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BEFORE THE INSURANCE COMMISSIONER

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	
AREVALO TORTILLERIA, INC.,	)	FILE AHB-WCA-16-05
	)	
Appellant,	)	
	)	
From the Decision of the	)	
	)	
CALIFORNIA INSURANCE COMPANY;	)	
APPLIED UNDERWRITERS CAPTIVE RISK	)	
ASSURANCE COMPANY, INC.; and	)	
APPLIED UNDERWRITERS, INC.,	)	
	)	
Respondents.	)	
	)	

DECISION

Statement of the Case

Workers' compensation insurance is a comprehensive benefits system that balances the interests of workers and their employers. Workers receive timely compensation for employment-related injuries but are generally barred from suing their employers. Employers are protected from lawsuits but must provide benefits regardless of fault.[1]

Because workers' compensation insurance is mandatory for all California employers,[2] the Legislature charged the Insurance Commissioner with supervising all insurance plans to protect

[1] See 2 Witkin, Summary Cal. Law 11th, Workers' Compensation § 1 (2018).
[2] Labor Code, § 3700.

both workers and their employers.[3] To assist the Commissioner in carrying out this responsibility and to support employers seeking affordable coverage, the Insurance Code mandates that insurers publicly file with the Commissioner all rates and related information used to set workers' compensation insurance premiums.[4]

This proceeding, and the dozens like it, arises out of California Insurance Company (CIC), Applied Underwriters (AU) and Applied Underwriters Captive Risk Assurance Company, Inc.'s (AUCRA) decision to circumvent California's filing and approval requirements and directly sell an unfiled insurance plan to unwitting employers. Appellant asserts this unfiled plan, titled EquityComp and its accompanying Reinsurance Participation Agreement (RPA), unlawfully modified CIC's filed guaranteed cost plan rates. Appellant's argument substantially relies upon the Insurance Commissioner's precedential decision *In the Matter of Shasta Linen Supply, Inc.*,[5] in which the Commissioner determined that Respondents' unfiled RPA was unlawful and void.

Respondents maintain that neither the RPA nor its contents were required to be filed, notwithstanding the *Shasta Linen* decision. Respondents further argue the Insurance Commissioner lacks jurisdiction over this appeal and may not grant the remedies Appellant requests. Lastly, Respondents contend the Administrative Law Judge (ALJ) denied them due process by denying discovery, excluding certain witnesses, and prohibiting Respondents from relitigating *Shasta Linen's* factual findings and conclusions.

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[3] *Nielsen Contracting, Inc. v. Applied Underwriters, Inc.* (2018) 22 Cal.App.5th 1096, 1118.
[4] See Ins. Code §§ 11730-11742.
[5] *In the Matter of the Appeal of Shasta Linen Supply, Inc.* (Cal. Ins. Comm'r, Jun. 20, 2016, AHB-WCA-14-31) (*Shasta Linen*). *Shasta Linen* was designated precedential under Government Code section 11425.60, subdivision (b).

For the reasons discussed below, the Commissioner concludes as follows: First, that he has exclusive jurisdiction to adjudicate this appeal. Second, Respondents misapplied CIC's rate filings by supplanting these rates with the RPA's unfiled rates. Third, the RPA is void and unenforceable. And finally, Respondents were not denied due process.

I. Issues Presented

1. Did Respondents misapply their Insurance Code section 11735 filings to Appellant by entering into and applying the RPA Arevalo?
2. If so, what is the appropriate remedy?

II. Procedural History

On January 28, 2016, Arevalo filed an appeal with the Department of Insurance, Administrative Hearing Bureau (AHB) in response to Respondents' January 8, 2016 decision rejecting Arevalo's Complaint and Request for Action. [6] Respondents filed their response on February 10, 2016.[7]

The Chief Administrative Law Judge (CALJ) continued this matter pending the Commissioner's final decision in *Shasta Linen, a* matter involving the materially identical RPA. On June 20, 2016, the Insurance Commissioner issued a precedential decision in *Shasta Linen.*

On August 3, 2017, the CALJ ordered the parties to brief the issue of whether the Commissioner's *Shasta Linen* decision precluded Respondents from rearguing the issues decided in that case. On December 1, 2017, the CALJ took Official Notice of the following three documents: 1) the Commissioner's precedential decision and order *In the Matter of the Appeal of*

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[6] Additionally, these proceedings were conducted in accordance with California Code of Regulations, title 10, sections 2509.40 et seq., and the administrative adjudication provisions of the California Administrative Procedure Act referenced in Regulations section 2509.57. Throughout this Proposed Decision, "Regulations" refers to California Code of Regulations, title 10.

[7] The Workers' Compensation Insurance Rating Bureau of California ("WCIRB") also filed a response on February 19, 2016, electing not to actively participate in this appeal.

Shasta Linen Supply, Inc., AHB-WCA-14-31 and the entire evidentiary record before the California Department of Insurance's Administrative Hearing Bureau in that appeal; 2) the Stipulated Consent Cease and Desist Order *In the Matter of the Certificates of Authority of California Insurance Company and Applied Underwriters Captive Risk Assurance Company, Inc.*, MI-2015-00064; and 3) the Settlement Agreement between the California Department of Insurance, California Insurance Company and Applied Underwriters Captive Risk Assurance Company, executed by the parties in June 2017. On the same date, the CALJ issued an order precluding Respondent's from relitigating *Shasta Linen's* findings of fact and conclusions of law.

On February 1, 2018, Respondents requested formal discovery of the following: (1) documents relating to workers' compensation coverage options available to Appellant when it entered into the EquityComp program; (2) documents relating to Appellant's decision to enter into the EquityComp program; (3) documents exchanged between Appellant and its broker relating to the EquityComp program; and (4) documents exchanged between Appellant and its broker relating to loss sensitive workers' compensation options presented to Appellant during the five years before it entered into the EquityComp program. On February 7, 2018, the CALJ denied that request.

On February 13, 2018, the CALJ re-assigned the appeal to ALJ John H. Larsen, who noticed the appeal for a hearing on March 26, 2018. In accordance with the prehearing order, the parties pre-filed witness lists and exhibits, and filed objections to witness and exhibits before the hearing. On March 15, 2018, the ALJ issued an order excluding expert testimony and other witnesses.

At the evidentiary hearing, Gregg Rapoport, Esq. of the Law Office of Gregg Rapoport appeared on behalf of Arevalo. Spencer Y. Kook, Esq. and Brian Noh, Esq. of Hinshaw & Culbertson LLP, appeared on behalf of Respondents. The parties submitted documentary evidence and Appellant presented Alexander Arevalo as its sole witness. Respondents did not call any witnesses.

After the filing of post-hearing briefs and requests for Official Notice, the ALJ ruled on the requests for Official Notice and closed the record on August 16, 2018.

On September 11, 2018 a Proposed Decision was submitted to the Insurance Commissioner in this matter. On November 8, 2018, the Commissioner, pursuant to the provisions of 10 CCR 2509.69, chose not to adopt the proposed decision as his decision, but to decide the case upon the record.

Findings of Fact

The Commissioner finds, by a preponderance of evidence, the following material facts.[8]

I. Arevalo's Business and Workers' Compensation Insurance Coverage

For the last 30 years, the Arevalo family has manufactured tortillas in California.[9] This privately-held, California corporation has operated in three locations in or near Montebello, California with no operations or employees outside of California.[10] Jose Arevalo and Emilia Arevalo each own fifty percent of Arevalo.[11]

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[8] 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. at p. 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. References to transcripts and exhibits in *Shasta Linen* are preceded by "*Shasta Linen*."
[9] Tr. at pp. 19-21.
[10] Exh. 200 at p. 200-2, 214 at p. 214-2; Tr. at p. 99.
[11] ALJ Exh. 7 at p. 12.

Since its inception, Arevalo has purchased workers' compensation insurance exclusively through guaranteed cost policies.[12] In 2008, Arevalo had between 60 and 80 employees. At that time, Jose Arevalo was Arevalo's president,[13] and Jose's son, Alexander Arevalo, served as Arevalo's vice-president and controller.[14] In 2008, Arevalo was growing rapidly and in the process of expanding its operations.[15] Accordingly, Arevalo sought a better-priced insurance policy to take advantage of a more favorable recent loss history. [16] In response, Arevalo's broker prepared an application for EquityComp based on Arevelo's history of workers' compensation payroll, premium and losses.[17]

Arevalo's broker reviewed different carriers, but none of them stuck out as a "clear winner" in terms of affording the best price for the coverage.[18] The broker suggested that Appellant consider Respondents' EquityComp program, in part, because it would set Arevalo's rates for three years, with adjustments for payroll changes.[19] EquityComp also appeared to offer Arevalo the possibility of a rebate.[20] The Arevalos did not review any contracts or program proposals with minimum or maximum costs or documentation concerning specific estimated costs for EquityComp.[21]

II. Respondent's Sale of EquityComp to Arevalo

On November 27, 2008, Jose Arevalo bound coverage for workers compensation insurance through Respondents' EquityComp program by signing and transmitting a Request to

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[12] Tr. at p. 24:1-18.
[13] Tr. at p. 22.
[14] Tr. at pp. 16-19; In 2015, Alexander became president of Arevalo, which had grown to130 employees. Tr. at p. 19-21.
[15] Tr. at pp. 27-28.
[16] Exh. 209 at p. 209-01; Tr. at pp. 24-29, 33, 100.
[17] Tr. at pp. 30, 82.
[18] Tr. at p. 82.
[19] Tr. at pp. 28-29, 35, 79-81, 82-89, 94-95.
[20] Tr. at pp. 30, 82.
[21] Tr. at pp. 30 - 31.

