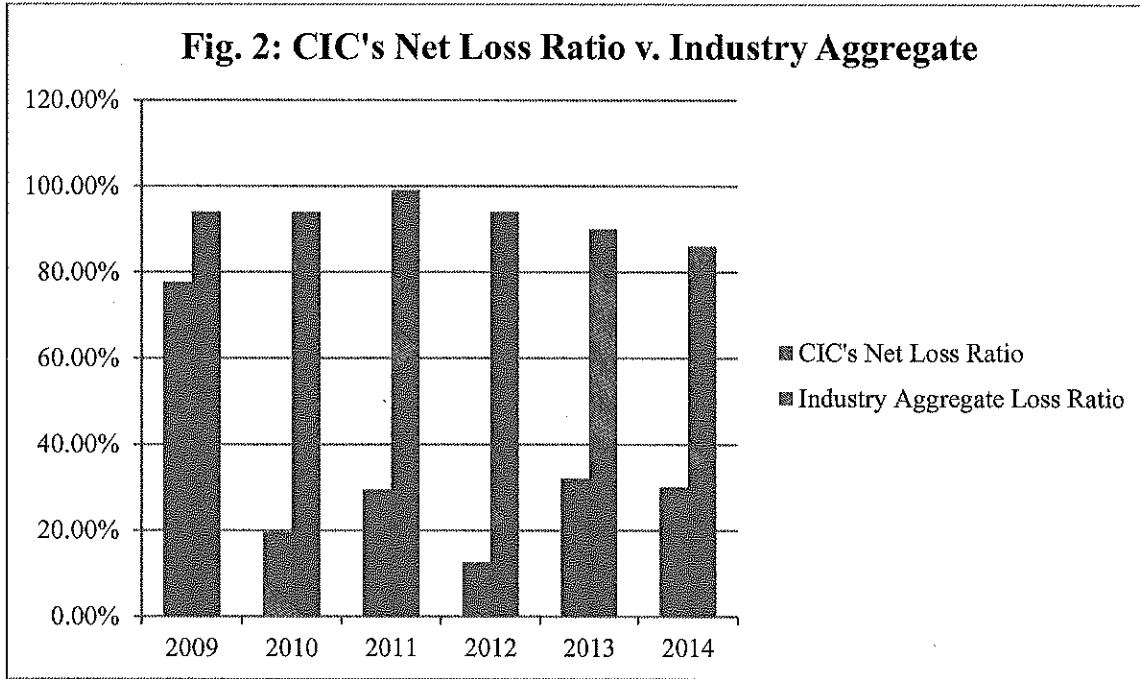


In comparison, CIC's total combined profit for the three years prior to EquityComp's 2008 inception totaled \$47,172,997.<sup>70</sup>

From 2009 through 2014, CIC also posted significantly lower loss and combined ratios than other comparable carriers. CIC's calendar year ratios versus those of the industry as a whole are shown below:<sup>71</sup>

<sup>70</sup> CIC's 2010 Annual Statement, Five-Year Historical Data, p. 17.

<sup>71</sup> WCIRB's Insurer Experience Report on December 31, 2014, released April 20, 2015. This Report is available on the WCIRB's website. The Commissioner takes Official Notice of the WCIRB's Insurer Experience Report.



In fact, CIC recorded the lowest loss ratio among the top 30 workers' compensation insurance carriers in 2013, and the lowest loss ratio among the top 15 workers' compensation carriers in

2012.<sup>72</sup>

From 2008 through 2014, CIC also saw its market share increase. In 2008, prior to the inception of the EquityComp program, CIC ranked 37<sup>th</sup> in total written workers' compensation insurance premium with 0.867 percent of the market.<sup>73</sup> By 2010, CIC ranked 29<sup>th</sup> in total written premium and its market share increased to 0.963%.<sup>74</sup> In 2013, CIC ranked 10<sup>th</sup> in total written premium as its market share increased to 2.366%<sup>75</sup>, and by 2014, CIC ranked 7<sup>th</sup> in total written premium with a market share of 2.92%.<sup>76</sup>

In 2006, the CDI conducted a financial examination of CIC's management practices, assets and liabilities from 2002 through 2006.<sup>77</sup> The financial examination noted that CIC offers an EquityComp program to medium-sized businesses.<sup>78</sup> The 2006 examination also noted that EquityComp is similar to an incurred loss retrospective rating plan.<sup>79</sup> The report does not indicate CDI reviewed the RPA or any other EquityComp program documents. The CDI conducted a follow-up financial examination for the period of January 1, 2007 through December 31, 2009.<sup>80</sup> The 2009 financial examination also made a passing reference to CIC's EquityComp program, again noting the program is similar to a retrospective rating plan.<sup>81</sup> In 2013, CDI issued yet another financial examination for CIC. The 2013 exam mentions the EquityComp program and its accompanying "Profit Sharing Plan" sold through CIC's affiliate,

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<sup>72</sup> 2012 & 2013 California P & C Market Share Report, Workers' Compensation Line. The Market Share Report is published by the CDI and available on the CDI's website. The Commissioner takes Official Notice of these Reports.

<sup>73</sup> 2008 California P & C Market Share Report, Workers' Compensation Line.

<sup>74</sup> 2010 California P & C Market Share Report, Workers' Compensation Line.

<sup>75</sup> 2013 California P & C Market Share Report, Workers' Compensation Line.

<sup>76</sup> Ms. Gardiner testified CIC's market share totaled less than 1%. (Tr. 866:15-20.) This testimony lacks credibility given the CDI's published report. In addition, CIC failed to present any documentation contradicting the CDI's calculations.

<sup>77</sup> Exh. 233.

<sup>78</sup> Ms. Gardiner testified the EquityComp program began in 2008. (Tr. 867:1-4). Ms. Gardiner's testimony is apparently inaccurate given the discussion of EquityComp in the 2006 report.

<sup>79</sup> Exh. 233-11.

<sup>80</sup> Exh. 234.

<sup>81</sup> Exh. 234-7.

AUCRA.<sup>82</sup> The 2013 Exam does not explain the “Profit Sharing Plan’s” terms nor does the report indicate CDI inspected the RPA. Lastly, in 2014, the CDI issued a Market Conduct Report regarding CIC’s operating practices. The scope of the confidential examination included a review of CIC’s rates, rating plan, forms and underwriting rules, as well as CIC’s marketing materials and active complaints.<sup>83</sup> The Market Conduct Report makes only a passing reference to EquityComp. There is no evidence CDI examiners reviewed the RPA or EquityComp materials for statutory compliance, nor did either party call witnesses to discuss these examinations.

### **C. The EquityComp Program**

AU promotes EquityComp as a loss sensitive, profit-sharing plan appropriate for “middle market” insureds. AU began marketing this product in 2008 and since that date, the number of programs sold has increased exponentially each year. In California alone, AU writes approximately 10 new EquityComp policies per month.<sup>84</sup> As noted above, EquityComp comprises approximately 80 percent of CIC’s policy premium.<sup>85</sup>

CIC has not filed the terms or rates of the RPA or EquityComp with the WCIRB or the Insurance Commissioner.

#### **1. Trademark and Patent**

On June 24, 2010, AU filed a United States Patent application for a Reinsurance Participation Plan.<sup>86</sup> Authored by Mr. Silver, CIC’s Chief Executive Officer Steve Menzies and three other AU employees, the application sought to patent the EquityComp/RPA concept sold to

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<sup>82</sup> Exh. 274-9.

<sup>83</sup> Exh. 235.

<sup>84</sup> Tr. 1331:10-14.

<sup>85</sup> CIC refused to provide the total number of EquityComp participants for each year from 2008 through 2014 despite being ordered to do so on two separate occasions.

<sup>86</sup> ALJ Exh. 1; Tr. 1181:5-9.



Shasta Linen, and other California employers.<sup>87</sup> The federal government granted the RPA patent on March 15, 2011. The “Reinsurance Participation Plan” patent application explains in detail the motivation behind the program and the terms thereof.

Under the traditional guaranteed cost policy, there is frequently a mismatch between what the insurance company feels is a fair premium and what the employer considers a fair premium.<sup>88</sup> This is in part because an insurer considers an employer’s average losses to be its expected losses, whereas most employers consider the median losses to be their expected losses. This dichotomy led to the development of linear retrospective rating plans.

Pricing a guaranteed cost policy is straightforward. Under a guaranteed cost policy, the insured company pays a fixed premium regardless of its subsequent loss experience during the policy term. The fixed premium is the sum of the expected average losses and the basic fees. A linear retrospective rating plan varies the premium an employer will pay based on the employer’s actual losses during a coverage period. The minimum premium covers the basic fixed fees. The premium then increases linearly with respect to actual losses until it reaches a maximum plateau. The standard equation describing the relationship between premium and actual losses in linear retrospective plans is:

$$\text{Premium} = \text{Basic Fees} + C * \text{Actual Losses, where } C \text{ is a constant Loss Conversion Factor.}$$

But only large companies with expected losses of over \$500,000 can qualify for retrospective rating plans in the United States. This rule is meant to protect small and mid-size employers who are presumably less sophisticated insurance consumers and who have less of an ability to predict their future losses.<sup>89</sup> In addition, until the advent of EquityComp and the RPA,

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<sup>87</sup> Tr. 1179:10-15.

<sup>88</sup> ALJ Exh. 1, col. 3, lines 38-44.

<sup>89</sup> Tr. 310:10-23.

all retrospective plans were linear retrospective rating plans. This was due in part “to governmental and other regulatory requirements as well as computational difficulties inherent in providing premium quotes for a broad range of companies.”<sup>90</sup>

With the invention of EquityComp and the RPA, AU altered this landscape by introducing a “non-linear retrospective premium plan for medium sized companies.”<sup>91</sup> The non-linear retrospective premium function comprises an initial relatively steep portion, a breakpoint, a subsequently shallow portion and a plateau. Like the linear retrospective premium plan, the minimum premium covers the basic fixed fees and costs.<sup>92</sup> There is a breakpoint early in the function and then a shallow increase in the curve until the premium plateaus. Because of the early breakpoint in the function, the plateau portion, i.e. the maximum premium due, can be significantly lower than the plateau on a linear retrospective plan.<sup>93</sup> AU achieves this result with the initial steep curve which results in more premium collected at lower loss levels, where most insurers will end up.<sup>94</sup>

AU acknowledges that one of the challenges of a “fundamentally new premium structure” is that “the structure must be approved by the respective insurance departments regulating the sale of insurance.”<sup>95</sup> In addition, many states prohibit the sale of retrospective plans to small and medium size companies. AU’s response to this regulatory challenge is “a reinsurance based approach to providing non-linear retrospective plans to insureds that may not have the option of such a plan directly.”<sup>96</sup>

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<sup>90</sup> ALJ Exh. 1, column 4, lines 47-55.

<sup>91</sup> ALJ Exh. 1, column 4, lines 62-63.

<sup>92</sup> ALJ Exh. 1, column 5, lines 42-43.

<sup>93</sup> ALJ Exh. 1, column 5, lines 44-47.

<sup>94</sup> ALJ Exh. 1, column 5, lines 47-49.

<sup>95</sup> ALJ Exh. 1, column 6, lines 22-26.

<sup>96</sup> ALJ Exh. 1, column 6, lines 39-42.

AU attempts to achieve this compliance by introducing a “reinsurance” company into the mix. The so-called reinsurance company enters into a separate Participation Agreement with the insured whereby a credit or debit is assessed on the insured as a function of the losses it experiences. First, an admitted insurance company seeks approval from a state regulator “by using an industry standard Guaranteed Cost policy and filing premium rate requests with the insurance department.”<sup>97</sup> The insurance department, already familiar with such guaranteed cost policies, approves the rates. The insurance carrier then sells these policies, along with the unregulated participation plan, to a targeted group of employers, in this case small to medium sized companies.<sup>98</sup> The participation plan requires the employer to fund a segregated cell from which all the insured’s losses are paid. According to the Patent for the RPA, the result is the following:

The reinsurance company can now provide funds to implement a non-linear retrospective rating plan as a “participation plan.” The reinsurance company does this by entering into a separate contractual arrangement with the insured. If the insured has lower than average losses in the next year, then the reinsurance company can provide a premium reduction according to the participation plan. If the insurance has higher than average losses in a given year, then the reinsurance company will assess additional premium accordingly. The insured can now, in effect, have a retrospective rating plan because of the arrangement among the insurance carrier, the reinsurance company and the insured even though, in fact, the insured has Guaranteed Cost insurance coverage with the insurance carrier.<sup>99</sup>

In essence, CIC sells employers a guaranteed cost workers’ compensation policy that is then superseded by the terms of a participation plan. Premium owed under the guaranteed cost policies is replaced by premium paid for EquityComp under the RPA. The participation plans have a three-year term, in contrast to the one-year term of the guaranteed cost policies.