Bind Coverages and Services.[22] The program began on November 27, 2008 and ended on November 27, 2011.[23] Jose Arevalo did so with the assistance of his son and his broker due to Jose's limited English proficiency.[24] The Arevalos did not know that the RPA's rating information had not been filed with the Department of Insurance.[25]

III. Respondents' Organizational Structure

Respondents' organizational structure is extensively described in *Shasta Line*n, and that description is adopted here.[26] Briefly, EquityComp is a program of Applied Underwriters, Inc. which is an indirect subsidiary of Berkshire Hathaway, Inc.[27] AU's insurance companies include North American Casualty Group, which wholly owns California Insurance Company (CIC). CIC is a licensed property and casualty insurance company, domiciled in California and licensed to transact business in 26 states.[28] AU is also the indirect parent company of Applied Underwriters Captive Risk Assurance Company (AUCRA) and Applied Risk Services (ARS).[29] AU manages all of CIC's underwriting, investment, administrative, actuarial, and claim services involving the EquityComp program. AUCRA is an insurance company and is domiciled in Iowa. Its sole purpose is to provide what Respondents called reinsurance to CIC. Pursuant to the RPA, ARS is the billing agent for the EquityComp Program. 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 Claim Services Agreement wherein ARS pays losses and loss adjustment expenses on CIC Policies.

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[22] Tr. at p. 93.
[23] ALJ Exhs. 5, 6, and 7.
[24] Tr. at pp. 22-24, 99.
[25] Tr. at p. 105.
[26] Specifically, the findings in part V(B) of *Shasta Linen* are incorporated herein.
[27] ALJ Exh. 1-2. EquityComp documents presented and signed by Arevalo bear the name and logo of Applied Underwriters, Inc. and EquityComp as a registered trademark of AU.
[28] *Shasta Linen Supply, Inc.*, at pp. 9-10.
[29] *Id.* at p. 10; *Shasta Linen* Tr. at p. 620.

CIC reimburses ARS for all losses and allocated loss adjustment expenses incurred on CIC claims.[30]

IV. EquityComp's Purpose and Program Mechanics

EquityComp is marketed as a "seamlessly integrated package providing nationwide workers' compensation insurance and sophisticated risk financing solutions."[31] EquityComp's purpose and structure are described in detail in *Shasta Linen* and that description is adopted here.[32] In brief, EquityComp's underlying purpose was to circumvent California's workers' compensation policy aims by providing a type of loss-sensitive insurance to employers who were too small to qualify for that kind of coverage under California law.[33] In loss-sensitive programs, the employer's cost for a given policy year is impacted by the workers' compensation claims incurred that year.[34] In contrast, a guaranteed cost policy's price is unaffected by claims incurred during the policy year.[35]

Generally, carriers market loss-sensitive programs to large employers. Indeed, many jurisdictions, including California, restrict the sale of loss-sensitive programs to employers whose annual premium exceeds $500,000.[36] Large employers are typically better able to cope with loss variations and are in a better position to control claims costs.[37] And given their sophistication, larger companies are often better positioned to evaluate the cost effectiveness of different types of insurance.[38] Arevalo's estimated annual premiums during the policy years at

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[30] *Id.* at p. 11; Exh. 252 at p. 6.
[31] ALJ Exh. 1 at p. 2.
[32] The Commissioner's findings of fact in *Shasta Linen* starting at page 15, subpart (c), through page 30 are incorporated in this Proposed Decision, excluding the first two full sentences on page 30.
[33] *Shasta Linen, supra*, at pp. 23-24, 66.
[34] *Id.* at p. 15.
[35] *Id.* at p. 22.
[36] *Shasta Linen* Tr. at pp. 2, 110, 310:10-16; *Shasta Linen* ALJ Exh. 1.
[37] *Id.* at p. 15.
[38] *Id.* at pp. 15-16; *Shasta Linen* Tr. pp. 310:17-23, 311:4-11.

issue in this appeal did not meet the $500,000 threshold.[39]

EquityComp is a specific form of loss-sensitive insurance known as a "retrospective rating plan."[40] Respondents' EquityComp patent describes the scheme as follows:

> 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 insured 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.[41]

AU acknowledged 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."[42] In addition, as noted above, California and other states prohibit the sale of retrospective plans to small and mid-sized employers. AU attempted to skirt that regulatory environment by implementing "a reinsurance based approach to providing non-linear retrospective plans to insureds that may not have the option of such a plan directly."[43]

Following the framework outlined in Respondents' patent, the EquityComp program sold to Appellants was effectuated under separate annual guaranteed cost policies, combined with a three-year Reinsurance Participation Agreement.[44] The RPA superseded the guaranteed cost

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[39] ALJ Exh. 5 through 7.
[40] *Shasta Linen, supra*, at p. 23.
[41] *Id.* at p. 24.
[42] *Id.* at p. 23; *Shasta Linen* ALJ Exh. 1at pp. 1-19 through 1-20.
[43] *Ibid.*
[44] ALJ Exh. 1-4.

policies.[45] Premium owed under the policies was replaced by amounts paid under the RPA.[46] The contracts are discussed in more detail below.

A. Guaranteed Cost Policies

Under a guaranteed cost policy, insured companies pay 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.

The policies must contain statutory language approved by the Commissioner. For example, Arevalo's guaranteed cost policies each contained rates, premium, and other terms required by the Insurance Code and its applicable regulations.[47]

Appellant's guaranteed cost policies set forth the rates for each classification. In calculating Appellant's premium, Respondents multiplied Arevalo's expected payroll in each classification by the filed rate, factored in Appellant's experience modification and added applicable taxes and fees. Respondents estimated Arevalo's annual guaranteed cost premiums to be $207,092.81, $199,313.55, and $144,560.48 for each respective policy year.[48] CIC warrants that it adheres to a single uniform experience rating plan and applies such experience rating to each policy. However, as in *Shasta Linen*, these terms were not applied to Arevalo.

Each guaranteed cost policy contains the dispute resolution process provided for under California Insurance Code section 11737, subdivision (f). This 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

[45] *Shasta Linen, supra,* at pp. 24, 55.
[46] *Ibid.*
[47] ALJ Exh. 5, 6, 7.
[48] ALJ Exh. 5 at p. 5-03, ALJ Exh. 6 at p. 6-04, and ALJ Exh. 7 at p. 7-03, respectively.

> 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.[49]

CIC's guaranteed cost policies also include a cancellation provision and a "short rate" cancellation notice. The policies provide that after cancellation, the final premium will be determined as follows:

> If you cancel, the final premium may 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.[50]

The short rate penalty, which discourages employers from changing insurers mid-year, is a percentage of the full-term premium based on the number of days of coverage in the canceled policy.[51] CIC's short rate calculation table provides a formula for determining the early cancellation penalty.[52]

B. Respondents' Charges for EquityComp

From December 2008 until August 2011, Respondents issued Arevalo monthly Equity Comp statements and plan analyses.[53] In August 2011, Arevalo received a monthly bill for over

[49] ALJ Exh. 5 at p. 15, ALJ Exh. 6 at p. 19, ALJ Exh. 7 at p. 22.
[50] ALJ Exh. 7 at p. 27; see also *Shasta Linen,* supra, at p. 12.
[51] *Shasta Linen,* supra, at p. 14.
[52] ALJ Exh. 7 at pp. 7-28 through 7-29; see also *Shasta Linen* at p. 14.
[53] ALJ Exhs. 8-13.

$100,000.[54] This amount was over five times the previous monthly EquityComp bill.[55] Arevalo could not afford this monthly payment and sought an explanation for the monumental increase. EquityComp representatives could not explain how the bills were calculated, stating the information was proprietary. As a result of the lack of information and Arevalo's inability to afford this payment, Arevalo stopped paying for EquityComp.[56] As of February 2018, Arevalo's total bill for EquityComp is $613,791.43 of which Arevalo has paid $386,871.80.[57]

C. The RPA

The RPA is materially identical to the Reinsurance Participation Agreement at issue in *Shasta Linen*, with the exception of the rates and factors set forth in the RPA's Schedule 1.[58] Where the RPA and the guaranteed cost policies differ, the RPA's terms control.[59] This can be seen in Respondents' final Plan Analysis statements. The statements show that Arevalo's EquityComp bills are derived from Program Costs and Claims Costs based on figures in the RPA, including Loss Pick Containment Rates. For example, the RPA's rates, termed "loss pick containment rates," supplant the rates in Appellant's guaranteed cost policies.[60] These rates along with the rates from Appellant's guaranteed cost policies are shown in Table 1. Additionally, the Workers' Compensation Program Proposal & Rate Summary provided to Appellants in October 2012 states that Appellants would be billed at the RPA's loss pick containment rates.[61]

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[54] ALJ Exh. 12-15.
[55] Tr. at pp. 39-40.
[56] Tr. at pp. 41-46.
[57] The parties agree on the amount Respondents claim Arevalo owes under EquityComp. This figure is based on Exhibit 220-3. Both parties based the amount paid by Arevalo on Exhibit 220. The total amount paid is also shown on Exhibit 220-3.
[58] ALJ Exh. 4; *Shasta Linen* Exh. 207; *Shasta Linen* Tr. at pp. 684, 868, 1304-1305.
[59] ALJ Exh. 1 at p. 1-4.
[60] ALJ Exh. 4 at p. 4-10, Schedule 1, Table C. The values of $6.63 and $6.64 per $100 of payroll are the same to the tenth decimal point; Exh. 13 at p. 13-028.
[61] ALJ Exh. 1 at p. 1-04.

Rates Per $100 of Payroll

Classification Codes	2008 Policy	2009 Policy	2010 Policy	RPA
2003	10.63	10.86	10.51	6.64
8742	1.00	1.03	1.00	0.54
8810	0.86	0.86	0.84	0.63

Table 1[62]

As with Shasta Linen Supply, Inc., Respondents did not bill Arevalo separately for the guaranteed cost policy.[63] Other than establishing a mechanism for paying claims, the guaranteed cost policy had no effect.[64]

Unlike Respondent's guaranteed cost policies, the RPA does not provide a fixed cost for any period of the EquityComp program, unless a participant has no claims. Some RPA terms used to determine a participant's claims payment, such as the Exposure Group Adjustment Factor, are subject to change without notice.[65] In essence, participants pay all of their own claims plus costs and continue to do so until they reach 93 percent of the maximum program costs.[66]

The length of the EquityComp program is determined by the RPA, not the guaranteed cost policies. Rather than a series of separate one-year terms, EquityComp has a three-year active term. In addition to a three-year active term, RPA paragraph 7 provides that a participant's 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 RPA is terminated by Respondents.[67]

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[62] ALJ Exh. 4 at p.4-10, ALJ Exh. 5 at p.5-3, ALJ Exh. 6 at p. 6-4, ALJ Exh. 7 at p. 7-3.
[63] *Shasta Linen* Tr. at p. 774.
[64] *Shasta Linen* Tr. at pp. 1331, 1351.
[65] ALJ Exh. 4 at p. 4-9, Schedule 1, Table B.
[66] *Shasta Linen* Tr. at p. 897:3-8.
[67] ALJ Exh. 4 at p. 4-02, para. 4.

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.[68]

The RPA provides that all disputes be exclusively governed by and construed in accordance with the law of Nebraska. In addition, the RPA contains a two-page dispute resolution provision subjecting all disputes to binding arbitration in the British Virgin Islands. This dispute resolution provision supersedes the language provided for in the guaranteed-cost policy.

Respondents did not file the RPA's rates or other financial terms described in this subpart with the Commissioner before or during the RPA's term.[69] Nevertheless, Respondents charged Appellants in accordance with the RPA's rates and terms rather than those of the guaranteed cost policies.[70]

V. The *Shasta Linen* Settlement and Stipulation to Cease and Desist Selling the RPA

On June 22, 2016, the Commissioner issued the *Shasta Linen* decision finding Respondent's RPA void as a matter of law and unenforceable. On June 28, 2016, the CDI issued a Notice of Hearing and Order for CIC and AUCRA to Cease and Desist from the Issuance or Renewal of Workers' Compensation Insurance Policies and Collateral/Ancillary Agreements in Violation of Insurance Code sections 11658 and 11735 and California Code of Regulations, title 10, Sections 2251 and 2268.

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[68] Tr. at p. 1329:9-18;
[69] See *Shasta Linen* Exh. 19. 20, 21, 23, 24; *Shasta Linen* Tr. at pp. 684, 1169:18-20.
[70] *Shasta Linen* Tr. at pp. 684, 1169:18-20.

On July 1, 2016, CIC and AUCRA filed a Petition for a Preemptory Writ of Mandate and Declaratory Relief challenging the *Shasta Linen* decision.

On September 6, 2016, the Commissioner adopted a Stipulated Consent Cease and Desist Order (Consent Order) signed by CDI, CIC, & AUCRA. As part of the Consent Order, the parties agreed that:

> A. CIC and AUCRA will cease and desist from issuing new RPAs or renewing existing RPAs with respect to a California Policy until such time as the RPA has been submitted to the WCIRB and the CDI in compliance with the requirements of Insurance Code sections 11658 and 11735 and all other applicable statutes and regulations, and the RPA has not been disapproved;
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> B. CIC may renew a Policy issued in connection with an RPA in force as of July 1, 2016;
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> C. Arbitration under either an RPA that is currently an in-force RPA or a past RPA entered into or issued in California will take place in California;
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> D. CIC and AUCRA will not apply run-off loss development factors in any Policy at any time, including upon termination, cancellation or nonrenewal of the Policy;
>
> E. CDI actuaries, on the one hand, and CIC and AUCRA actuaries on the other hand, will immediately meet and confer for the purpose of determining and agreeing upon modified loss development factors ("LDFs") to be used in connection with the Policies [and] [u]pon agreement among the actuaries as to modified LDF's which may include the current LDF's, those LDF's will apply to the Policies and RPAs.[71]

On June 17, 2017, CDI, CIC and AUCRA entered into a settlement agreement settling the *Shasta Linen* mandamus action. As part of this settlement, the parties agreed further that:

> 1. There is a good faith dispute between the Parties as to the Shasta Order, specifically as to the remedy authorized by the California Insurance Code and whether the RPA is void as a

[71] The modified LDF's are found in Exh. 260.

matter of law under the California Legislature's comprehensive regulatory scheme and relevant case law.

2. The Shasta Order applies to Shasta Linen Supply, Inc. and is based upon the facts and circumstances of the Shasta Action. The designation of the Shasta Order as precedential pursuant to California Government Code section 11425.60, subdivision (b) applies to administrative proceedings before the CDI in cases involving facts and circumstances substantially similar to those in the Shasta Action.

3. CDI and AUCRA have met and discussed the Shasta Order and modification to the RPA and have agreed that the RPA, as modified (the "Amended RPA") is an agreement between a third party and the insured, and attached in form and substance as Exhibit 1, Form Number AUCRA-CAL102 (3/17). The Amended RPA will be issued after execution of an Accredited Participant Acknowledgment and Disclosure (the "Acknowledgement") Form Number AUCRA-CAL. 101 (5/17). The CDI by execution of this Agreement hereby approves the Amended RPA and Acknowledgment. AUCRA further agrees that it will not make any changes to the Amended RPA or Acknowledgment in the State of California without first submitting it to the CDI for review and approval. CIC and AUCRA agree to provide the AUCRA –CAL. 101 and AUCRA-CAL. 102 forms to any prospective insured prior to the inception date to the coverage.

Notably, the Amended RPA provides that EquityComp may not be sold to companies with annual workers' compensation premiums of less than $500,000. In addition, employers must 1) meet minimum requirements for years in business, experience and familiarity with workers' compensation insurance, 2) understand the basic terms of the applicant's workers' compensation insurance policies, and 3) acknowledge that Respondents' RPA changes those terms.[72]

[72] Settlement Agreement between the California Department of Insurance, California Insurance Company and Applied Underwriters Captive Risk Assurance Company, Inc. executed in June 2017. The ALJ took Official Notice of this filing on December 1, 2017.

Analysis

Respondents claim the Commissioner lacks jurisdiction over this appeal and further contend the RPA does not violate the Insurance Code or its applicable regulations. Respondents also argue they were denied due process by the ALJ's refusal to permit discovery and the testimony of certain witnesses.[73] The Commissioner finds Respondent's arguments unpersuasive as discussed below.

I. The Commissioner Has Exclusive Jurisdiction Over This Appeal

A. Applicable Law

1. The Statutory Rate Filing Scheme

California has an "open rating" workers' compensation regulatory system in which each insurer sets its own rates and files them with the Commissioner. This framework serves many purposes including curtailing monopolistic and discriminatory practices, ensuring rates adhere to a uniform experience rating plan, and providing the public access to rate information so employers may find coverage at the best rates.

Insurance Code section 11735, subdivision (a) provides in part, "Every insurer shall file with the commissioner all rates and supplementary rate information that are to be used in this state. The rates and supplementary rate information shall be filed not later than 30 days prior to the effective date." The term "rate" means "the cost of insurance per exposure base unit," subject to certain limitations.[74] And "supplementary rate information" means "any manual or plan of rates, classification system, rating schedule, minimum premium, policy fee, rating rule, rating plan, and any other similar information needed to determine the applicable premium for an

[73] Respondents' Post-Hearing Brief, dated May 7, 2018 (Resp. Post-Hearing Br."), at pp. 15-19.
[74] Ins. Code, §11730, subd. (g).

insured."[75]

2. Insurance Code section 11737, Subdivision (f)

Insurance Code section 11737, subdivision (f), grants the Commissioner jurisdiction to hear and decide private party appeals concerning the application of insurers' section 11735 filings. Specifically, the statute provides, in pertinent part:

> Every insurer… shall provide within this state reasonable means whereby any person aggrieved by the application of its filings may be heard by the insurer… on written request to review the manner in which the rating system has been applied in connection with the insurance afforded or offered. … Any party affected by the action of the insurer… on the request may appeal… to the commissioner, who after a hearing … may affirm, modify, or reverse that action.[76]

This jurisdiction is exclusive to the Commissioner. As explained in *Farmers Ins. Exchange v. Superior Court*:

> Particularly when regulatory statutes provide a comprehensive scheme for enforcement by an administrative agency, the courts ordinarily conclude that the Legislature intended the administrative remedy to be exclusive unless the statutory language or legislative history clearly indicates an intent to create a private right of action [in court].[77]

B. Analysis and Conclusions of Law

Arevalo appeals the manner in which Respondents sold Appellant workers compensations insurance based on unfiled information that supplanted the terms of the filed guaranteed cost policies and fundamentally altered the nature of the insurance offered. In their Complaint and Request for Action, Appellant requests that Respondents' RPA be found unenforceable.[78] Respondents denied this request.

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[75] Ins. Code, § 11730, subd. (j).
[76] Section 11737, subdivision (f) appeals must be filed with the CDI's Administrative Hearing Bureau in accordance with California Code of Regulations, title 10, section 2509.40 et seq.
[77] *Farmers Ins. Exchange v. Superior Court* (2006) 137 Cal.App.4th 842, 850.
[78] Appellant's Post Hearing Brief, dated May 4, 2018 ("App. Post-Hearing Br.").