<sup>97</sup> ALJ Exh. 1, column 6, lines 53-56.

<sup>98</sup> ALJ Exh. 1, column 6, lines 60-63.

<sup>99</sup> ALJ Exh. 1, column 7, lines 42-54 (emphasis added).

Although titled a "Reinsurance Participation Agreement," the RPA is not "reinsurance" as defined by Insurance Code section 620, but instead a separate contract entered into as part of the EquityComp program. Reinsurance is the process by which an insurance company buys insurance on its own risks. Respondent stipulated that the RPA is not a reinsurance contract.<sup>100</sup>

## 2. Sales and Marketing

AU employs approximately 40 salespersons dedicated solely to selling EquityComp nationwide.<sup>101</sup> Of those 40, four salespersons specifically service California brokers.<sup>102</sup> Every salesperson is a licensed insurance broker and all work out of AU's home office in Omaha, Nebraska.<sup>103</sup> Sales professionals receive two and one-half weeks of EquityComp training. Salespersons do not receive any follow-up EquityComp training.<sup>104</sup> AU's training department performs all required training.<sup>105</sup>

As part of the sale and marketing of EquityComp, AU issues a five-page Program Proposal and Rate Quotation (Program Proposal) to each potential insured.<sup>106</sup> AU's underwriting staff generates the Program Proposals and forwards them to the Sales department for dissemination.<sup>107</sup> Potential participants do not generally receive a copy of the RPA until they have agreed in principle to the EquityComp terms. In fact, AU's Sales division does not disseminate the RPAs, requests for service or officer exclusion forms.<sup>108</sup> AU's New Business

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<sup>100</sup> Tr. 614:24-615:10.

<sup>101</sup> Tr. 1271:20-21.

<sup>102</sup> Tr. 1274:8-9.

<sup>103</sup> Tr. 1276:1-17.

<sup>104</sup> Tr. 1275:13-22; Tr. 1278:10-18.

<sup>105</sup> Tr. 1277:2-17.

<sup>106</sup> Exh. 201.

<sup>107</sup> Tr. 1337:12-21.

<sup>108</sup> Tr. 1299:8-17.

department presents the RPA to potential participants on the day participants sign all EquityComp documents.<sup>109</sup>

The Program Proposal introduces potential participants to the “Profit Sharing Plan” central to EquityComp. The Program Proposal notes the reinsurance plan is separate from the guaranteed cost plan and that an insured’s “risk retention is created by your participation in, and cessation of allocated premiums and losses to our facultative reinsurance facility, Applied Underwriters Captive Risk Assurance Company.” The Program Proposal further states that the profit sharing plan “is not a filed retrospective rating plan or a dividend plan” and that a minimum three-year commitment is required. Taking into account a participant’s estimated payroll, AU provides the participant with a projected one-year and three-year minimum premium and maximum premium. The Program Proposal also notes that AU determines the final net cost of the program using the participant’s ultimate claims costs, along with the factors and tables set forth in the RPA.<sup>110</sup> Those “factors and tables” are not provided within the Proposal. Instead, AU informs participants they must maintain capital deposits in their cell accounts equal to: (1) the estimated annual loss pick containment amount multiplied by 10% during the first year, 10% during the second year, or 10% thereafter; and (2) outstanding reserves limited so not to exceed the maximum permissible cost. AU also informs participants that loss development factors, outlined in the RPA, will be applied to all claims to estimate their ultimate cost.

Under EquityComp, an employer is charged rates per \$100 of compensable payroll.<sup>111</sup> These rates do not match those provided in the guaranteed cost policy sold to the employer.<sup>112</sup> A participant’s “loss pick containment rate” (per \$100 of payroll) is multiplied by a “pay-in factor”

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<sup>109</sup> Tr. 1297:13-19.

<sup>110</sup> Exh. 201-3.

<sup>111</sup> Exh. 201-4.

<sup>112</sup> Tr. 1292:13-17.

based on the participant's expected losses. This results in the participant's "net pay-in rate." The net pay-in rate is then multiplied by the amount of payroll in that classification to calculate the estimated annual pay-in amount.<sup>113</sup> The estimated annual pay-in amount differs from amounts quoted in the guaranteed cost policy and supersedes those terms. Experience modifiers and other guaranteed cost policy modification factors are not part of the profit sharing plan. Any changes to those factors does not impact the rates charged under EquityComp.<sup>114</sup> Lastly, the net pay-in amounts do not include applicable assessments and taxes.

AU's Sales department distributes a Program Summary & Scenario to brokers and their clients.<sup>115</sup> The Scenarios demonstrate the minimum and maximum three-year program costs and estimate the final program costs based on ultimate claims costs. The Scenarios chart the single-year prorated amounts a participant could expect to pay. For example, if an employer has no losses during the first year, the employer can expect to pay \$100,000 in program costs for that year. But this chart is misleading. EquityComp is sold as a three-year program and not three one-year programs.<sup>116</sup> Accordingly, the single-year table does not represent the one-year cost of the program. In fact, it is the employer's three-year loss history that ultimately guides the cost of the program.

The Sales division also distributes a Request to Bind Coverages & Services. The Request to Bind must be executed along with the Reinsurance Participation Agreement. Each potential client may participate in a conference call with an AU "technical representative" to answer any questions about the Proposal and Summary. Lastly, the Request to Bind requires employers to arbitrate all claims, disputes or controversies involving EquityComp or the underlying

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<sup>113</sup> Exh. 201-4.

<sup>114</sup> *Ibid.*

<sup>115</sup> Tr. 1305:14-8.

<sup>116</sup> Tr. 1364:8-22.

policies.<sup>117</sup> The Request to Bind's dispute resolution provision differs from the provision of guaranteed cost policy sold to employers and supersedes the guaranteed cost policy.<sup>118</sup>

After disseminating all the relevant marketing materials to a broker, AU's salespersons initiate a conference call with the broker to further discuss the program.<sup>119</sup> But only 10 percent of brokers actually participate in a conference call.<sup>120</sup> AU does not initiate a conference call with the employer itself; AU offers only the insurance broker a chance to discuss the program mechanics.<sup>121</sup> The conference calls last anywhere from 30 minutes to one hour and are not recorded by AU.<sup>122</sup> Salespersons do not work off a script and are permitted to answer questions about the program themselves. A majority of the questions asked by brokers and potential clients pertain to claims handling or the proposed scenarios.<sup>123</sup> If a salesperson cannot answer a broker's question, the salesperson seeks a response from a Sales Manager. Salespersons are not trained to answer questions about the RPA itself, but are able to answer questions about Schedule 1 of the RPA, which contains the loss development and run-off loss development factors.<sup>124</sup> Questions regarding the meaning of terms in the RPA are forwarded by the Sales department to Mr. Silver for a response.<sup>125</sup>

Potential EquityComp participants interested in enrolling are directed to the New Business department. The New Business department distributes the RPA, as well as the Request for Service. These documents, along with the Request to Bind Coverages and Services, must be signed by the participant before any coverage takes effect. Insureds that refuse to sign the RPA

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<sup>117</sup> Exh. 205-1.

<sup>118</sup> Tr. 1329:9-18.

<sup>119</sup> Tr. 1299:24-1300:9.

<sup>120</sup> Tr. 1300:22-1301:9.

<sup>121</sup> Tr. 1301:10-16.

<sup>122</sup> Tr. 1281:6-13.

<sup>123</sup> Tr. 1283:9-23.

<sup>124</sup> Tr. 1314:23-1315:1; Tr. 1316:13-24.

<sup>125</sup> Tr. 1315:2-8.

lose their guaranteed cost insurance policy coverage with CIC.<sup>126</sup> Insurance coverage does not revert back to the terms of the guaranteed cost policy and insureds are left without insurance coverage from CIC.<sup>127</sup> In addition, nothing in the Program Proposal, Request to Bind or Summary and Scenarios names CIC as the insurer.<sup>128</sup>

### 3. Program Mechanics

Taking the components and provisions of EquityComp by themselves does not necessarily present a working understanding of the program's mechanics. Indeed, the parties presented no less than six witnesses in an effort to explain EquityComp's operation. While most rating plans use a straightforward formula to calculate the overall policy costs, EquityComp uses only a narrative.<sup>129</sup>

EquityComp pricing involves three separate components. The first is similar to the standard premium in a guaranteed cost policy. EquityComp calls this the loss pick containment rate and like the standard premium in a guaranteed cost policy, that amount is multiplied by \$100 of payroll to generate what is effectively the base policy premium.<sup>130</sup> The second component is a loss cost component. The loss cost component, or ultimate cost of claims, is calculated using paid claim amounts, reserved amounts and an estimate of future additional costs, multiplied by the loss developments factors set forth by AU.<sup>131</sup> The third component of the program is fees. Fees under EquityComp are calculated as a percentage of an employer's loss pick containment amount. Specifically, an employer's loss pick containment amount is multiplied by an allocation factor (or minimum cost factor) and by an exposure group allocation factor.<sup>132</sup> As AU calculates

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<sup>126</sup> Tr. 1362:21-25.

<sup>127</sup> Tr. 1362:11-25.

<sup>128</sup> See Exhs. 201, 203 and 205.

<sup>129</sup> Tr. 352:24-353:4.

<sup>130</sup> Tr. 322:11-19.

<sup>131</sup> Tr. 323:5-10.

<sup>132</sup> Tr. 342:12-21.



fees based on the loss pick containment amount, participants will pay significant program expenses even when there are no claims filed.<sup>133</sup> For example, using the Scenarios presented to Shasta Linen, an employer with no claims during EquityComp's three-year term would pay \$322,623.<sup>134</sup> The entire amount would constitute EquityComp "fees" since no claims were filed. But if during that three-year period, an employer has one claim for \$30,000, the program cost more than doubles to \$672,627; \$642,627 of which are program fees received by CIC.<sup>135</sup>

Participants receive a monthly EquityComp bill from ARS. The bill provides an overall EquityComp program cost but does not delineate between premium or program costs.<sup>136</sup> In addition, AU distributes a quarterly Plan Analysis that outlines the program fees and summarizes all claim costs.<sup>137</sup> Each open and closed claim is listed separately as are the amounts paid to injured employees. Participants remit their monthly payments to ARS, who then forwards the payment to CIC. CIC then allocates the monies to AUCRA in accordance with the agreement between AUCRA and CIC.<sup>138</sup> Monies ceded to AUCRA fund the participant's captive cell and are held in that cell until called upon by CIC.

When an employee files a workers' compensation claim, CIC pays the claim and then cedes that liability to AUCRA. AUCRA, in turn, cedes the liability to the participant's cell.<sup>139</sup> In essence, participants pay all of their own claim costs and continue to do so until they reach 93 percent of the maximum program costs. Participants can expect an increase in their bill in the month following any claim payments as the RPA calls for specific cell funding levels.<sup>140</sup>

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<sup>133</sup> Tr. 344:13-19.

<sup>134</sup> Exh. 46-6.

<sup>135</sup> *Id.* \$672,627 - \$30,000 = \$642,627.

<sup>136</sup> Tr. 774:17-22.

<sup>137</sup> See Exh. 216.

<sup>138</sup> Tr. 816:9-15; Tr. 893:18-894:23.

<sup>139</sup> Tr. 895:16-896:2.

<sup>140</sup> Tr. 897:3-8.

#### **D. Reinsurance Participation Agreement**

The RPA is a 10-page contract between AUCRA and the insured. The RPA's first six pages state the participant's monetary obligations, the length of the program, the dispute resolution mechanism for the program and a choice of law provision. Pages seven through ten, subtitled Schedule 1, set forth the calculation and allocation of premium and loss amounts, define the required capital deposit amounts and the penalty for early termination of the program, outline the applicable loss development and exposure group factors, and set the loss pick containment rate for each applicable classification.