Insurance Code section 11737, subdivision (f) sets out a comprehensive scheme to address workers' compensation rate filing violations. Pursuant to section 11737, subdivision (f) appellants may challenge "the manner in which the rating system has been applied in connection with the insurance afforded …" Because this appeal involves the manner in which Respondents applied their rates, this appeal falls squarely within the Commissioner's jurisdiction.[79]

II. CIC, AU, and AUCRA Are a Single Enterprise for the Purposes of this Appeal

Respondents argue the appeal against AUCRA and AU must be dismissed because neither party provided Appellant workers' compensation insurance. [80] This argument ignores law requiring related corporations to be treated as a single enterprise.

A. Applicable Law

Distinctions between related corporations may be disregarded under the "single enterprise" doctrine.[81] "Two conditions are generally required for the application of the doctrine to two related corporations: (1) such a unity of interest and ownership that the separate corporate personalities are merged, so that one corporation is a mere adjunct of another or the two companies form a single enterprise; and (2) an inequitable result if the acts in question are treated as those of one corporation alone."[82]

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[79] Appellants also asserted a violation of Insurance Code section 11658 in this proceeding. The Commissioner determined in *Shasta Linen* that Respondents violated that section by failing to file the RPA form. (*Shasta Linen* at 69; see also *Nielsen Contracting v. Applied Underwriters, Inc.* (2018) 22 Cal.App.5th 1096, [RPA's arbitration clause held unlawful and unenforceable because it was not filed as required by section 11658].) Respondents are precluded from further litigating that issue in these proceedings, as addressed in the Notice Regarding the Preclusive Effect of the *Shasta Linen* Decision (AHB), dated December 1, 2017. The outcome of this appeal is not dependent upon the determination of that issue because it need not be addressed further in this Proposed Decision.

[80] Resp. Post-Hearing Br. p. 10.

[81] *Tran v. Farmers Group, Inc.* (2002) 104 Cal.App.4th 1202, 1218.

[82] *Id.* at p. 1219.

B. Analysis and Conclusions of Law

As the Commissioner determined in *Shasta Linen*, AUCRA is not an independent party. Instead, 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. In addition, AUCRA's sole purpose is to serve as the 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 discuses EquityComp as a CIC product, and there is no evidence CIC sought to distinguish itself from EquityComp.[83] Thus, CIC and AUCRA shared such a unity of interest and ownership that AUCRA acted as a "mere adjunct" to CIC for the purposes of EquityComp.

The Commissioner further found as follows:

> 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. …
>
> Lastly, the Commissioner must also determine whether the rates and rating plan sold to [the appellant] adhere to the Insurance Code and the approved rating plan. If [the appellant's] rates differ from those quoted by CIC and approved by the Commissioner, [the appellant] may challenge those rates under section 11737, subdivision (f), regardless of whether CIC or AUCRA sold [the appellant] the RPA.[84]

In *Nielsen Contracting*, the Court of Appeal confirmed the Commissioner's findings that AUCRA and CIC are so "enmeshed" and "intertwined" that they must be considered together in

[83] *Shasta Linen*, supra at pp. 49-51.
[84] *Ibid.*

determining whether the RPA modified CIC's policies.[85] Accordingly, this argument is without merit.

III. Respondents Violated Insurance Code section 11735 by Supplanting CIC's Filed Rates with the RPA's Unfiled Rates and Supplementary Rate Information, Thereby Misapplying CIC's Rating Plan

A. Applicable Law

As previously indicated, Insurance Code section 11735, subdivision (a), requires insurers to file all rates and supplementary rate information, without exception, before using them in California. The term "supplementary rate information" includes any "minimum premium, policy fee, rating rule, rating plan, and any other similar information needed to determine the applicable premium for an insured."[86] The Commissioner and the Courts construe premium broadly to include any amounts paid to insurers for coverage.[87] Thus, any information necessary to determine amounts owed by an insured to its insurer must be filed and open to public inspection under section 11735.

In addition, insurers may charge premium only in accordance with their filed rates and supplementary rate information.[88] As the Commissioner determined in *Shasta Linen*, an insurer's use of unfiled rates or supplementary rate information is unlawful.[89] That is true regardless of whether the Commissioner disapproved the unfiled rates under Insurance Code section 11737.[90]

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[85] See *Nielsen Contracting, Inc. v. Applied Underwriters*, Inc., 22 Cal.App.5th 1096 (2018), p. 11. [adopting Commissioner's determination in Shasta Linen that AU, AUCRA, and CIC are "'so enmeshed' and 'intertwined' that they should be considered together in determining whether the RPA constitutes a modification of the CIC policies"]. For the reasons set forth in this part, the ALJ overrules Respondents' jurisdictional objections to the inclusion of AUCRA and AU as parties to this appeal.

[86] Ins. Code, § 11730, subd. (j), emphasis added.

[87] ["Money paid by an insured to an insurer for coverage constitutes premium regardless of its name."] *Shasta Linen* at pp. 48-49. *Troyk v. Farmers Group Inc.* (2009) 171 Cal.App.4th 1305, 1325 ["[I]nsurance premium includes not only the 'net premium,' or actuarial cost of the risk covered (i.e., expected amount of claims payments), but also the direct and indirect costs associated with providing that insurance coverage and any profit or additional assessment charged."].

[88] Shasta Linen, supra, at p. 49.

[89] *Id.* at p. 52.

[90] See *Ibid.*

B. Analysis and Conclusions of Law

Respondents misapplied their section 11735 filings to Arevalo by: (1) not charging Arevalo for insurance based on the rates and supplemental information it filed, and (2) charging Arevalo for insurance based on information it should have filed pursuant to Section 11735. Respondents' arguments to the contrary are neither supported by the facts nor by the public policy behind the Commissioner's workers' compensation rate supervision.

1. Respondents Charged Appellant Unfiled Rates

Insurance Code section 11735, subdivision (a), requires insurers to file all rates, without exception, before using them in California. Starting in policy year 2008, the RPA imposed "loss pick containment rates" of $6.64 for Classification Code 2003, $0.54 for Classification Code 8742, and $0.63 for Classification Code 8810. Those rates were not filed in accordance with section 11735. In contrast, the filed rates for those classification codes set out in the 2008 guaranteed cost policy, were $10.63, $1.00, and $0.86, respectively. Similar discrepancies can be seen with respect to those and other classification codes in all three policy years, as shown in Table 1.

Simply put, Respondents charged Appellant the unfiled loss pick containment rates in the RPAs, not the guaranteed cost policies' filed rates. The monthly EquityComp plan analyses confirm that Appellant's program cost was based on the RPA's rates rather than those in the policies. It is beyond doubt that instead of charging Appellant the guaranteed cost policy rates, Respondents charged Appellant for their actual claims plus costs according to Respondents' RPA. Moreover, the Commissioner found in *Shasta Linen* that the RPA rates and payment terms supplanted those of CIC's policies, and Respondents are precluded from arguing otherwise.

Because Respondents charged Appellant unfiled rates, they misapplied the filed rates in the guaranteed cost policies.

2. Respondents Applied Unfiled Supplementary Rate Information

Insurance Code section 11735, subdivision (a), also requires insurers to file all supplementary rate information used to determine amounts owed by an insured. The RPA is predominantly comprised of supplemental information used to determine Appellant's premium based on its actual losses. Respondents included none of this information in their rate filings. Such information was required to be filed and made public under Insurance Code section 11735.

Respondents claim "the RPA does not change the cost of premium under the CIC Policies."[91] This assertion lacks merit. Respondents' patent clearly explains how the RPA creates a framework for altering Appellant's premium. Respondents' EquityComp patent describes the premium alteration as follows:

> 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 insured has higher than average losses in a given year, then the reinsurance company will assess additional premium accordingly.

Respondents further argue the RPA's reference to premium only refers to the premiums ceded by CIC to AUCRA, not "premium that is charged by CIC under its Policies to ATI."[92] But Respondents' patent proves otherwise. As quoted above, "if the insured has higher than average losses in a given year, then the reinsurance company will assess additional premium accordingly." In addition, distinctions between Respondents' different entities are meaningless. As the Court found in *Nielsen Contracting*, AU, AUCRA, and CIC are "so enmeshed and

[91] Resp. Post-Hearing Br. at p. 21:9-12.
[92] Resp. Post-Hearing Br. at pp. 20:26 - 21:8.

intertwined that they should be considered together" in determining Respondents application of its RPA.[93]

The contractual mechanism for determining amounts owed by an insured is described in the supplementary information in RPA sections 1, 2 and 4, which establish the "segregated cell" account that Appellants must pay into and the "run-off term" during which additional premium may be assessed. The mechanism is further described in sections 1 through 4 of RPA Schedule 1, which detail the calculation and allocation of Appellants' premium based in large part on "loss pick containment amounts" and "loss development factors."

In addition, RPA section 4 and RPA Schedule 1, section 6 impose early cancellation fees not set out in Respondents' rate filings, and modify the guaranteed cost policies' cancellation terms and filed rates. Finally, the RPA removes Appellants' loss experience modification factor in calculating premium. That factor, which is detailed in Respondents' rate filings and the guaranteed cost policies, is required by law.

In sum, all of the RPA's economic terms determined Appellant's obligations for its workers' compensation insurance coverage. Those terms constitute "rates" or "supplementary rate information" as defined in Insurance Code section 11730. Because Respondents excluded all the RPA's terms from its rate filings, the RPA unlawfully changed and misapplied Respondents' filed rates in violation of Insurance Code section 11735.[94]

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[93] See *Nielsen Contracting, Inc. v. Applied Underwriters, Inc.*, 22 Cal.App.5th 1096 (2018), p. 11. [adopting Commissioner's determination in Shasta Linen that AU, AUCRA, and CIC are "'so enmeshed' and 'intertwined' that they should be considered together in determining whether the RPA constitutes a modification of the CIC policies"].

[94] See *Shasta Linen* Exh. 19, 20, 21, 23, 24; *Shasta Linen*, *supra*, at p. 52.

3. Respondents' Failure to File the RPA's Rates and Supplementary Rate Information Contravened Public Policy

Respondents argue that "the focus of section 11735 is not on the insured and how much it pays, but is instead on the insurer to protect it against insolvency and to ensure its ability to pay claims to injured workers."[95] This argument ignores the Legislature's clear statements on this issue.

Section 11735's filing and public inspection requirements ensure that the Commissioner has sufficient rate information to determine that rates comply with the requirements of section 11730 et seq., including curtailing monopolistic and discriminatory practices,[96] ensuring rates adhere to a uniform experience rating plan,[97] and providing the public access to rate information so employers may find coverage at the best rates.[98] By withholding the RPA's rate information, Respondents prevented the Commissioner from exercising this authority.

When rate information is transparent, policyholders are better able to compare coverage and reduce their costs. And insurers are less likely to gain a monopolistic advantage when all carriers' pricing information is public. For these reasons, section 11742, subdivision (a) mandates the filing of rating information to establish and maintain "a central information source [to] help employers find required coverage at the best competitive rate" because "many employers do not know which carriers are offering coverage, and it is difficult and time consuming to try to get information on rates and coverages from competing insurance companies." This is particularly the case when insurance companies do not file rating information they are required to file by statute. Respondents clearly contravened the policy of

[95] Resp. Post-Hearing Br. at pp. 21-23.
[96] Ins. Code, § 11732.
[97] Ins. Code, § 11742, subd. (a).
[98] Ins. Code, § 11735, subd. (b); see also Ins. Code § 11742, subd. (a).

open rating by withholding the rates and rating information in its RPA.

Respondents' EquityComp program is a retrospective rating or loss sensitive insurance plan that differs from conventional guaranteed cost policies. The cost of EquityComp varies with losses. Knowing the public policy of restricting the sale of such policies to small or mid-sized employers,[99] Respondents chose not to file its RPA, and thereby, preventing the Commissioner from disapproving or modifying its terms.[100] By failing to file the RPA, Respondents prevented the Commissioner from protecting California employers from the uncertainties of unfamiliar loss-sensitive policies.[101] In addition, withholding rating information hampers the CDI's ability to develop workers' compensation insurance cost comparison guides for policies other than standard guaranteed cost policies. Circumventing all rate oversight in a manner that limited competition and prevented the Commissioner from protecting employers flagrantly contravened public policy.

4. Rate Disapproval Procedure are Not Applicable to This Proceeding

Respondents argue the Commissioner may only disapprove an unfiled rate pursuant to section 11737, subdivision (a) and (d).[102] This argument is not persuasive. *Shasta Linen* determined that use of unfiled rates is unlawful regardless of any rate disapproval action.[103] Respondents are bound by that determination and are precluded from rearguing it here.[104] In any

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[99] *Shasta Linen* Tr. at pp. 14, 56.
[100] *Shasta Linen*, at pp. 20-24; *Shasta Linen* ALJ Exh. 1 at p. 20, column 6, lines 27-67.
[101] See for example, the Program Proposal which describes the participant's "actual" cost after three years as "final net cost" "determined using the ultimate cost of your claims along with the factors and tables set forth in your RPA which specifies …" Exh. 1 at p. 3; *Shasta Linen* Tr. 2132:4-13, 2164:22-2165, 2245:25-2246:5.
[102] Resp. Post-Hearing Br. at p. 13.
[103] *Shasta Linen, supra*, at pp. 45, 52.
[104] See part V(C) below regarding *Shasta Linen's* preclusive effect.

event, their argument is incorrect. Finding the use of unfiled rate information unlawful under subdivision (f) is not dependent on rate disapproval.[105]

Section 11737 delineates two separate roles for the Commissioner. Subdivision (f) authorizes the Commissioner to hear private party appeals concerning the application of rate filings. In contrast, subdivisions (a) though (e) permit the Commissioner to bring his own actions to disapprove unfiled or otherwise improper rates. When the Commissioner finds an unfiled rate or supplementary rating information unlawful under subdivision (f), he performs an adjudicatory function. When the Commissioner disapproves an unfiled rate under subdivisions (a) and (d), he acts in an enforcement capacity. Indeed, subdivision (f) makes no reference to disapproval. Thus, contrary to Respondents' assertions, determinations of unlawfulness and rate disapprovals are not equivalent.

Respondents further argue that use of unfiled rate information remains lawful unless the rates are first disapproved.[106] Their argument implies that if use of unfiled rates were per se unlawful, the Commissioner's authority to disapprove those rates would be superfluous. According to that argument, disapproval must be a prerequisite to finding unfiled rates unlawful.[107] But the argument overlooks statutory language and relevant case law.

First, rate disapproval allows the Commissioner to forestall the use of unlawful rates prior to private party appeals. If the Commissioner learns an insurer is using an unfiled rate, he may stop the unlawful activity by disapproving the rate on his own initiative, rather than waiting until

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[105] See *Shasta Linen*, *supra*, at p. 45 ["The authority to hear grievances of employers for misapplication of rates … is separate from the Commissioner's authority to disapprove rates."]
[106] Resp. Post-Hearing Br. at pp. 14-15.
[107] See, e.g., *Shasta Linen Supply, Inc. v. Applied Underwriters, Inc.* (E.D.Cal. Jun. 20, 2016, Civ. No. 2:16-158 WBS AC) 2016 WL 3407797 at p. *4.

a private party appeal.[108] Thus, rather than being superfluous, the rate disapproval mechanism serves an important policy aim.

Second, California courts have not accepted Respondents' argument. In *South Tahoe Gas Co. v. Hofmann Land Improvement Co.*,[109] the plaintiff public utility sought to enforce a higher contractual rate than the rate it had filed with the Public Utilities Commission ("PUC"). The defendant countered that the contract was illegal and violated state law and PUC regulations since it charged an unfiled rate. Much like Insurance Code section 11735, the Public Utilities Code section 489 requires the utility to file its rates and rating information. And similar to Insurance Code section 11737, Public Utilities Code section 728 permits the PUC to disapprove a utility's rates. Although there was no indication the PUC acted under section 728, the Court of Appeal agreed that a charge in excess of the filed rate was illegal.[110] In essence, the Court's ruling confirms that rate disapproval proceedings are not a prerequisite to finding the use of unfiled rates unlawful.

Finally, Respondents rely upon an unpublished opinion of the Court of Appeal and interlocutory orders in another case to argue that use of unfiled rates remains lawful unless disapproved by the Commissioner.[111] Those cases are easily distinguished. In both, the plaintiffs attempted to base Unfair Competition Law ("UCL")[112] claims on violations of section 11735's filing requirements. The courts held that such a violation could not form the basis for a claim in court when the Commissioner had not disapproved the unfiled rates. In reaching this result, the

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[108] Of course, the fact the rates are unfiled makes it likely the Commissioner will not learn of their unlawful use until an aggrieved private party raises an appeal, in which case rate disapproval would be too late to benefit the appellant.
[109] *South Tahoe Gas Co. v. Hofmann Land Improvement Co.* (1972) 25 Cal.App.3d 750 (*South Tahoe Gas*).
[110] *Id.* at p. 755.
[111] Resp. Post-Hearing Br. at p. 15:6-23 [citing *Bristol Hotels & Resorts v. Nat. Council on Compensation Ins., Inc.* (Mar. 13, 2002, E027037) [nonpub. opn.]]; *Shasta Linen Supply, Inc. v. Applied Underwriters, Inc., supra,* 2016 WL 6094446 at pp. *3-*6].
[112] Bus. & Prof. Code, § 17200 et seq.

Court of Appeal relied on *Samura v. Kaiser Foundation Health Plan, Inc.*[113] The *Samura* court held that a UCL claim may not be based on violations of a statute whose enforcement "has been entrusted exclusively" to a regulatory agency.[114] Such a claim, if allowed, would result in the court improperly invading the agency's exclusive purview.[115] But nothing in *Samura* suggests the agency charged with enforcing the statute may not remedy its violation. While courts may not have original jurisdiction to remedy a violation of section 11735 in a private party action, the Commissioner does.[116]

IV. The RPA Must Be Severed from the Guaranteed Cost Policies

Having found the RPA void, the Commissioner must consider the appropriate remedy. Respondents argue the Commissioner has no authority to order retrospective remedies under Insurance Code section 11737, subdivision (f). Specifically, Respondents assert the Commissioner may not find a contract void or unenforceable in private party appeals. Appellants argue the appropriate remedy is to enjoin Respondents from enforcing the RPA based on *Shasta Linen.*[117] The Commissioner finds Respondents arguments unpersuasive and does not enforce the RPA against Appellant.

A. Applicable Law

1. Insurance Code Section 11737, Subdivision (f)

Section 11737, subdivision (f), grants the Commissioner broad authority to award remedies in workers' compensation appeals. As previously noted, the statute authorizes him to "affirm, modify, or reverse" an insurer's action concerning the application of its rating system.

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[113] *Samura v. Kaiser Foundation Health Plan, Inc.* (1993) 17 Cal.App.4th 1284 (*Samura*).
[114] *Id.* at p. 1299.
[115] *Ibid.*
[116] See the discussions on jurisdiction in part I above and remedies in part IV below.
[117] App. Post-Hearing Br. at p. 9.