##### **1. Policy Term & Extensions**

The RPA's initial "active term" is three years. During the RPA's active term, a participant's guaranteed cost workers' compensation insurance policy must be provided by a Berkshire Hathaway insurance carrier; i.e. California Insurance Company or Continental Insurance Company.<sup>141</sup> If the insurer provides workers' compensation coverage outside of the RPA's active term, special "extension" terms apply. These extension terms require the participant to immediately pay a cash deposit equal to 55% of the premium anticipated, to maintain a cash deposit sufficient to cover outstanding losses plus incurred but not reported losses, and to pay an early cancellation fee equal to 20% of the premium anticipated, all of which are determined exclusively by AUCRA.<sup>142</sup>

In addition to the three-year active term language, RPA paragraph 7 provides that the parties' RPA obligations extinguish "only where the Company no longer has any potential or actual liability to the issuing insurers with respect to the Policies reinsured by" AUCRA. Accordingly, while the RPA is active for three years, the parties' obligations continue until the

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<sup>141</sup> Exh. 207-2.

<sup>142</sup> *Id.*

RPA is terminated in accordance with the terms set forth in Schedule 1, discussed below.<sup>143</sup>

## 2. Choice of Laws and Dispute Resolution Procedure

The RPA provides that all disputes be exclusively governed by and construed in accordance with the laws of Nebraska.<sup>144</sup> The RPA also contains a two-page dispute resolution provision subjecting all disputes to binding arbitration in the British Virgin Islands.<sup>145</sup> All arbitration awards must be enforced in Nebraska courts.<sup>146</sup> According to CIC, this dispute resolution provision supersedes the language provided in the guaranteed cost policy.<sup>147</sup> In addition, nothing in the RPA or other EquityComp documents inform participants of their right to negotiate choice of law and dispute resolution provisions.

## 3. Early Cancellation Provision

The RPA sets forth its own early cancellation terms and penalties, different from those in the guaranteed cost policy. Any participant who cancels the RPA, or cancels the underlying guaranteed cost insurance policy, prior to the end of the active term is subject to the penalties set forth in Schedule 1 of the RPA.<sup>148</sup>

In the event of early cancellation either by the participant or AUCRA:

- (a) the Exposure Group Adjustment Factor will be multiplied by 1.25;
- (b) the Cumulative Aggregate Limit will be determined using Policy Payroll annualized to reflect the full term of the Agreement;
- and (c) the following amounts will be immediately due and payable to the Company; i) any remaining premium, including short rate penalties, due under the Policies; ii) capital deposit equal

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<sup>143</sup> Exh. 207-2.

<sup>144</sup> Exh. 207-5. In addition, any matter concerning the RPA "that is not subject to the dispute resolution provisions of Paragraph 13," shall be resolved exclusively by the courts of Nebraska without reference to its conflict of laws.

<sup>145</sup> Exh. 207-3 to 207-4, paragraph 13(A). Paragraph 13(I) further provides that all arbitrations shall be conducted in accordance with the rules of the American Arbitration Association and shall take place in Tortola, British Virgin Islands.

<sup>146</sup> Exh. 207-5, paragraph 14.

<sup>147</sup> Tr. 1329:9-18. Mr. Watson testified that once a participant enrolls in EquityComp, "the guaranteed cost policy . . . has no effect." Similarly, Ms. Gardiner could not provide an example where the guaranteed cost policy's dispute resolution provision would be applicable. (Tr. 887:7-12.)

<sup>148</sup> Tr. 1329:9-18.

to the cell's maximum liability; and iii) a Cancellation Fee equal to 8% of the Estimated Annual Loss Pick Containment Amount.<sup>149</sup>

The RPA does not explain these cancellation terms in monetary figures nor does AU provide the participant with a sample calculation based on early termination figures. But Ms. Gardiner provided uncontroverted testimony that had Shasta Linen chosen not to renew its guaranteed cost policy at the end of the policy's one year term in December 2011, AUCRA would have levied a \$1.1 million cancellation penalty against Shasta Linen.<sup>150</sup>

#### 4. Premiums, Capital Deposits and Applicable Rates

AU calculates EquityComp premium based on policy payroll and the loss pick containment amount. The loss pick containment amount is an amount equal to the product of policy payroll and the respective Loss Pick Containment Rates listed in Table C of Schedule 1.<sup>151</sup> These rates are per \$100 of policy payroll and are fixed for the effective period. They do not mirror the rates provided for in the guaranteed cost policy and do not change even if the stated rates on the guaranteed cost policy decrease.<sup>152</sup> In addition, changes in experience modifiers and other modification factors do not affect these rates. Thus, if an employer's experience modification factor decreases during the active term of the RPA, this reduced experience modification would have no impact on the EquityComp premium or costs.<sup>153</sup>

The RPA also calculates loss development factors (LDFs) for each loss under the policies. These LDFs are generated by AU's underwriting department and are extrapolated from valuations provided by the WCIRB.<sup>154</sup> During the active term of the program, AU applies the weekly or monthly LDFs to each claim. If, at the end of the three-year active term, a participant

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<sup>149</sup> Exh. 207-8.

<sup>150</sup> Tr. 885:1-5.

<sup>151</sup> Exh. 207-7.

<sup>152</sup> Tr. 1291:16-20; Tr. 899:1-9.

<sup>153</sup> Tr. 318:12-21; Tr. 897-898:14-7; Exh. 207-7; Exh. 44-4.

<sup>154</sup> Tr. 795:8-12.

refuses to renew the EquityComp program or AU refuses to offer renewal, the RPA applies “run-off LDFs” to each open and closed claim.<sup>155</sup> AU coined the term “run-off LDF” for purposes of the RPA. It is not a term used in the insurance industry or a valuation method used by other carriers.<sup>156</sup> For open claims, the run-off LDFs are 50 percent higher than LDFs applied during the active term.<sup>157</sup> In practical terms, a claim reserved at \$75,000 one month prior to the end of the program’s active term could be reserved at \$293,000 the next month, resulting in a \$218,000 bill from AU after expiration of the program.<sup>158</sup> Run-off LDFs are also generated by AU’s underwriting department and are non-negotiable.<sup>159</sup>

All losses under the policies are ultimately paid from the participant’s cell account and a participant is solely responsible for paying its losses up to 93 percent of its three-year loss pick containment amount.<sup>160</sup> Participant’s fund their own cell account through the premiums and capital deposits. Participants agree to make and maintain a capital deposit equal to the estimated annual loss pick containment amount multiplied by 10 percent during the first year, 10 percent the second year and 10% thereafter.<sup>161</sup> In addition, participants must make an additional capital deposit equal to the lesser of the ultimate loss or the cumulative aggregate limit.<sup>162</sup>

## **5. Cell Liquidation**

At the end of the RPA’s 3-year active term, AUCRA may, at its sole discretion, liquidate the participant’s cell and return any excess premium and fees to the participants. That said, liquidation of the cell cannot occur unless:

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<sup>155</sup> Exh. 207-7; Tr. 886:11-19; Tr. 1318:12-21.

<sup>156</sup> Tr. 891:12-892:3; Tr. 350:2-7.

<sup>157</sup> Tr. 799:1-19.

<sup>158</sup> Tr. 802:4-9.

<sup>159</sup> Tr. 795:8-17; Tr. 1319:15-18.

<sup>160</sup> Tr. 1321:5-14.

<sup>161</sup> Exh. 207-7.

<sup>162</sup> Exh. 207-8.

- i) all claims under the Policies are closed and three years have elapsed since the expiration of all of the Policies; or
- ii) the Participant's maximum liability has been reached and three years have elapsed since the expiration of all of the Policies; or
- iii) the amount of paid losses allocated to the cell under the policies has exceeded the Participant's maximum liability; or
- iv) seven years have elapsed since the expiration of all of the Policies; or
- v) the Company deems itself insecure with respect to Participant's ability or willingness to fulfill its obligations under this Agreement.<sup>163</sup>

In essence, a program participant must wait, at a minimum, an additional three years after expiration of the RPA in order to receive a return of excess funds paid to CIC and AU.<sup>164</sup> There is no provision to accelerate this process and, indeed, AUCRA may withhold these funds for up to seven years after expiration of the policy.<sup>165</sup> To date, AUCRA has not made any profit-sharing distributions.<sup>166</sup>

#### **E. Dispute Between Shasta Linen and CIC**

In January 2013, AU billed Shasta Linen for \$244,213.31. Shasta Linen challenges this bill. Understanding this dispute requires analysis of Shasta Linen's guaranteed cost policies, the terms of its RPA and AU's claims processing.

##### **1. Guaranteed Cost Policy**

CIC issued Shasta Linen three, one-year guaranteed cost policies, the first of which incepted on January 1, 2010 and expired on January 1, 2011. Subsequent policies incepted on

<sup>163</sup> Exh. 207-8.

<sup>164</sup> Tr. 1325:4-15; Tr. 813:20-814:3.

<sup>165</sup> Tr. 441:15-20.

<sup>166</sup> In order to secure a complete and accurate record, the ALJ twice ordered Respondent to provide the number of participants who received a profit-sharing distribution, the date upon which their program ended and the date upon which they received a distribution. Respondent refused to comply with the ALJ's Order. Pursuant to Evidence Code sections 412 and 413, the Commissioner infers from Respondent's failure to produce this readily available evidence that AUCRA has not made any profit-sharing distributions.

January 1, 2011 and January 1, 2012, and expired on January 1, 2012 and January 1, 2013, respectively. Each policy contained the statutory language regarding dispute resolution, premium calculation and early termination, outlined in Section B, subdivision (2)(a), *infra*.

Each of Shasta Linen's guaranteed cost policies included an information page and an extension of information page. The information page estimated Shasta Linen's annual premium, while the extension page listed Shasta Linen's rates per \$100 of payroll and experience modification factor.<sup>167</sup> As is customary under a guaranteed cost policy, CIC multiplied Shasta Linen's expected payroll in each classification by the rate quoted, factored in Shasta Linen's experience modification and added applicable taxes and fees in order to estimate Shasta Linen's annual premium.

For policy year 2010, CIC quoted the following rates per \$100 of payroll: \$17.77 for classification code 2585; \$1.00 for classification code 8743; and \$0.84 for classification code 8810. Based on Shasta Linen's estimated payroll and experience modification factor of 1.68, CIC approximated Shasta Linen's annual premium at \$339,800.<sup>168</sup>

In policy year 2011, CIC increased Shasta Linen's rates per \$100 of payroll as follows: \$19.59 for classification code 2585; \$1.02 for classification code 8742; and \$0.83 for classification code 8810. The increase in rates, higher payroll amounts and a larger experience modification factor of 1.94 resulted in an estimated annual premium of \$407,920.<sup>169</sup>

CIC did not alter Shasta Linen's rates per \$100 of payroll in 2012. But Shasta Linen's experience modification factor dropped from 1.94 to 1.01. As a result, Shasta Linen's estimated annual premium for the 2012 policy year equaled \$285,368.<sup>170</sup>

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<sup>167</sup> Exh. 208-1; Exh. 208-3.

<sup>168</sup> Exh. 208-20.

<sup>169</sup> Exh. 209-23.

<sup>170</sup> Exh. 210-26.

Shasta Linen's estimated premium and rate charges under the guaranteed cost policy are summarized as follows:

	2585 (per \$100)	8742 (per \$100)	8810 (per \$100)	Ex. Mod. Factor	Annual Premium
2010	\$17.77	\$1.00	\$0.84	1.68	\$339,800
2011	\$19.59	\$1.02	\$0.83	1.94	\$407,920
2012	\$19.59	\$1.02	\$0.83	1.01	\$285,368

## 2. EquityComp/RPA Program

In December 2009, AU quoted Shasta Linen a minimum single-year premium of \$107,541, a maximum premium of \$322,623 and an annual loss pick containment amount of \$283,450.<sup>171</sup> The EquityComp rates per \$100 of payroll differed from those quoted in Shasta Linen's guaranteed cost policy and constitute the actual rates charged to Shasta Linen.<sup>172</sup>

	Loss Pick Containment Rate	Estimated Annual Payroll	Annual Pay-In Amount
2585 (per \$100)	\$18.68	\$1,500,000	\$280,200.00
8742 (per \$100)	\$1.05	\$155,000	\$1,627.50
8810 (per \$100)	\$ .88	\$188,319	\$1,657.20
			\$283,484.00

The EquityComp rates remained the same for the three-year duration of the program and did not change when Shasta Linen saw a reduction in its experience modification factor. For example, Shasta Linen's 2012 experience modification factor dropped from 1.94 to 1.01. This decrease had no impact on Shasta Linen's costs or premium under EquityComp.