The statute contains no language restricting remedies the Commissioner may order. Nor has any California court inferred such restrictions from the statute. Indeed, the breadth of the Commissioner's authority is consistent with his comprehensive role of requiring every insurer to fully comply with all the provisions of the Insurance Code[118] and to remedy violations of them to promote the public welfare.[119]

While Respondents argue that remedies concerning rate disapprovals may only be applied prospectively,[120] remedies for finding unlawfulness under subdivision (f) may either be prospective or retrospective.[121] In fact, nothing in subdivision (f) suggests the Commissioner's decision to "modify" or "reverse" an insurer's action may apply only on a going-forward basis. Further, that subdivision principally concerns past harm, in that it authorizes an aggrieved private party (past tense) to request action by an insurer to review the manner in which its rating system "has been applied" (past action) in connection with the "insurance afforded or offered" (past tense). Since a prospective remedy would do nothing to address past harm, logically, remedies under subdivision (f) may be retrospective.

Finally, because section 11737, subdivision (f), does not limit the available remedies, the Commissioner may void contracts that are based on unlawful rates and sever unlawful provisions, as appropriate.[122] The California Supreme Court's holding in *Marathon Entertainment, Inc. v. Blasi* clarifies this authority.[123] There, an actress brought a claim before the California Labor Commissioner, seeking to void a contract with her manager on the grounds the agreement violated the Talent Agency Act. The Labor Commissioner found a violation and

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[118] Ins. Code, § 12936.
[119] *Association of California Insurance Companies v. Jones* (2017) 2 Cal.5th 376, 405.
[120] Resp. Post-Hearing Br. at p. 3. This Proposed Decision need not, and does not, decide whether there may be circumstances in which rate disapproval remedies may be applied retrospectively.
[121] *Shasta Linen, supra* at p. 53.
[122] *Id.* at pp. 65-66.
[123] *Marathon Entertainment, Inc. v. Blasi* (2008) 42 Cal.4th 974.

declared the contract void, although the statute did not specify a remedy. The California Supreme Court explained that since "the Legislature has not seen fit to specify the remedy for violations" of the act, "the full voiding of the parties' contract is available, but not mandatory; likewise, severance is available, but not mandatory."[124] And the Court stated those remedies could be imposed at the administrative level, as well as by the courts.[125]

2. Civil Code Sections 1598 and 1608

Civil Code sections 1598 and 1608 make a contract "void" if its object or consideration are unlawful.[126] And the California Supreme Court has held that a contract made in violation of a regulatory statute is generally void.[127] Indeed, courts will not normally enforce an illegal agreement or one against public policy as the public importance of discouraging prohibited transactions outweighs equitable considerations of possible injustice between the parties.[128]

This is especially true where regulated entities fail to file their rates as required by law. In such cases, California courts have held contractual provisions based on the unfiled rates unlawful and void.[129] Similarly, the California Insurance Commissioner determined that insurance contracts based on unfiled rates in violation of Insurance Code section 11735, subdivision (a), are unlawful and void.[130]

In compelling cases, the courts will enforce illegal contracts in order to avoid unjust enrichment to a defendant and a disproportionately harsh penalty upon the plaintiff.[131] "[T]he extent of enforceability and the kind of remedy granted depend upon a variety of factors,

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[124] *Ibid.*
[125] *Id.* at pp. 996, 998.
[126] *R. M. Sherman Co. v. W. R. Thomason, Inc.* (1987) 191 Cal.App.3d 559, 563.
[127] *Asdourian v. Araj* (1985) 38 Cal.3d 276, 291.
[128] *Ibid.*
[129] *South Tahoe Gas Co. v. Hofmann Land Improvement Co., supra*, 25 Cal.App.3d at p. 752.
[130] *Shasta Linen, supra,* at pp. 52, 65-66.
[131] *Asdourian v. Araj, supra*, 38 Cal.3d at p. 292.

including the policy of the transgressed law, the kind of illegality and the particular facts."[132] A contract is absolutely void where the illegality involves malum in se—acts "of an immoral character, those which are inequities in themselves, and those opposed to sound public policy or designed to further a crime or obstruct justice."[133] On the other hand, where the illegality involves malum prohibitum, the contract will be voidable "depending on the factual context and the public policies involved."[134] In deciding whether to enforce an illegal contract, courts may also consider whether the parties are in pari delicto and whether the statute's purpose would best be served by enforcement of the contract.[135]

In addition, a contract made in violation of statute will be enforced "where the penalties imposed by the Legislature exclude by implication the additional penalty of holding the contract void."[136] In determining whether to enforce such a contract, "the courts should strive to deal with the transaction so as to give effect to the fundamental purpose of the Legislature and to a wise public policy."[137]

3. Civil Code Section 1599

The California Civil Code permits severing unlawful provisions from an otherwise lawful contract. Civil Code section 1599 states that "[w]here a contract has several distinct objects, of which one at least is lawful, and one at least is unlawful, in whole or in part, the contract is void as to the latter and valid as to the rest." Section 1599 applies "when the parties have contracted, in part, for something illegal. Notwithstanding any such illegality, it preserves and enforces any lawful portion of a parties' contract that feasibly may be severed."[138]

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[132] *South Tahoe Gas Co. v. Hofmann Land Improvement Co., supra*, 25 Cal.App.3d at p. 759.
[133] *Vitek, Inc. v. Alvarado Ice Palace, Inc.* (1973) 34 Cal.App.3d 586, 593.
[134] *Asdourian v. Araj, supra*, 38 Cal.3d at p. 293.
[135] *Homestead Supplies, Inc. v. Executive Life Ins. Co.* (1978) 81 Cal.App.3d 978, 990-991.
[136] *Asdourian v. Araj, supra,* 38 Cal.3d at p. 291.
[137] *Vitek, Inc. v. Alvarado Ice Palace, Inc., supra*, 34 Cal.App. at p. 593.
[138] *Marathon Entertainment, Inc. v. Blasi, supra,* 42 Cal.4th at p. 991.

Severing illegal terms prevent parties from gaining undeserved benefit or suffering undeserved detriment as a result of a voided contract.[139] And it further conserves a contractual relationship where doing so would not condone an illegal scheme.[140]

The doctrine of severability is equitable and fact specific.[141] The overarching inquiry is whether severance would further the interests of justice.[142] As explained in *Baeza v. Superior Court*:[143]

> Courts are to look to the various purposes of the contract. If the central purpose of the contract is tainted with illegality, then the contract as a whole cannot be enforced. If the illegality is collateral to the main purpose of the contract, and the illegal provision can be extirpated from the contract by means of severance or restriction, then such severance and restriction are appropriate. [Citation.] California cases take a very liberal view of severability, enforcing valid parts of an apparently indivisible contract where the interests of justice or the policy of the law would be furthered.

4. Civil Code Section 3399

Civil Code section 3399 authorizes courts to reform—i.e., revise—a contract that "does not truly express the intention of the parties" as a result of fraud or mistake.[144] Absent those circumstances, however, adjudicators may not reform a contract unless specifically authorized by statute.[145] "Generally, courts reform contracts only where the parties have made a mistake [citation] and not for the purpose of saving an illegal contract."[146]

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[139] *Baeza v. Superior Court* (2011) 201 Cal.App.4th 1214, 1230.
[140] *Ibid.*
[141] *Marathon Entertainment, Inc. v. Blasi, supra,* 42 Cal.4th at p. 998.
[142] *Ibid.*
[143] *Baeza v. Superior Court, supra*, 201 Cal.App.4th at p. 1230.
[144] *American Home Ins. Co. v. Travelers Indemnity Co.* (1981) 122 Cal.App.3d 951, 961. Section 3399 provides: "When, through fraud or a mutual mistake of the parties, or a mistake of one party, which the other at the time knew or suspected, a written contract does not truly express the intention of the parties, it may be revised on the application of a party aggrieved, so as to express that intention, so far as it can be done without prejudice to rights acquired by third persons, in good faith and for value."
[145] *Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83, 125 [Courts have no power "under their inherent limited authority to reform contracts."].
[146] *Kolani v. Gluska* (1998) 64 Cal.App.4th 402, 407-408.

B. Analysis and Conclusions

1. The Entire RPA Is Void and Its Terms Cannot Be Severed

Because the RPA is based on unfiled rates and supplementary rate information in violation of Insurance Code section 11735, the agreement is unlawful and void as matter of law.[147] This determination is consistent with California case law concerning unfiled rates and the Commissioner's determination in *Shasta Linen*.[148] And because the RPA's sole objective is to circumvent lawfully filed rates, its terms cannot be severed.

Consider *South Tahoe Gas Co. v. Hofmann Land Improvement Co.,*[149] discussed above. There, the plaintiff public utility sought to enforce a higher contractual rate than was set out in the plaintiff's regulatory rate filings. The Court found the unlawful contractual rate void and unenforceable.[150] The court severed the unlawful rate and enforced the remainder of the contract in that case because "there is no law against contracting for the extension of a gas main. It is only the amount that can be charged which is regulated."[151] That contrasts with this appeal, where the RPA's central purpose was to illegally modify Respondents' filed rates and override the legal rate scheme set out in the guaranteed cost policies. As earlier discussed, the RPA's economic terms consist of unfiled rates and supplementary rate information whose use is illegal. The remainder of the RPA is boilerplate that serves only to implement the economic provisions.[152] Accordingly, the RPA "has but a single object,"[153] making it impossible to sever only those provisions relating to rates and supplementary rate information. In addition, no interest of justice

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[147] *Shasta Linen, supra,* at pp. 52, 65-66.
[148] See *South Tahoe Gas Co. v. Hofmann Land Improvement Co., supra,* 25 Cal.App.3d at p. 752 [public utility's unfiled rate held void]; *Shasta Linen, supra,* at 52, 65-66.
[149] *South Tahoe Gas Co. v. Hofmann Land Improvement Co., supra,* 25 Cal.App.3d at p. 752.
[150] *Ibid.*
[151] *South Tahoe Gas Co. v. Hofmann Land Improvement Co., supra,* 25 Cal.App.3d at p. 757.
[152] Civil Code, §1598.
[153] *Marathon Entertainment, Inc. v. Blasi, supra,* 42 Cal.4th at p. 996.

or public policy would be furthered by enforcing any of the boilerplate terms. Thus, the Commissioner finds the entire RPA is void and unenforceable.