Shasta Linen paid AU an initial set-up fee of \$3,203 and a capital deposit of \$28,345.<sup>173</sup> From January 2010 through June 2011, Shasta Linen's monthly payments ranged from \$12,903

<sup>171</sup> Exh. 201-3.

<sup>172</sup> See also Exh. 207-10.

<sup>173</sup> Exh. 202-2; Exh. 211-1.



to \$36,513.<sup>174</sup> In July 2011, AU sent Shasta Linen a bill for \$83,612.49.<sup>175</sup> The significant increase in charges caused Shasta Linen to take a closer look at the EquityComp program.<sup>176</sup> The substantial bill also forced Shasta Linen into a promissory note with AU to spread out the payments over a four month period.<sup>177</sup>

In addition to monthly billing concerns, Shasta Linen became concerned that neither CIC nor AU possessed incentive to investigate workers' compensation claims. As evidence of this concern, Ms. Richardson recounted the case of employee Mr. M.<sup>178</sup> After failing to turn over customer payments, Mr. M went out on disability and indicated he was unable to fulfill his duties as a driver. Shortly thereafter, Ms. Richardson witnessed Mr. M driving a truck on the highway. Ms. Richardson informed AU of this fact but AU took no action. Mr. M's workers' compensation claim ultimately cost Shasta Linen \$111,679.<sup>179</sup>

In November 2012, Shasta Linen changed insurance brokers and informed SVIS of this change.<sup>180</sup> On December 19, 2012, Shasta Linen's SVIS broker informed Ms. Richardson that AU wished to offer Shasta Linen a one-year extension on the EquityComp program.<sup>181</sup> Ms. Richardson declined this offer and reminded SVIS that it no longer represented Shasta Linen.

By December 2012, Shasta Linen had paid AU program costs totaling \$934,466 despite suffering three-year cumulative losses of only \$268,000.<sup>182</sup> In addition, nearly \$200,000 remained in Shasta Linen's captive cell. Nonetheless, in January 2013, AU requested an

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<sup>174</sup> Exh. 212-9; Exh. 211-23.

<sup>175</sup> Exh. 212-11. Ms. Richardson testified "we never knew what we were going to be billed" and this made budgeting for workers' compensation insurance extremely difficult. (Tr. 123:21-124:3) It was ultimately determined that the \$83,000 bill for July 2011 was due to a calculation error by AU and ARS. (Tr. 127:20-128:4.)

<sup>176</sup> Tr. 123:21-124:3.

<sup>177</sup> Exh. 2.

<sup>178</sup> The Commissioner intentionally omits the full name of the employee at issue.

<sup>179</sup> Tr. 134:21-25.

<sup>180</sup> Tr. 149:17-22; Exh. 33.

<sup>181</sup> Tr. 150:23-151:6. Exh. 4-6.

<sup>182</sup> Exh. 218-157.

additional \$244,213.31 in program costs based entirely on the application of run-off LDFs to Shasta Linen's two remaining open claims. Shasta Linen has refused to pay these additional costs.

### 3. Subsequent Workers' Compensation Insurance Premiums

In January 2013, Shasta Linen's secured a guaranteed cost workers' compensation insurance policy from Pacific Compensation with an annual premium of \$315,283. In January 2014, Shasta Linen secured a guaranteed cost insurance policy from Insurance Company of the West with an annual premium of \$261,499.<sup>183</sup> In each of these guaranteed cost policies, Shasta Linen benefitted from a reduced experience modification factor, which was the result of their more favorable loss history while insured by CIC.<sup>184</sup>

#### F. Reinsurance Treaty and Addendums

CIC filed with the Department the reinsurance treaty and addendums.<sup>185</sup> The reinsurance treaties and addendums were signed by Steven Menzies for both CIC and AUCRA, first as Executive Vice President and Vice Presidents for each company, respectively, and then as President for both entities. The Department acknowledged the filings by letter dated June 25, 2008, and noted its review of the Treaty and Addendums was limited to those provisions related reinsurance agreements.<sup>186</sup>

The parties stipulated in this proceeding that the RPA is not actually reinsurance.<sup>187</sup> This stipulation by CIC is in direct conflict to the representations made to the Commissioner by CIC when the reinsurance treaty and addendums were filed and acknowledged by the Commissioner

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<sup>183</sup> Exh. 83.

<sup>184</sup> An employer's experience modification factors reflects a three year period, commencing four years and nine months prior and terminating one year and nine months prior to the date for which an experience modification is to be established. (California Workers' Compensation Experience Rating Plan (ERP), Section III, Rule 3.)

<sup>185</sup> Exh. 232

<sup>186</sup> *Ibid.*

<sup>187</sup> Tr: 614:24 - 615:2

and the testimony offered at hearing.

The RPA itself is based upon and results from the reinsurance treaties filed by CIC. As noted in the testimony of Jeffrey Silver, General Counsel of CIC, Shasta Linen was a “party” to the reinsurance agreement between CIC and AUCRA by virtue of the RPA, and the RPA becomes part of and is based upon the reinsurance agreement between CIC and AUCRA.<sup>188</sup> CIC was the party initiating and filing the reinsurance with AUCRA.

## **VI. Applicable Law**

In California, the Legislature is granted plenary power through our State Constitution to create and enforce a complete system of workers’ compensation.<sup>189</sup> This includes “full provision for adequate insurance coverage against liability to pay or furnish compensation; full provision for regulating insurance coverage in all its aspects....”<sup>190</sup> Therefore, workers’ compensation insurance programs are closely scrutinized and highly regulated based upon the provisions of the California Insurance Code, and the Legislature has created a comprehensive scheme mandating employer coverage and regulatory oversight. In order to execute this broad regulatory structure, the Legislature charged the Insurance Commissioner with the authority to oversee the form and substance of all workers’ compensation insurance plans; everything from the scope of required coverage provided to employees to the amount employers pay insurers for premiums.

The Insurance Code sets forth both comprehensive workers’ compensation policy form and rate requirements for all insurers. Article 2 of Chapter 3, which is set forth in Insurance Code Sections 11651 through 11664, and Article 2 of Chapter 3, which is set forth in Insurance Code Sections 11730 to 11742, delineate these provisions. For instance, every policy must contain a clause providing that the insurer is directly and primarily liable for payment of any

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<sup>188</sup> Tr: 1210:12-20; 1212:2-4.

<sup>189</sup> California Constitution, Art. XIV, Section 4.

<sup>190</sup> *Ibid.*

compensation for which the employer is liable.<sup>191</sup> Policies must also state that the insurer is not relieved from payment “if the employer becomes insolvent or is discharged in bankruptcy” during the policy period.<sup>192</sup> The insurer will “be bound by and subject to the orders, findings, decisions, [and] awards rendered against the employer subject to the terms of the policy.”<sup>193</sup> Section 11654 also specifies that the “insurance contract shall govern as between the employer and the insurer as to payments by either in discharge of the employer's liability for compensation.”

**A. Statutory Authority for Pre-Filing of Workers' Compensation Forms**

Under both the Insurance Code and its applicable Regulations, insurers must adhere to a two-step process before using any policy or endorsement in California. First the policy form or endorsement must be filed with a licensed rating organization, and the licensed rating organization is to confirm those policy forms and endorsements comply with law. The policy forms and endorsements are then filed with the Insurance Commissioner and cannot be used until after 30 days or, in some instances, authorized by the Insurance Commissioner. The clearest recitation of this requirement is found in Insurance Code section 11658:

(a) A workers' compensation insurance policy or endorsement shall not be issued by an insurer to any person in this state unless the insurer files a copy of the form or endorsement with the rating organization pursuant to subdivision (c) of Section 11760 and 30 days have expired from the date the form or endorsement is received by the commissioner from the rating organization without notice from the commissioner, unless the commissioner gives written approval of the form or endorsement prior to that time.

An endorsement may concern matters unrelated to the description of the insurer's indemnity and

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<sup>191</sup> Ins. Code § 11651.

<sup>192</sup> Ins. Code § 11655.

<sup>193</sup> Ins. Code § 11654.

insurance obligations.<sup>194</sup>

Section 11750.3 provides the WCIRB, the only licensed rating organization, with authority to examine all policies, endorsements and other forms for the purpose of determining whether such policies, endorsements and forms comply with California law. In addition, California Code of Regulations, title 10, section 2218 requires “all workers’ compensation forms be submitted in duplicate” to the WCIRB for inspection and then to the Insurance Commissioner for final action.

The Insurance Commissioner has consistently stated these requirements. For example, in 2011, the CDI reminded the WCIRB to inform its insurer members that agreements that affect the obligations of a workers’ compensation insurer or insured must be filed with the WCIRB and the Insurance Commissioner prior to use. The letter noted that the Insurance Commissioner was particularly concerned with arbitration provisions contained in unattached collateral agreements and considered such terms unenforceable unless the insurer demonstrated that the arbitration agreement was expressly agreed to by the insured at the time the policy was issued.<sup>195</sup>

In sum, insurers who offer and issue workers’ compensation insurance policies, endorsements and forms in California must submit such policies, endorsements and forms, however titled by the insurer, for review. Such materials must be filed with the WCIRB, which reviews them and forwards them to the Insurance Commissioner for final review before use in California.<sup>196</sup> Rate information is submitted directly to the Insurance Commissioner pursuant to section 11735. An insurer may begin offering filed policies, endorsements or other materials 30

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<sup>194</sup> See *Donahue Constr. Co. v. Transport Indem. Co.*, 7 Cal.App.3d 291, 303 [insurance policies may include the duty to defend an insured]; *Genuser v. Ocean Accident & Guarantee Corp.*, 57 Cal.App.2d 979, 983 [insurance policy may limit the time within which a lawsuit may be brought under the policy].

<sup>195</sup> Notice of Hearing and Order to Show Cause, in *The Matter of Zurich American Insurance Company*, DISP-2011-00811 at p. 6. The ALJ took Official Notice of this filing.

<sup>196</sup> Ins. Code § 11658

days after the Insurance Commissioner receives the materials, if the Insurance Commissioner has not already advised the insurer that the materials do not comply with California law.<sup>197</sup> If the Insurance Commissioner advises the insurer at any time that the filed materials do not comply with California law, the insurer may not issue any policy, endorsement or other form that includes such material.<sup>198</sup>

**B. Statutory Authority Prohibiting Unfiled Collateral Agreements**

California Code of Regulations, title 10, section 2268 states that no collateral agreement to a workers' compensation insurance policy may be made that modifies the obligation of the parties unless the agreement is made part of the policy's terms. Specifically, section 2268 states:

No collateral agreements modifying the obligation of either the insured or the insurer shall be made unless attached to and made a part of the policy, provided, however, that if such agreements are attached and in any way restrict or limit the coverage of the policy, they shall conform in all respects with these rules.

This regulation is clear on its face that any obligation of either the insurer or the insured concerning the workers' compensation insurance that is not contained in the insurance policy is required to be made part of the policy and unendorsed side agreements are prohibited. This regulation therefore requires the filing of any agreement that modifies or alters the insured's: (1) obligation to reimburse or otherwise pay the insurer for loss adjustment expenses and/or other claims or policy related expenses; (2) indemnity or loss obligation; (3) payment or reimbursement obligation; (4) allocation of loss adjustment expenses or other fees and expenses; (5) timing of reimbursements or payments to the insurer; (6) collateral; (7) circumstances that constitute a default; (8) choice of law; (9) arbitration obligation; and (10) other material

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<sup>197</sup> *Ibid.*

<sup>198</sup> *Ibid.*

obligations under any workers' compensation insurance program, plan or policy.<sup>199</sup>

**C. Statutory Authority for Pre-Filing of Workers' Compensation Rates**

The regulatory obligation for insurers to file their workers' compensation rates before use in this state is set forth in Insurance Code sections 11735 and 11750.3 and in the California Code of Regulations. Section 11735 requires every insurer to file with the Insurance Commissioner "all rates and supplementary rate information that are to be used in this state." The rates and supplementary rate information must be filed no later than 30 days prior to use. A filed rate may be disapproved by the Insurance Commissioner pursuant to the applicable subdivisions of Section 11737.

**D. Statutory Appeal Language**

The Insurance Code also permits policyholders harmed by the application of a rate or rating plan to file an appeal with the Insurance Commissioner. Specifically, Insurance Code section 11737, subdivision (f) states:

(f) Every insurer or rating organization shall provide within this state reasonable means whereby any person aggrieved by the application of its filings may be heard by the insurer or rating organization on written request to review the manner in which the rating system has been applied in connection with the insurance afforded or offered. If the insurer or rating organization fails to grant or reject the request within 30 days, the applicant may proceed in the same manner as if the application had been rejected.

Any party affected by the insurer or rating organization's response may appeal to the Insurance Commissioner within 30 days after written notice of the action. The Commissioner, after conducting an evidentiary hearing, may affirm, modify, or reverse that action.

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<sup>199</sup> *American Zurich Ins. Co. v. Country Villa Serv. Corp.* (2015) 80 Cal. Comp. Cases 687, 703-704; Notice of Hearing and Order to Show Cause, in *The Matter of Zurich American Insurance Company*, *supra*, DISP-2011-00811 at pp. 4-5.

The authority to hear grievances of employers for misapplication of rates, noted above, is separate from the Commissioner's authority to disapprove rates. Subdivisions (a) through (e) and (g) of Section 11737 deal with rate disapproval by the Commissioner. Subdivision (h) of Section 11737 deals with the rate that will be in effect if there is no applicable rate.

#### **E. Reinsurance**

Section 620 of the Insurance code defines reinsurance as: "A contract of reinsurance is one by which an insurer procures a third person to insure him against loss or liability by reason of such original insurance." The original insured has no interest in the reinsurance as a matter of law.<sup>200</sup> Reinsurance is "a special form of insurance obtained by insurance companies to help spread the burden of indemnification. A reinsurance company typically contracts with an insurance company to cover a specified portion of the insurance company's obligation to indemnify a policyholder.... The reinsurance contract is not with the insured/policyholder." *Catholic Mut. Relief Soc. v. Superior Court* (2007) 42 Cal. 4th 358, 368, quoting *Ascherman v. General Reinsurance Corp.* (1986) 183 Cal.App.3d 307, 311, fn. 5.

A reinsurance policy may not be used to change the underlying insurance policy. "An essential feature of reinsurance is that it does not alter the terms, conditions or provisions of the contract of liability insurance between the direct liability insurer and its insured..." *Catholic Mut. Relief Soc., supra*, 42 Cal. 4th at 369. Thus, by definition, a reinsurance contract may not involve the original insured/policyholder's contract of insurance.

This is not to say reinsurers may not contract with the original insured at all. In fact, the Insurance Code clearly indicates that a reinsurer may contract separately with a policyholder but only as to rights of policyholders against the reinsurer: "The original insured or policyholder shall not have any rights against the reinsurer which are not specifically set forth in the contract

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<sup>200</sup> Ins. Code § 623.



of reinsurance, or in a specific agreement between the reinsurer and the original insured or policyholder.”<sup>201</sup> Since the Insurance Code defines reinsurance as only between an insurer and a reinsurer, a reinsurer cannot directly insure an insurer’s policyholder, including changes in rates, premium, claims handling, etc., so as to modify the underlying contract between the insurer and its insured. For a reinsurer to do otherwise effectively results in it becoming an insurer.

## **VII. Discussion**

Shasta Linen contends the EquityComp program, with its required RPA, modifies the guaranteed cost policy’s rates, dispute resolution provision, and cancellation terms, and as such must be filed and approved by the Insurance Commissioner prior to use. CIC argues the CDI lacks jurisdiction over this appeal, that the RPA does not alter the terms of the guaranteed cost policy, and that mention of the EquityComp program in CDI market examinations constitutes approval of the program. CIC also argues the CDI may not void the RPA’s terms.

After examining the facts and applicable law, the Insurance Commissioner concludes he has jurisdiction over this appeal; EquityComp and its accompanying RPA constitute a collateral agreement pursuant to California Code of Regulations, title 10, section 2268, which is void as a matter of law; CIC was the primary party instituting an illegal program to modify its rates with its insureds and ultimately the premium charged to Shasta Linen through the collateral agreement; and CIC made misrepresentations to the Commissioner concerning its workers’ compensation insurance programs and reinsurance.

### **A. The Insurance Commissioner’s Exclusive Jurisdiction over this Appeal**

CIC initially contended that the Commissioner lacks jurisdiction to consider this case. Specifically, CIC argues (1) appeals filed under Insurance Code section 11737, subdivision (f) may only determine “whether CIC has properly applied its [rate] filings to determine how much

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<sup>201</sup> Ins. Code § 922.2, subd. (c).

premium to charge” and may not address the potential illegality of the rate filing,<sup>202</sup> (2) the RPA is between AUCRA and Shasta Linen and relief in this forum is not possible,<sup>203</sup> (3) whether the RPA is an unlawful collateral agreement in violation of the Insurance Commissioner’s Regulations is beyond the scope of the CDI’s jurisdiction,<sup>204</sup> and (4) only the Insurance Commissioner may initiate a hearing to disapprove a rate on the ground that it is unfiled.<sup>205</sup> Each of these arguments lack merit as discussed below.

### **1. Section 11737(f) Appeals Address Insurer Filings**

CIC contends this appeal may only consider whether CIC assessed Shasta Linen’s premium in accordance with its approved rate filings.<sup>206</sup> But CIC misinterprets the statute and inserts language that is not included.

Insurance Code section 11737 provides the Insurance Commissioner the authority to take various actions regarding rates, including disapproval of rates that fail to comply with filing requirements, result in inadequate or discriminatory premiums or threaten an insurer’s solvency. Subdivision (f) provides employers with a similar right to challenge filed rates as they apply to that particular employer and authorizes the Insurance Commissioner to determine the proper application of the filed rate.

Every insurer or rating organization shall provide within this state reasonable means whereby any person aggrieved by the application of its filings may be heard by the insurer or rating organization on written request to review the manner in which the rating system has been applied in connection with the insurance afforded or offered.<sup>207</sup>

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<sup>202</sup> Respondent’s Post-hearing Opening Brief, 21:13-22:7.

<sup>203</sup> Respondent’s Post-hearing Opening Brief, 22:8-18.

<sup>204</sup> Respondent’s Post-hearing Opening Brief, 23:8-14.

<sup>205</sup> Respondent’s Post-hearing Opening Brief, 23:21-24:6.

<sup>206</sup> Respondent’s Post-hearing Opening Brief, 22:4-7.

<sup>207</sup> Ins. Code § 11737, subd. (f).

If the employer disagrees with the carrier's response, it may appeal to the Insurance Commissioner. Appeals presented to the Insurance Commissioner are heard by the Administrative Hearing Bureau pursuant to California Code of Regulations, title 10, section 2509.40 et seq.

Nothing in section 11737, subdivision (f) limits review to premiums charged under the rating system. Contrary to CIC's argument, an insurer's rating plan and rates are not synonymous with "premium." Section 11730, subdivision (g) defines rates as "the cost of insurance per exposure base unit, prior to any application of individual risk variations based on loss or expenses considerations and does not include minimum premiums." Section 11737, subdivision (f) provides an employer aggrieved by an insurer's application of its rates to that employer with a forum for such disputes. Shasta Linen complains CIC did not adhere to its filed rating plan and rates in assessing workers' compensation premium and costs under EquityComp. Certainly such a dispute falls under section 11737, subdivision (f).

Even assuming section 11737, subdivision (f) pertains only to premiums charged, the underlying complaint satisfies such a requirement. Shasta Linen argues the EquityComp premium and rates per \$100 of payroll differ from those filed and approved by the Commissioner. CIC counters this argument by stating the RPA charges program fees, not premiums.<sup>208</sup> While CIC is careful to call EquityComp costs "program costs" and not premiums, this is a distinction without a difference. Indeed, Mr. Watson used the terms interchangeably during his testimony and the patent application itself calls the costs under the RPA "premiums."<sup>209</sup> Moreover, money paid by an insured to an insurer for coverage constitutes

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<sup>208</sup> Respondent's Post-hearing Opening Brief, 25:1-20.

<sup>209</sup> ALJ Exh. 1, col. 1, lines 44-48: "The risk sharing participation program is structured such that the insured's net premium payment will vary in a non-linear manner with respect to their actual losses. In particular, there will be accelerated savings in premiums for particularly low losses over a given period of time." See also, Tr. 1292:22-15.

premium regardless of the name. This, of course, is consistent with the structure of the program. Accordingly, even under CIC's limited reading of the statute, the dispute is properly before the Commissioner.

Shasta Linen was aggrieved by the modification of the guaranteed cost rate and resulting premium which was inconsistent with that which was supposed to be charged under CIC's rate filing and the terms of the guaranteed cost policy that was actually issued. No other rate is applicable except for those filed by CIC, and the RPA cannot be used as either the rate or to calculate the premium of Shasta Linen since it had not been filed with the Commissioner.<sup>210</sup>

## **2. AUCRA is Not a Necessary Party to this Appeal**

CIC asserts the RPA is a contract between AUCRA and Shasta Linen and as the appeal names only CIC, the Insurance Commissioner cannot rule on the agreement's legality. More specifically, CIC argues that AUCRA is not an insurer, and therefore not subject to the appeal procedures under section 11737. This argument is without merit.

While it is true that the RPA is a contract between AUCRA and an employer, AUCRA is not an independent third party or unrepresented at this hearing. AUCRA is a wholly-owned subsidiary of Applied Underwriters, Inc.; the same corporation that owns CIC. The Boards of Directors for CIC, AU, and AUCRA are identical in composition and officers and directors of all three entities testified during the hearing.<sup>211</sup> In addition, AUCRA's sole purpose is to serve as a supposed reinsurer to CIC. As such, it is inextricably intertwined with CIC and AU. Indeed, the affiliated entities are so enmeshed that each of CIC's financial examinations discusses EquityComp as a CIC product, and there is no evidence CIC sought to distinguish itself from

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<sup>210</sup> See Ins. Code §§ 11735 and 11737.

<sup>211</sup> Tr. 1153:2-4; Tr. 863:1-3.

EquityComp<sup>212</sup>

It is also true that the EquityComp program requires CIC or another licensed insurance carrier participate in the program. And while CIC may not be a signatory to the RPA, CIC represented that the rates filed and approved by the Commissioner would be the rates charged to California consumers. That CIC contracted with an affiliated corporation to alter or modify those rates does not absolve the carrier from liability in this proceeding, nor does it protect the RPA from analysis. This is especially true given that AU structured EquityComp and the RPA to circumvent state regulators.<sup>213</sup>

It is most important to note that CIC is the party that, through its Executive Vice President, and then President, Steven Menzies<sup>214</sup> created and entered into the reinsurance treaty and addendums that transferred its EquityComp insured policyholders to AUCRA. The treaty specifically notes the ceding of EquityComp business to AUCRA by CIC. CIC now stipulates that the arrangement between it and AUCRA is not actually reinsurance. However, a party merely stipulating at hearing does not alter or eliminate the facts in this record that CIC did enter into reinsurance treaties with a reinsurer related to it through its corporate parent, with common executives facilitating the transaction, and utilized that reinsurance to perpetuate its scheme to change its filed rates and insurance contracts with its insureds. CIC, through this stipulation, is merely trying to wash its hands of responsibility as the primary party responsible for this arrangement.

Lastly, the Commissioner must determine whether the rates and rating plan sold to Shasta Linen adhere to the Insurance Code and the approved rating plan. If Shasta Linen's rates differ

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<sup>212</sup> Exh. 233-11.

<sup>213</sup> ALJ Exh. 1, column 7, lines 42-54.