The California Supreme Court's holding in *Marathon Entertainment* also supports the Commissioner's authority to determine the RPA is void. Nevertheless, Respondents argue an agency may not impose a remedy for noncompliance "unless expressly permitted by statute."[154] In support of this contention, Respondents rely on three pre-*Marathon Entertainment* cases. These cases are unpersuasive and inapplicable. First, Respondents mischaracterize the holding in *American Federation of Labor v. Unemployment Insurance Appeals Board*, in which the Supreme Court stated that statutory remedies may be authorized either expressly or by implication.[155] Neither of the other two cases suggest otherwise. Second, the statutes at issue in all three cases define and limit the available remedies, unlike the statute discussed in *Marathon Entertainment* and unlike section 11737, subdivision (f).[156] Where statutory remedies are defined, an agency may not exceed their scope. But when remedies remain undefined, as here, *Marathon Entertainment* is clear that voiding and severance are available.

2. No Compelling Reason Exists to Enforce the RPA Against Arevalo

Even assuming the illegal RPA were merely voidable, rather than void per se, no valid reason exists to enforce it.[157] Failure to enforce the agreement would neither result in unjust enrichment to Appellant nor an unduly harsh penalty to Respondents. Nor is there any indication the Legislature intended to exclude the remedy of voiding the RPA.

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[154] Resp. Post-Hearing Br. at p. 12:8-10.
[155] *AFL* at p. 1039 ["[W]e should not necessarily limit an agency's powers to those expressly granted, because the statutory scheme may 'necessarily imply' those powers."];
[156] *Id.* at p. 1025 [remedy limited to payment of unemployment benefits]; Peralta at 46 [enumerated remedies "related to matters which serve to make the aggrieved employee whole in the context of employment"]; Shernoff at 409 [remedies "limited to restraint of future illegal conduct"].
[157] See *Shasta Linen, supra,* at pp. 67-68.

a. Finding the RPA Unenforceable Would Not Result in Unjust Enrichment or an Unduly Harsh Penalty

The policy behind Insurance Code section 11735, the nature of the illegality, and the particular facts of this case support the conclusion that the RPA should not be enforced.

First, there is no risk of unjust enrichment by Appellant, because "an insurer's issuance of an illegal contract, even if it results in enrichment to the insured, does not result in unjust enrichment, since the insured did nothing wrong and the insurer should have known of its own legal duties."[158] Further, Respondents retain any premium claims they may have under the guaranteed cost policies. In other words, Appellant is obligated to pay Respondents reasonable consideration for the insurance afforded.

Second, denying enforcement of the illegal RPA is not unduly harsh, because Respondents knew of their filing requirements under California law. In fact, their EquityComp patent makes it clear that Respondents not only knew of the filing requirements but used the RPA to evade their regulatory obligations.[159] Additionally, enforcing the RPA's would encourage illegal activity—i.e., the use of unfiled rates and supplementary rate information.[160]

Third, the parties are not in pari delicto. Appellants had no reason to know the RPA's rates and supplementary rate information was unfiled. Respondents are the sole parties at fault, since it used the RPA to circumvent California's filing requirements. "[I]t would not be equitable to allow the party who created the illegality to enforce the illegal contract."[161]

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[158] *American Zurich Ins. Co. v. Country Villa Service Corp.* (C.D.Cal. Jul. 9, 2015, No. 2:14-cv-03779-RSWL-AS) 2015 WL 4163008 at *16; accord *Shasta Linen* at pp. 67-68.
[159] *Shasta Linen, supra,* at pp. 23-24, 61-62.
[160] *American Zurich Ins. Co. v. Country Villa Service Corp., supra*, at *17; *Shasta Linen, supra*, at p. 68.
[161] *American Zurich Ins. Co. v. Country Villa Service Corp., supra*, at *17; *Shasta Linen, supra,* at p. 68.

Respondents nevertheless argue under *Medina v. Safe-Guard Products*[162] that the RPA should be enforced because Appellants suffered no harm or loss due to its unfiled rates.[163] But Respondents' reliance on *Medina* is misplaced. There, the statute specifically required the plaintiff to have "'suffered injury in fact and ha[ve] lost money or property'" in order to make out a claim.[164] In contrast, Insurance Code section 11737, subdivision (f) requires no such injury or loss. Indeed, the court in *South Tahoe Gas* found an unfiled rate unenforceable even though the buyer apparently suffered no harm from the rate's unfiled status.[165]

Accordingly, the illegal RPA should not be enforced.

b. The Insurance Code Permits Finding the RPA Void

The Insurance Code does not prevent the Commissioner from finding illegal insurance contracts void, nor is there any indication the Legislature intended such. While section 11737, subdivision (a) authorizes the Commissioner to bring separate proceedings to disapprove unfiled rates, rate disapproval complements, rather than precludes, remedies in private party appeals. As discussed above, disapproval proceedings to prevent the use of unfiled rates should the Commissioner promptly learn of the illegal activity. The fact that the Legislature granted the Commissioner such enforcement authority in no way suggests it intended to leave aggrieved parties without a remedy where the Commissioner fails to bring disapproval proceedings because, for example, he was not informed of the unlawful activity in time or lacks the necessary resources. To the contrary, "wise public policy" best discourages the unlawful use of unfiled rates where the Commissioner has authority to forestall it through the disapproval process and to provide aggrieved parties meaningful recourse after the fact. The Legislature implemented this

[162] *Medina v. Safe-Guard Products* (2008) 164 Cal.App.4th 105, 115 (*Medina*).
[163] Resp. Post-Hearing Br. at pp. 26-27.
[164] *Medina, supra,* at p. 115.
[165] *South Tahoe Gas Co. v. Hofmann Land Investment Co., supra,* 25 Cal.App.3d at p. 755.

policy by including both the rate disapproval process and the separate private appeal process in Section 11737.

c. The RPA Must Be Severed from the Guaranteed Cost Policies

Given that the RPA is void and unenforceable, we turn to the question of whether to sever the RPA and enforce the guaranteed cost policies, or whether instead to find the parties' entire contractual arrangement void. The Commissioner finds the RPA must be severed from the guaranteed cost policies.

While the main purpose of the RPA was illegal— i.e., to use unfiled rate information to modify and misapply Respondents' filed rates—the central purpose of the parties' overall arrangement was valid; to provide Appellant with workers' compensation insurance. The RPA, with its focus on unlawful rates and supplementary rate information, was collateral to that central purpose. Additionally, there has been no allegation in this appeal that any portion of the guaranteed cost policies is unlawful. Moreover, "the interest of justice or the policy of the law would be furthered"[166] by enforcing the guaranteed cost policies. Finding the entire arrangement void, including the policies, would leave Appellants uninsured for the period in question. That would be neither lawful, since the law requires Appellants to have workers' compensation insurance, nor would it be in the best interest of the workers left without coverage for any injuries occurring during that period. Accordingly, the RPA is severable from the guaranteed cost policies.

V. Respondents Received Due Process and a Fair Hearing

Respondents argue their due process rights were impinged when the ALJ denied the discovery of documents and the presentation of certain witnesses, and precluded Respondents

[166] *Baeza v. Superior Court, supra,* 201 Cal.App.4th at p. 1230.

from litigating facts and conclusions decided in *Shasta Linen*.[167] These arguments are without merit.

A. Discovery Limits Did Not Deprive Respondents of Due Process

As required by California Code of Regulations, title 10, section 2509.59, Respondents requested permission to conduct formal discovery of certain documents. As discussed in the CALJ's February 7, 2018 Order Denying Respondent CIC's Request for Discovery, the request was denied because the requested documents would have been irrelevant and cumulative.

Respondents rely on *Petrus v. Department of Motor Vehicles*[168] to argue that they were improperly denied a right to discovery.[169] However, *Petrus* involved a hearing under the formal hearing procedures of Chapter 5 of the California Administrative Procedures Act (the "APA").[170] In contrast, this appeal is conducted in accordance with the informal procedures of APA Chapter 4.5.[171] Unlike Chapter 5,[172] there is no general right to formal discovery under Chapter 4.5. Nor is such a right specified in Insurance Code section 11737, subdivision (f), or its implementing regulations. Instead, Regulations section 2509.59 provides: "Formal discovery by the parties will be permitted by the hearing officer only upon written notice and a showing of good cause." As discussed in the February 7, 2018, Order Denying Respondent CIC's Request for Discovery, Respondents failed to demonstrate good cause.

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[167] Resp. Post-Hearing Br. pp. 15-19.
[168] *Petrus v. Department of Motor Vehicles* (2011) 194 Cal.App.4th 1240, 1242-1245 (*Petrus*).
[169] Resp. Post-Hearing Br. at p. 18:3-20.
[170] *Petrus* at p. 1244 [License suspension hearing was conducted pursuant to Vehicle Code section 14112, which invokes APA chapter 5.].
[171] Cal. Code Regs., tit. 10, § 2509.57.
[172] See Gov. Code, § 11507.6.

Respondents' contention that CIC was not "apprised of the documents and witnesses that would be used against it at the hearing" is simply false.[173] Appellants' pre-filed hearing exhibits, exhibit list, and witness list were served on or before March 5, 2018, as evidenced by the proofs of service attached to those documents. The evidentiary hearing was conducted several weeks later on March 26, 2018. At the hearing, Appellants called only the witness identified on their witness list. And they introduced no documentary evidence other than the pre-filed exhibits. Respondents thus had ample opportunity to review the evidence that would be used at the hearing.