<sup>214</sup> Steven Menzies was at the time of the signing of the reinsurance treaties the Vice President and then President of AUCRA. See Exh. 232.

from those quoted by CIC and approved by the Commissioner, Shasta Linen may challenge those rates under section 11737, subdivision (f), regardless of whether CIC or AUCRA sold Shasta Linen the RPA.

### **3. Conclusions Regarding RPA are Not Beyond Scope of Appeal**

CIC argues that analysis and conclusions regarding the RPA are beyond the scope of a section 11737, subdivision (f) hearing. CIC argues the RPA does not impact the “rating system” and thus it is irrelevant whether the RPA is an unlawful collateral agreement under the Insurance Code and its Regulations. This argument is also without merit.

Whether the RPA impacts rates or the rating system is a question of law to be determined by the Insurance Commissioner.<sup>215</sup> CIC’s argument relies upon the legal conclusion that the RPA does not impact rates and thus is outside the Insurance Commissioner’s jurisdiction. This appeal requires the Insurance Commissioner to consider the impact of the RPA. As stated in CIC’s parent company’s own patent, the RPA, set up through CIC’s reinsurance agreement with ACURA, was intended to modify the guaranteed cost policy and change it into a retrospective rating plan.<sup>216</sup> Permitting the RPA to be beyond the scope of this appeal will impose upon Shasta Linen improper rates and premium in this state, which harms both this employer and the workers’ compensation system established by the Legislature.

### **4. Section 11737 Hearings May Be Initiated by Insurance Commissioner or Insured**

CIC argues that only the Insurance Commissioner may initiate a hearing to disapprove an unfiled rate. In support of this contention, CIC cites section 11737, subdivision (a) arguing the Insurance Commissioner has discretion to approve unfiled rates and *Bristol Hotels & Resorts v.*

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<sup>215</sup> *Conestoga Servs. Corp. v. Executive Risk Indem., Inc.* (9<sup>th</sup> Cir. 2002) 312 F.3d 976, 981; *Fragomeno v. Ins. Co. of the West, Inc.* (1989) 207 Cal.App.3d 822, 827.

<sup>216</sup> ALJ Exh. 1.

*National Council on Compensation Ins. Inc.* (2002) 2002 WL 387266. Neither argument is persuasive.

Pursuant to Insurance Code section 11735 an insurer *shall* file all rates and supplementary rate information that are to be used in this state no later than 30 days prior to their effective date.<sup>217</sup> Pursuant to Insurance Code section 11658, an insurer *shall* not issue a policy unless it has been approved in form and substance by the Insurance Commissioner and the WCIRB.<sup>218</sup> Similarly, California Code of Regulations, title 10, section 2218 requires insurers submit all workers' compensation insurance forms to the WCIRB and the Insurance Commissioner for approval prior to use. The statute and regulations are clear. An unfiled rate or policy form or endorsement is unlawful.<sup>219</sup> And as discussed above, under section 11737, subdivision (f) a consumer may challenge the use of an unfiled rate.

CIC also cites *Bristol Hotels & Resorts, supra*, arguing that an unfiled rate is not an unlawful one. *Bristol Hotel & Resorts* is an unpublished California case. The California Rules of Court however, prohibit citation to an unpublished decision for this purpose.<sup>220</sup> The rules authorize reference to unpublished opinions only in a narrow set of circumstances, none of which apply here.<sup>221</sup> Accordingly, the ALJ disregards the citation to *Bristol Hotels & Resorts* and CIC's argument thereunder.<sup>222</sup>

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<sup>217</sup> Ins. Code § 11735, subd. (a).

<sup>218</sup> Ins. Code § 11658, subd. (a).

<sup>219</sup> See also, *American Zurich Ins. Co., supra*, 80 Cal. Comp. Cases 687, 709-710.

<sup>220</sup> Cal. Rules of Court, rule 8.115(a).

<sup>221</sup> Cal. Rules of Court, rule 8.115(b).

<sup>222</sup> *Humane Soc'y of the United States v. Superior Court of Yolo County* (2013) 214 Cal.App.4<sup>th</sup> 1233, 1266.

**5. Subdivision (f) of Insurance Code Section 11737 Permits the Insurance Commissioner to Apply the Applicable Filed Rate to the Aggrieved Insured.**

The Insurance Commissioner has authority to hear any dispute concerning a policyholder aggrieved by an insurer's application or misapplication of the insurer's filed rates pursuant to subdivision (f) of Insurance Code section 11737. Subdivision (f) has no time limitations for a grievance to be filed and only requires that the policyholder be aggrieved by the application of an insurer's rate. In this matter, CIC utilized an unfiled side agreement through its reinsurer to apply an unfiled rating plan. Subdivision (f) states nothing in its provisions that requires it to be applied prospectively. By the subdivisions own terms, it may be applied retroactively since the provision uses the past-tense term "aggrieved" and requires the Commissioner to review the "manner in which the rating system has been applied in connection with the insurance afforded...."<sup>223</sup>

If one were to apply subdivision (f) only prospectively, any insured that obtained a policy would have no recourse to an insurer's improper rating. The remedy afforded to the policyholder under subdivision (f) is not the discontinuance of an unfiled rate, but the Commissioner applying the proper filed rate applicable to the policyholder through this administrative process.<sup>224</sup>

**B. EquityComp and RPA are Collateral Agreements**

Having rejected CIC's jurisdictional arguments, the analysis turns to the agreed-upon issue in this appeal: whether EquityComp and its accompanying RPA modify or alter the terms and rates of the underlying guaranteed cost policy. CIC initially contends the RPA is not a collateral agreement since it does not modify CIC's indemnity obligations. CIC also argues the RPA does not alter the rates charged to Shasta Linen or modify any other terms of the guaranteed

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<sup>223</sup> Ins. Code § 11737, subd. (f).

<sup>224</sup> *Ibid.*



cost policy. But CIC's contentions ignore the statutory language and relevant case law on this issue, and disregard witness testimony and the terms of the RPA.

### 1. Modifications Not Limited to Indemnity Obligations

CIC argues the RPA does not constitute a collateral agreement since it does not limit or restrict CIC's obligation to pay claims.<sup>225</sup> This narrow interpretation is not supported by the statute or relevant case law.

The legislatively-created, comprehensive regulatory scheme requires all workers' compensation insurance policies and forms be filed and approved by the Insurance Commissioner. Section 11658 clearly states that all policies, as well as endorsements to an insurance policy, must be approved prior to use. Similarly, Insurance Code section 11750.3 instructs the WCIRB to review for legal compliance all "policies, daily reports, endorsements or other evidence of insurance." An endorsement is an amendment or modification of an existing policy that alters or varies *any term or condition* of the policy.<sup>226</sup> While some endorsements make minor changes to a policy, other endorsements add or delete insureds or substantially change the premium charged.<sup>227</sup> In light of such a comprehensive regulatory scheme, it is unreasonable to limit the filing requirements of section 11658 to endorsements that modify an insurer's indemnity obligations for loss or liability. Nothing in the language of section 11658, or the language of any other related statute or regulation, requires such a limited interpretation.

In addition, the Insurance Commissioner and the federal courts have rejected this narrow reading of section 11658. In *Zurich American Ins.*, the Insurance Commissioner explained that agreements that modify an insurer's choice of law, dispute resolution options, cancellation and default penalties or payment obligations constitute collateral agreements that must be filed and

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<sup>225</sup> Respondent's Post-hearing Opening Brief, pp. 38-39.

<sup>226</sup> *Adams v. Explorer Ins. Co.*, *supra*, 107 Cal.App.4<sup>th</sup> at 450-451;

<sup>227</sup> Croskey et al., Cal. Practice Guide: Insurance Litigation (The Rutter Group 2002) ¶ 3:188, p. 3-50.

approved.<sup>228</sup> The Insurance Commissioner's interpretation of section 11658 is clear and entitled to great weight.<sup>229</sup> Similarly, in *American Zurich Insurance Co. v. Country Villa Serv. Corp.* (*Country Villa*), a California federal district court rejected the notion that filing requirements pertain only to agreements that modify indemnity obligations. Relying on the Insurance Commissioner's interpretation and previous case law, the federal court held that it was unreasonable to limit section 11658 to "the narrow sliver of an insurance agreement regarding only the insurers 'indemnity obligation for loss or liability.'"<sup>230</sup>

Accordingly, CIC's contention is without merit.

## 2. RPA Modifies the Terms of the Guaranteed Cost Policy

Contrary to CIC's assertion, the RPA modifies a number of guaranteed cost policy provisions, namely, the rates charged, the choice of law and dispute resolution requirements, non-renewal penalties and early cancellation fees. In fact, where the RPA and the guaranteed cost policy differ, the RPA terms supplant those of the guaranteed cost policy.<sup>231</sup>

There is no question that the guaranteed cost policy rates charged per \$100 of payroll differ from those charged under the EquityComp program. In policy year 2010, the guaranteed cost policy quoted \$17.77 per \$100 of payroll for classification 2585, while the RPA quoted \$18.68 for that same policy year. This same discrepancy can be seen in policy years 2011 and 2012. And there is no question that the rates Shasta Linen paid to CIC were not those quoted under the guaranteed cost policy and approved by the Commissioner. First, the EquityComp Proposal itself notes that the applicable rates are the "loss pick containment rates" charged under

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<sup>228</sup> *In the Matter of Zurich American Insurance Company, supra*, DISP-2011-0081 at pp. 10-12.

<sup>229</sup> *Ass'n for Retarded Citizens v. Dep't of Developmental Serv.* (1985) 38 Cal.3d 384, 391.

<sup>230</sup> *American Zurich Ins. Co. v. Country Villa Serv. Corp., supra*, 80 Cal. Comp. Cases 687, 703.

<sup>231</sup> Tr. 1329:9-18.

the RPA and not those quoted in the guaranteed cost policy.<sup>232</sup> Second, all witnesses agree that the RPA terms governed Shasta Linen's payments under the policy and plan. Both Dr. Levine and Ms. Gardiner detailed Shasta Linen's costs under EquityComp. Those calculations incorporated the RPA's loss pick containment rates and not the rates quoted under the guaranteed cost policy.<sup>233</sup> In addition, the EquityComp Sales Manager testified that the terms of EquityComp and the RPA supplant those of the guaranteed cost policy.<sup>234</sup> In fact, the policy terms are irrelevant in determining the premium and fees under the RPA.<sup>235</sup> Third, while the guaranteed cost policy applies an employer's experience modification factor in calculating premium, EquityComp specifically excludes this mandatory factor.<sup>236</sup> The effect is yet another change in an employer's rate and overall premium. Although CIC asserts RPA costs and fees do not constitute "rates" or "premium," this argument is simply erroneous.

The RPA also presents a dispute resolution and choice of law provision intended to supersede those of the guaranteed cost policy. Disputes under the guaranteed cost policy are exclusively governed by section 11735, subdivision (f), which provide for an evidentiary hearing by the CDI. Language outlining this right is mandated by the Insurance Code and must be included in each workers' compensation policy. No provision is made for binding arbitration, and disputes are governed by California law. But the RPA modifies these rights. The RPA and the Request to Bind provide for binding arbitration of disputes. And such disputes are exclusively heard in the British Virgin Islands using Nebraska law. This modification is extremely disconcerting since the Insurance Code prohibits the use of arbitration provisions

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<sup>232</sup> Exh. 201-4.

<sup>233</sup> Exh. 75; Exh. 279.

<sup>234</sup> Tr. 1350:2-12.

<sup>235</sup> Tr. 318:23-25.

<sup>236</sup> The Commissioner notes for the record that a failure to apply an employer's experience rating factor in calculating premium constitutes a violation of Insurance Code section 11734, subdivision (c).

without written notice to the policyholder that such a provision is negotiable.<sup>237</sup> In addition, it is clear the RPA's dispute resolution and choice of law provisions are meant to replace those of the guaranteed cost policy. In fact, CIC's witnesses could not conceive of a dispute that would fall under the guaranteed cost policy.<sup>238</sup>

Enrollment in EquityComp also significantly alters the guaranteed cost policy's early cancellation terms. While the guaranteed cost policy must include statutory early cancellation provisions, the RPA specifies its own, unapproved, early cancellation penalty. The difference between these two contractual provisions can be illustrated monetarily. An employer with \$300,000 in premium, who cancels their guaranteed cost policy after 100 days, is liable for \$114,000. That same employer, if enrolled in EquityComp, would be liable for more than \$1.1 million if they chose to cancel their EquityComp enrollment or the underlying CIC guaranteed cost policy after only 100 days.

Lastly, the RPA applies a non-renewal penalty disfavored by the Insurance Code. After a guaranteed cost policy expires, an employer is free to select a new insurer without penalty or restriction. That is not the case for those who enroll in EquityComp. The RPA's terms and obligations continue long after the end of the three-year program term. After EquityComp expires, all of a participant's open and closed claims are subjected to run-off LDFs which

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<sup>237</sup> Ins. Code § 11658.5 states as follows:

(a)(1) An insurer that intends to use a dispute resolution or arbitration agreement to resolve disputes arising in California out of a workers' compensation insurance policy or endorsement issued to a California employer shall disclose to the employer, contemporaneously with any written quote that offers to provide insurance coverage, that choice of law and choice of venue or forum may be a jurisdiction other than California and that these terms are negotiable between the insurer and the employer. The disclosure shall be signed by the employer as evidence of receipt where the employer accepts the offer of coverage from that insurer.

(2) After compliance with paragraph (1), a dispute resolution or arbitration agreement may be negotiated by the insurer and the employer before any dispute arises.

(b) Nothing in this section is intended to interfere with any authority granted to the Insurance Commissioner under current law.

(c) Failure by the insurer to observe the requirements of subdivision (a) shall result in a default to California as the choice of law and forum for resolution of disputes arising in California.

<sup>238</sup> Tr. 875:7-11; Tr. 1329:9-18.

significantly increase a participant's financial obligations. After the expiration of a guaranteed cost policy, a participant owes nothing to the carrier. For Shasta Linen, this difference was significant. At the expiration of the EquityComp program, Shasta Linen received a bill for nearly \$250,000. If only the terms of the guaranteed cost policy applied, Shasta Linen would owe nothing. This provision also serves to penalize California employers who choose to switch insurance carriers. Run-off LDFs apply only to those employers who choose not to renew their EquityComp enrollment. Essentially, CIC penalizes those employers who are dissatisfied for whatever reason. Such a penalty is also contrary to public policy. As an analogy, the ALJ considers the rules regarding dividend distribution. Under California Code of Regulations, title 10, section 2507.2, an insurer may not restrict the payment of a policyholder's dividend due to the policyholder's failure to accept renewal of the policy or subsequent policies offered by the same insurer. Such a practice is coercive and illegal and constitutes an unfair practice.<sup>239</sup>

In sum, the RPA alters the underlying rates, costs and fees of an insurance policy, as well as the choice of law, dispute resolution and cancellation terms. As such, it is by definition a collateral agreement pursuant to California Code of Regulations, title 10, section 2268.

### **3. Case Law Requires Filing of the RPA**

Case law also supports a finding that the RPA constitutes a collateral agreement under the Insurance Code.

A California federal court reiterated the Insurance Commissioner's directive regarding collateral agreements. In *Country Villa*, Zurich and Country Villa were parties to seven consecutive workers' compensation insurance policies. Each of the policies contained a standard-form provision that stated: "The terms of this policy may not be changed or waived

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<sup>239</sup> *Ibid.*

except by endorsement issued by us to be part of the policy.”<sup>240</sup> Zurich and Country Villa then entered into a 20-page Incurred Deductible Agreement (IDA) which by its own terms “supersedes any Deductible endorsements to the Policy(ies), prior communications, negotiations, participating plans or letters of election.” The IDA defined policy terms related to Country Villa’s cost obligations, created a new aggregate deductible and further stated that policy and “all endorsements, extensions, renewals and/or rewrites” are subject to the terms of the IDA.<sup>241</sup> Zurich did not file the IDA with the WCIRB nor did it seek approval from the Insurance Commissioner. Country Villa sought a judicial declaration that the IDA was void and unenforceable under California law as it was not filed pursuant to Insurance Code section 11658 and Regulation 2268. Zurich argued the IDAs were mere financial agreements with the “primary purpose” of securing Country Villa’s deductible obligations under the Large Deductible agreements attached to the insurance policies.<sup>242</sup>

The federal court held that the IDAs could not be understood as a financial agreement separate from the underlying insurance policy but instead as an agreement that changes the policy’s terms.<sup>243</sup> The court further noted that the policy language and the IDAs establish that the IDAs are part of the insurance program created by the policies. Specifically, the policies state that a later issued endorsement may change or waive the terms of the policy, and the IDAs state that the “Policy(ies) ... including all endorsements, extensions, renewals and/or rewrites” are “subject to” the IDA.<sup>244</sup> Accordingly, Zurich’s failure to file the IDA constituted a violation of the Insurance Code.

The facts herein are similar to those in *Country Villa*. CIC initially sold Shasta Linen a

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<sup>240</sup> *American Zurich Ins. Co. v. Country Villa Service Corp.*, *supra*, 80 Cal. Comp. Cases 687, 689.

<sup>241</sup> *Id.* at 690.

<sup>242</sup> *Id.* at 700.

<sup>243</sup> *Id.* at 708.

<sup>244</sup> *Ibid.*

guaranteed cost policy approved by the Insurance Commissioner. Immediately after entering into this insurance contract, CIC required that Shasta Linen execute the 10-page RPA – a separate side agreement that modified the payment obligations, dispute resolution mechanism, choice of law and underlying rates. CIC did not file this separate agreement with the WCIRB or seek approval from the Insurance Commissioner. Instead, CIC argues the RPA merely outlines the profit-sharing mechanism and does not affect policy rates. But like the unlawful side agreements in *Country Villa*, the terms of the side agreement supersede those of the policy and as such must be, but were not, approved by the Commissioner.

#### **4. CIC's Policy Terms Required the RPA to be Endorsed**

By the terms of CIC's own policy with Shasta Linen, CIC was required to endorse the RPA to the policy. CIC engaged AUCRA through the reinsurance treaty to provide to CIC's policyholders the EquityComp program and ceded these policyholders to AUCRA by means of the treaty.<sup>245</sup> However, CIC stated, in both its policy and in the attached Policy Amendatory Endorsement—California, that the insurance policy with Shasta Linen was the sole insurance agreement, the terms could not be changed or waived except by endorsement issued by CIC, and that no other agreement not set forth in the policy or by endorsement shall affect the insurance contract or any rights, duties, or privileges arising from it.<sup>246</sup>

CIC participated in setting up an arrangement by reinsurance treaty, filed with the Department, to move its EquityComp policyholders to the arrangements handled by AUCRA, which circumvented the insurance rates and policy terms without abiding by its own insurance contract. By CIC's own policy terms, such an arrangement, despite initially characterizing it as reinsurance to the Department and then characterizing it as profit-sharing, should have been

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<sup>245</sup> Exh. 232

<sup>246</sup> Exhs 208, 209, and 210

endorsed to its policies. Based upon the patent filed for the EquityComp program, by Applied Underwriter, Inc., the parent company of both CIC and AUCRA, CIC had no intention of endorsing the arrangement to its policies, since the sole purpose of its EquityComp program and arrangements with AUCRA was to circumvent the necessary regulatory checks-and-balances needed in a comprehensive state workers' compensation system to protect insurers, employers, and injured workers and assure financial accountability, fairness, and non-discriminatory treatment of insureds.<sup>247</sup>

**C. EquityComp and the RPA Create a Non-Linear Retrospective Rating Plan**

Any lingering questions regarding the operation of EquityComp and the RPA are answered by AU's patent application and witness testimony.

**1. AU's Patent Calls the RPA a Non-Linear Retrospective Rating Plan**

AU's patent application puts to rest any remaining doubt about the nature of the EquityComp program. Although CIC distinguishes the RPA from other loss-sensitive programs, AU's patent application clearly states, on more than one occasion, that EquityComp and the RPA create a non-linear, retrospective rating plan.<sup>248</sup> For example, AU states the RPA is "a reinsurance based approach to providing non-linear retrospective plans to insureds that may not have the option of such a plan directly."<sup>249</sup> Under the RPA, "the insured can now, in effect, have a retrospective rating plan because of the arrangement among the insurance carrier, the reinsurance company and the insured even though, in fact, the insured has Guaranteed Cost insurance coverage with the insurance carrier."<sup>250</sup> AU's own admissions lead to only one conclusion; EquityComp and the RPA create a non-linear, retrospective rating plan.

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<sup>247</sup> ALJ Exh. 1

<sup>248</sup> ALJ Exh. 1, column 4, lines 62-63:

<sup>249</sup> ALJ Exh. 1, column 6, lines 39-42.

<sup>250</sup> ALJ Exh. 1, column 7, lines 42-54.



In addition, AU clearly states its objective in creating the RPA was to circumvent governmental regulators who restrict the sale of retrospective rating plans and who scrutinize carefully any new rating plans. But, to the extent that any participation plan modifies the terms of a guaranteed cost policy, it must be filed with WCIRB and approved by the Insurance Commissioner. And since AU defines the RPA as a retrospective rating plan, it follows that it must be filed with WCIRB and approved by the Insurance Commissioner.

CIC acknowledges that loss sensitive plans, including retrospective rating plans, must be filed with the WCIRB, approved by the Insurance Commissioner and attached as endorsements to a guaranteed cost policy.<sup>251</sup> Failure to do so renders the plans unlawful. The Insurance Commissioner finds no reason to ignore AU's own description of the RPA. As the RPA creates a non-linear retrospective rating plan, it must be filed and approved by the Commissioner pursuant to 11735 before use in this State.

## **2. EquityComp is Not a Fronting Arrangement**

Contrary to the statements made in the patent application, CIC now argues EquityComp is merely a captive fronting agreement and as such, need not be filed and approved by the two regulatory agencies.<sup>252</sup> This argument both ignores the patent and mischaracterizes witness testimony.

A "fronting" policy is a policy which does not indemnify or defend the insured but which is issued to satisfy financial responsibility laws of various jurisdictions "by guaranteeing to third persons who are injured that their claims against" the insured will be paid.<sup>253</sup> For example, in the area of reinsurance, an admitted insurer may agree to issue a primary policy with the

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<sup>251</sup> Tr. 875:2-4.

<sup>252</sup> Respondent's Post-hearing Opening Brief, 28:7-30:11.

<sup>253</sup> *Aerojet-Gen. Corp. v. Transp. Indem. Co.* (1997) 17 Cal. 4th 38, 50; *Columbia Casualty Co. v. Northwestern Nat. Ins. Co.* (1991) 231 Cal.App.3d 457, 471.

understanding that a non-admitted insurer will reinsure the entire risk. The admitted insurer typically receives a fee or a small percentage of the premium for serving as a “front” for the non-admitted insurer.

Nothing in the facts presented indicates EquityComp is a captive fronting arrangement. While CIC points to the testimony of Dr. Levine and Mr. Avagliano as evidence of a fronting arrangement, it is telling that neither Ms. Gardiner, AU’s Chief Actuary, Mr. Watson, the EquityComp Sales Manager, or Mr. Silver, CIC’s General Counsel described EquityComp as a fronting arrangement. In making this argument, CIC also mischaracterizes Dr. Levine’s testimony. First, Dr. Levine indicated that participants to a fronting arrangement are attempting to functionally create self-insurance in situations where the employer would not qualify as a licensed self-insurer.<sup>254</sup> Rather than portraying EquityComp as a fronting arrangement, Dr. Levine testified that EquityComp and the RPA substantially alter the terms of the guaranteed cost policy such that the CIC policy is meaningless. Dr. Levine further testified that in his opinion the RPA constituted a collateral agreement and as such must be filed and approved by the Insurance Commissioner.<sup>255</sup>

In addition, the EquityComp program does not merely cede the risk under the guaranteed cost policy to a captive reinsurer, as is typical in a fronting arrangement. Instead, the RPA modifies the rates charged and premium paid, reallocates risk to the insured, alters the cancellation terms, forces binding arbitration of disputes and implements non-renewal penalties. These modifications do not describe a fronting arrangement, but rather a collateral agreement that modifies the guaranteed cost insurance policy.

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<sup>254</sup> Tr. 457:7-23. Tr. 459:13-14.