In addition, Respondents argue that in limiting discovery into facts, such as those surrounding Appellant's decision to enter into the program and Appellant's sophistication and knowledge of the program, Respondents contend they were denied any opportunity to obtain information relating to the issue of enforceability.[174] This argument is not persuasive because Respondents deposed Appellant's only witness,[175] testimony regarding such facts were fully heard during extensive direct and cross-examination at the hearing, and Respondents declined to call their Director of Client Operations, Travis Koch.[176] Furthermore, factors related to enforceability of an unlawful and void agreement are not informed by additional evidence.[177] The documents speak for themselves.[178] Accordingly, the ALJ finds this Court properly limited unnecessary discovery.

[173] Resp. Post-Hearing Br. at p. 18:21-26.
[174] Resp. Post-Hearing Br. at pp. 17:15-18.
[175] App. Post Hearing Reply Brief, dated May 25, 2018 at p. 6:7-12.
[176] Tr. at p. 3.
[177] Respondents have not shown good cause for additional evidence pursuant to California Code of Regulations, title 10, sections 2509.66, subdivision (b).
[178] Tr. at p. 8:12-14.

B. Witness Limitations Did Not Deprive Respondents of Due Process

In accordance with the regulations governing this appeal,[179] the ALJ required the parties to pre-file witness lists identifying all witnesses scheduled to testify at the evidentiary hearing. Respondents identified lay witnesses Travis Koch (Director of Client Operations) and Ellen Gardiner and proposed experts Gary Osborne and William Hagar. Appellants objected to Ms. Gardiner, Mr. Osborne and Mr. Hagar on the grounds that their testimony was irrelevant and precluded by the decision and order in *Shasta Linen*. At the hearing, Appellant's witness testified extensively regarding its account and experience and Respondents declined to call Mr. Koch despite identifying him as a witness.

Appellant's contention was correct. Most of the proposed testimony from Ms. Gardiner, Mr. Osbourne, and Mr. Hagar concerned issues decided in *Shasta Linen*. Respondents were estopped from rearguing these facts. In addition, Respondents elicited extensive expert witness testimony in *Shasta Linen*. Consequently, testimony regarding similar information from Ms. Gardiner would have been cumulative and it is within the ALJ's authority to limit pursuant to California Code of Regulations, title 10, section 2509.40 et seq. Accordingly, The ALJ permitted Mr. Koch as a witness and sustained objections to the other three witnesses in the Order Excluding Witnesses dated March 15, 2018.

Respondents argue they were deprived the right to present testimony from their two experts regarding issues related to the nature of the EquityComp program unspecific to Appellant. However, Respondents fail to mention that its experts testified extensively in *Shasta Linen* regarding such matters.

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[179] California Code of Regulations, title 10, sections 2509.40 et seq.

Respondents reliance on *Sinaiko v. Superior Court* (2004) 122 Cal. App. 4th 1133 is also misplaced. Respondents cite *Sinaiko* for the general proposition that denying a party the right to present a witness is denial of a fair hearing. This case is not analogous because the need for expert testimony in a medical licensing case is different than the need for expert testimony in an insurance matter that revolves around the interpretation of documents. Moreover, the record in this case already includes extensive expert testimony from *Shasta Linen*. Accordingly, the ALJ finds this Court properly limited witnesses within the authority granted by state law and regulations promulgated for these proceedings.

C. Respondents May Not Relitigate *Shasta Linen's* Findings and Conclusions

Respondents contend they may reargue various issues decided in *Shasta Linen*.[180] That is incorrect. As discussed at length in the Notice Regarding the Preclusive Effect of the *Shasta Linen* Decision ("Preclusive Effect Notice"),[181] Respondents are precluded from further litigating those issues by the doctrines of collateral estoppel and failure to exhaust judicial remedies.

After the Preclusive Effect Notice was issued, Respondents raised new arguments on this issue. Specifically, Respondents assert that the Settlement Agreement terminating the *Shasta Linen* judicial review nullified the finality of the *Shasta Linen* decision for collateral estoppel purposes.[182] Additionally, Respondents contend the *Shasta Linen* decision is inconsistent with other determinations on the same issues.[183] For the reasons discussed below, those arguments are unpersuasive.

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[180] Respondents' Evidentiary Hearing Offer of Proof, filed March 6, 2018 ("Resp. Offer of Proof"), at pp. 8:4-13:22.
[181] Order Taking Official Notice; Notice Regarding Preclusive Effect of the Shasta Linen Decision, dated December 1, 2017.
[182] Resp. Offer of Proof at pp. 8:6-9:4.
[183] Resp. Post-Hearing Br. at p. 14:4-11.

1. The Settlement Agreement Did Not Undo Shasta Linen's Finality

Respondents argue under *Sandoval v. Superior Court*,[184] that the Settlement Agreement divested Shasta Linen of its finality.[185] That is incorrect.

Sandoval was the second of two product liability suits against a manufacturer of a cotton picking machine. In the earlier suit, the injured plaintiff obtained a verdict and judgment in the trial court, and the parties settled during the pendency of the defendant's appeal. Their agreement provided the settlement was not to be construed as an admission of liability, and dismissed the action. In a second action by a different plaintiff, the trial court denied the plaintiff's motion for partial summary judgment as to liability on the ground that the prior litigation was never final. On appeal, the Court of Appeal held that the liability determination was final for issue preclusion purposes. As the court said:

> We see nothing in the dismissal with prejudice concept that forecloses a finding of finality sufficient to preclude relitigation of the issues decided against defendant. This is particularly true when the agreement to dismiss with prejudice is part of a substantial settlement in plaintiff's favor after a final judgment in the trial court.[186]

The court found the settlement agreement favored the plaintiff because it included significant concessions from the defendant, such as an agreement to pay a large portion of the judgment. Nor was the court persuaded by the defendant's non-admission clause. The "facade of continued non-liability by the use of stereotyped language in the settlement agreement does not alter" who prevailed in the lawsuit.[187]

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[184] *Sandoval v. Superior Court* (1983) 140 Cal.App.3d 932, 936-937.
[185] Resp. Offer of Proof at pp. 8:4-9:4.
[186] *Sandoval v. Superior Court, supra*, 140 Cal.App.3d at p. 939.
[187] *Id.* at p. 940.

Similarly here, the Settlement Agreement contains numerous concessions by Respondents in CDI's favor, notwithstanding its boilerplate disclaimer of liability. Among those concessions are that *Shasta Linen* would remain precedential, that the RPA would be modified and filed in accordance with the CDI's instructions, and that any future RPA modifications require the CDI approval prior to use. The mandated filings resulting from the Settlement Agreement also set forth minimum eligibility requirements (which neither Appellant met), and require Respondents to make specific disclosures to prospective insureds about EquityComp. Prospective insureds must sign such disclosures acknowledging their understanding of EquityComp and the RPA.[188] Such concessions demonstrate the Settlement Agreement substantially favors the CDI, and thus the finality for collateral estoppel is met.

2. Shasta Linen is Not Inconsistent with Another Determination on the Same Issue

Respondents argue collateral estoppel cannot apply to the Commissioner's determination that the RPA misapplied CIC's Insurance Code section 11735 filings since a federal district court issued orders disagreeing with the Commissioner's determination.[189] This argument is not persuasive.

The Restatement Second of Judgments, section 29 states that where the determination relied upon as preclusive was itself inconsistent with another determination of the same issue, collateral estoppel may be unwarranted. Several courts, including the *Sandoval* court, follow the Restatement approach and decline to apply collateral estoppel where an inconsistent judgment or verdict exists.[190] But a review of California case law uncovered no instances where a court

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[188] Order Taking Official Notice, dated December 1, 2017 of Settlement Agreement, executed June 2017, at p. 2, § 3.
[189] Resp. Offer of Proof at pp. 12:24-13:22.
[190] See *id.* at p. 944; *Bravo-Fernandez v. United States* (2016) 580 U.S. __ [137 S.Ct. 352, 358]; *Robi v. Five Platters Inc.* (9th Cir. 1988) 838 F.2d 318, 320.

declined to apply collateral estoppel on the basis of an inconsistent interlocutory order. Here, the inconsistent determinations are federal district court interlocutory orders that cursorily address whether unfiled rates are per se unlawful.[191] The orders undertake minimal statutory analysis and do not discuss the broader regulatory framework or relevant case law. As such, they do not rise to the level of an "inconsistent determination" that prevents the application of collateral estoppel to any the Commissioner's *Shasta Linen* determinations.

Conclusions of Law

Based on the foregoing facts and analysis, the Commissioner makes the following legal conclusions:

1. Pursuant to Insurance Code section 11737, subdivision (f), the Commissioner has exclusive jurisdiction to adjudicate Appellants' claim that Respondent misapplied their Insurance Code section 11735 filings.

2. Respondents' RPA contained rates and supplementary rate information that must be filed pursuant to Insurance Code section 11735. Respondents violated section 11735 by failing to file the RPA's rates and supplementary rate information.

3. Respondents misapplied their Insurance Code section 11735 filings by overriding their filed rates with the RPA's unfiled rates and unfiled supplementary rate information.

4. Because the RPA applied unfiled rates and supplementary rate information, contravening Insurance Code section 11735, the RPA is illegal and void. The RPA cannot be reformed and no compelling reason exists to enforce it. Accordingly, the RPA must be severed from the guaranteed cost policies.

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[191] See *Shasta Linen Supply, Inc. v. Applied Underwriters, Inc., supra*, 2016 WL 3407797 at p. *4, 2016 WL 6094446 at pp. *3-*6.

ORDER

IT IS ORDERED:

To the extent Appellants have remitted to any of Respondents funds in excess of the total amount that may be validly charged under Appellants' guaranteed cost policies, CIC shall refund the excess to Appellants within 30 days of the date of this Decision.

Dated: January 4, 2019

DAVE JONES
Insurance Commissioner