<sup>255</sup> Tr. 450:15-452:4.

**D. CDI's Financial Audits Do Not Constitute Approval of Unfiled Agreement**

CIC also contends that prior CDI financial examinations reviewed the EquityComp program and the RPA, and constitute approval under the Insurance Code.<sup>256</sup> CIC's argument can be summarized as follows; since the examinations were silent with regard to EquityComp and the RPA, the CDI tacitly approved the RPA and EquityComp. This argument again ignores the clear mandate of Insurance Code section 11658 and mischaracterizes CDI's financial and market conduct reports.

Insurance Code section 11658 sets a clear mandate for insurers. All policy, forms and endorsements must be filed with the WCIRB and approved by the Insurance Commissioner prior to use. The Insurance Code does not permit insurers to sell unfiled and unapproved policies nor is the regulatory scheme furthered by implicit approval. Unapproved policies and forms do not become lawful over time, regardless of the number of examinations conducted.

In addition, CIC mischaracterizes the CDI's reports. All three financial examinations reviewed CIC's assets and liabilities, and evaluated CIC's prospective risks. Financial examiners did not review the RPA or confirm compliance with section 11658. The financial examinations make only passing references to EquityComp, and evaluation of EquityComp was well beyond the exam's scope. The Market Conduct report's silence is equally unpersuasive. The purpose of a market conduct audit is to evaluate an insurance carrier's general operating procedures.<sup>257</sup> The audit does not require the review and approval of side agreements, such as the RPA. Indeed, CIC's legal conclusions are based entirely on conjecture and silence. CIC provided no evidence to support its contention that the CDI reviewed the RPA and found that it complied with the Insurance Code. CDI examiners did not testify during the evidentiary hearing

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<sup>256</sup> Respondent's Post-hearing Opening Brief, 30:12-37:18.

<sup>257</sup> Cal. Code of Regs., tit. 10, § 2591.

nor did CIC make an evidentiary showing regarding the examination process. Accordingly, this argument is unsupported and without merit.

**E. The RPA is an Illegal Contract and Void as a Matter of Law**

Having determined the RPA to be an unfiled collateral agreement, CIC lastly contends the Insurance Commissioner lacks authority to void the RPA's application to Shasta Linen. CIC contends the Commissioner may only issue a prospective order to stop the use of an unfiled rate after a separate hearing on the merits of the RPA. This argument ignores the fact that the RPA is void as a matter of law, as indicated by the legislature's comprehensive regulatory scheme and relevant case law.

**1. Statutory Scheme Supports RPA is Void as a Matter of Law**

As detailed above, the RPA modifies the rates and rating plan sold to Shasta Linen by CIC. Nothing in section 11737, subdivision (f) limits the Insurance Commissioner's authority to remedy such violation where a policyholder is aggrieved or to make conclusions regarding items that are as a matter of law. Insurance Code section 11658 states that a workers' compensation insurance policy or endorsement "shall not be issued by an insurer" unless it is filed with the WCIRB and in one way or another approved by the Insurance Commissioner, and subsection (b) states that issuing an unapproved policy or endorsement "is unlawful." Section 11658 is clear: the unfiled and unapproved RPA is illegal under section 11658 and therefore void as a matter of law.<sup>258</sup>

Subdivision (a) of Insurance Code section 11735 requires all rates and supplementary rating information to be filed in this state before use and 30 days transpire before their effective date. The modifications of the Shasta Linen's rates or rating plan as a result of the RPA's re-

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<sup>258</sup> *Kremer v. Earl* (1891) 91 Cal. 112 (stating that "[i]t is not necessary that the act itself ... declare in express words" that a contract in violation of the act is "void"); see also *American Zurich Ins. Co. v. Country Villa Serv. Corp.*, *supra*, 80 Cal. Comp. Cases 687, 709.

rating process also support the conclusion that the RPA is void as a matter of law.<sup>259</sup>

In addition, if upon a review of the legislative scheme, a contract appears to contravene the design and policy of the laws, a court of equity will not enforce it.”<sup>260</sup> By its own admission, AU designed EquityComp and the RPA to circumvent workers’ compensation policy. It would defeat the statutory purpose to allow CIC to bypass the governmental review process by simply waiting until after the insurance policy has gone into effect to introduce additional or modified terms to its insurance program. Workers’ compensation insurance is mandatory and California employers expect the statute’s protection. CIC knew of the review and pre-approval process and deliberately ignored that process with regard to the RPA. It cannot now argue that the Insurance Commissioner should permit the use of an unapproved rate.

As noted above, the legal requirement for modifying any workers’ compensation insurance obligation is to endorse the agreement to the insurance policy.<sup>261</sup> This is done by filing the agreement with the WCIRB, which in turn will file it with the Insurance Commissioner, and endorse it to the insurance policy after the requisite time or approval.<sup>262</sup> Unfiled side agreements are prohibited and shall not be used without complying with these requirements; otherwise, they are not permitted in this state and are void as a matter of law.<sup>263</sup>

## 2. Case Law Supports RPA is Void as a Matter of Law

CIC’s argument is also devoid of case law support and ignores case law directly on point.

In *Country Villa*, discussed *ante*, the federal court using California law, determined that Zurich’s failure to file the IDA with the WCIRB and the Insurance Commissioner violated Insurance Code section 11658. The court held the proper remedy for such a violation was to find

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<sup>259</sup> Ibid.

<sup>260</sup> *Kremer v. Earl*, *supra*, 91 Cal. 112.

<sup>261</sup> Title 10 CCR § 2268.

<sup>262</sup> See Ins. Code § 11658.

<sup>263</sup> Ins. Code § 11658; *American Zurich Ins. Co. v. Country Villa Serv. Corp.*, *supra*, 80 Cal. Comp. Cases 687, 695.

the IDAs void and unenforceable.<sup>264</sup> In so holding, the district court stated that unfiled and unapproved side agreements are illegal and void as a matter of law. As such, the Commissioner's determination that the RPA is void as a matter of law, is amply supported by analogous case law.

### 3. No Compelling Reason Exists to Enforce RPA

In compelling cases, California courts will enforce illegal contracts "in order to avoid unjust enrichment and a disproportionately harsh penalty upon the plaintiff."<sup>265</sup> The extent of enforceability and the remedy granted depend upon a variety of factors, including the policy of the transgressed law, the type of illegality, and the particular facts. Application of these factors to the RPA supports the conclusion that the RPA should not be enforced.

First, the Insurance Code requires full disclosure, review, and approval for workers' compensation policies in order to safeguard California consumers from discriminatory, unsupported, or exploitative rates and to prevent monopolies. Shasta Linen is exactly the type of California employer the statutory scheme is meant to protect. It would defeat the statute's purpose to permit CIC and its affiliated companies to sell EquityComp and the RPA without regulatory approval and oversight. Indeed, it would be directly contrary to sections 11658 and 11735 to allow an insurance company to bypass the regulatory review process by waiting until after the policy has gone into effect to introduce additional or modified terms to its insurance program.<sup>266</sup>

Second, there is no risk of *unjust* enrichment by Shasta Linen. An insurer's issuance of an illegal contract, even if it results in enrichment to the insured, does not result in *unjust*

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<sup>264</sup> *American Zurich Ins. Co. v. Country Villa Serv. Corp.*, *supra*, 80 Cal. Comp. Cases 687, 695.

<sup>265</sup> *Malek v. Blue Cross of Cal.* (2004) 121 Cal.App.4th 44, 70; *Asdourian v. Araj* (1985) 38 Cal.3d 276, 291.

<sup>266</sup> *American Zurich Ins. Co. v. Country Villa Serv. Corp.*, *supra*, 80 Cal. Comp. Cases 687, 710.

enrichment, since the insured did nothing wrong.<sup>267</sup> And if the RPA is void, Shasta Linen remains liable to CIC under the guaranteed cost policies for the agreed-upon premium and fees based upon the applicable filed rates.

Third, denying enforcement of the void RPA is not unduly harsh. CIC knew California's filing requirements for policies and endorsement and chose not to seek the required regulatory approval. Permitting CIC to enforce the illegal RPA would encourage illegal activity by it and other insurers, run contrary to the workers' compensation insurance system, and would be an abdication of the Commissioner's regulatory oversight.

Finally, CIC is not blameless since it created a product to circumvent California's statutory and regulatory requirement; a product that ultimately enriched CIC at the expense of California employers. It would not be equitable to allow the party who created the illegality to enforce the illegal contract.<sup>268</sup>

Shasta Linen argues it should be liable only for the claims paid during the duration of the three-year program. Shasta Linen provides no support for this contention, nor does Shasta Linen explain why the Insurance Commissioner should bar enforcement of the guaranteed cost policy. Shasta Linen is not legally self-insured, it has a guaranteed cost policy with CIC, and it should pay the appropriate insurance premium based upon the filed rates applicable to Shasta Linen. Any additional remedies to which Shasta Linen is entitled based upon CIC's conduct are outside the scope of this proceeding.

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<sup>267</sup> *Id.* at 709.

<sup>268</sup> *American Zurich Ins. Co. v. Country Villa Serv. Corp.*, *supra*, *Id.* At 710.

### **VIII. Conclusion**

Pursuant to California Code of Regulations, title 10, section 2509.61, subdivision (a), a “party has the burden of proof as to each fact the existence or nonexistence of which is essential to the claim for relief or defense that he or she is asserting.”

Based on the foregoing findings of facts and conclusions of law, the Insurance Commissioner finds by a preponderance of the evidence that Shasta Linen met its burden of proof in demonstrating that it is aggrieved by CIC’s misapplication of its filed rates as a result of an unfiled and unapproved collateral agreement that modified the terms and conditions of the guaranteed cost policy, in violation of Insurance Code sections 11737 and 11658 and California Code of Regulations, title 10, section 2268.

Further, CIC’s EquityComp program’s Reinsurance Participation Agreement constitutes a collateral agreement modifying the rates and obligations of the insured and the insurer, and is void as a matter of law since it was required to be filed with the Workers’ Compensation Insurance Rating Bureau and filed with the Department of Insurance before its use in the State of California, pursuant to Insurance Code section 11658 and California Code of Regulations, title 10, sections 2268 and 2218.

### **ORDER**

1. Shasta Linen is responsible only for the premium and costs associated with the three guaranteed cost policies issued on January 1, 2010, January 1, 2011 and January 1, 2012 and the rates applicable to those policies. To the extent that Shasta Linen has remitted to CIC funds in excess of the amounts under the guaranteed cost policy, CIC shall refund that amount, including all amounts held in Shasta Linen’s captive cell, within 30 days of the date of this decision;



2. The entirety of this Decision and Order is designated precedential pursuant to Government Code section 11425.60, subdivision (b), and;

3. Pursuant to Government Code section 11519, this Decision shall be effective immediately.

**IT IS SO ORDERED.**

DATED: June 20, 2016

  
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**DAVE JONES**  
Insurance Commissioner

**DECLARATION OF SERVICE BY ELECTRONIC & U.S. MAIL**

Case Name/No.: In the Matter of the Appeal of:  
SHASTA LINEN SUPPLY, INC.  
File AHB-WCA-14-31

I, NATALIE BRUTON-YENOVKIAN, declare that:

I am employed in the County of Sacramento, California. I am over the age of 18 years and not a party to this action. My business address is State of California, Department of Insurance, Executive Office, 300 Capitol Mall, Suite 1700, Sacramento, California, 95814.

I am readily familiar with the business practices of the Sacramento Office of the California Department of Insurance for collection and processing of correspondence for mailing with the United States Postal Service. Said ordinary business practice is that correspondence is deposited with the United States Postal Service that same day in Sacramento, California.


On June 20, 2016, following ordinary business practices, I caused a true and correct copy of the following document(s):

**DECISION & ORDER**

to be placed for collection and mailing at the office of the California Department of Insurance at 300 Capitol Mall, Sacramento, California, 95814 with proper postage prepaid, in a sealed envelope(s) addressed as follows:

(SEE ATTACHED SERVICE LIST)

I declare under penalty of perjury that the foregoing is true and correct, and that this declaration was executed at Sacramento, California, on June 20, 2016.

  
NATALIE BRUTON-YENOVKIAN

**PARTY SERVICE LIST**  
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**AHB-WCA-14-31**

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