SUPERIOR COURT OF CALIFORNIA

COUNTY OF SAN MATEO

INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA, Applicant, v. CALIFORNIA INSURANCE COMPANY, a California corporation, Respondent.	**Case No. 19-CIV-06531** **FINAL STATEMENT OF DECISION AND ORDER AFTER HEARING 8-23-23** Dept. 3 Judge: Hon. Susan L. Greenberg

FINAL STATEMENT OF DECISION AND ORDER APPROVING PROPOSED REHABILITATION PLAN

The following constitutes the Court's Final Statement of Decision and Order After Hearing August 23, 2023. The Court has read and considered the Respondent California Insurance Company's General and Specific Objections to Proposed Statement of Decision and Tentative Order After Hearing August 23, 2023, which was filed March 26, 2024.

INTRODUCTION AND OVERVIEW OF REHABILITATION PLAN

On November 4, 2019, this Court granted the Verified Ex Parte Application of the Insurance Commissioner ("Commissioner" or "Conservator" or "Applicant")[1] under Insurance Code section 1011, subdivision (c),[2] for an Order Appointing Insurance Commissioner as Conservator and Restraining Order ("Conservation Application") placing Respondent California Insurance Company ("CIC")[3] in conservatorship ("Conservation Order"). The Conservation Application alleged that CIC was "in the midst of an attempt to merge with a newly formed New Mexico entity, thereby transferring control of CIC without obtaining the Commissioner's approval as required by law." (Conservation Appl. ¶ 4, citing § 1215.2.) California law would automatically revoke CIC's certificate of authority to transact insurance business upon consummation of this unapproved merger, as the New Mexico entity, a "nonadmitted insurer," could not transact insurance business in California. (Conservation Appl. ¶ 11, citing §§ 700, 701, 1760.1.)

In his Conservation Application, the Commissioner explained that "if CIC is permitted to consummate the illegal merger, CIC policyholders in California will be left holding policies of a non-admitted insurer. Since CIC could not legally service those policies, ***policyholders, including employees with serious work-related injuries and other claimants entitled to vital and necessary insurance***

[1] The Insurance Commissioner and the Conservator are the same state official. For clarity, the Court shall refer to him solely as the Commissioner, the parties' briefing shall retain original references to the Commissioner as Conservator or Applicant.

[2] All subsequent statutory citations are to the Insurance Code unless otherwise indicated.

[3] The Court shall solely refer to California Insurance Commission as CIC. However, the parties' briefing shall retain original references to CIC as Respondent.

benefits, may not have recourse to benefits." (*Id.* at 4, ¶ 11 [emphasis added].) The Commissioner emphasized that, prior to the unlawful merger attempt, "CIC had established a pattern of flouting regulatory processes designed to protect California policyholders from unfair and deceptive practices," citing CIC's illegal modifications to insurance policies. (*Id.* at 5-6, ¶ 17.)

The Court now considers the Commissioner's Application for Order Approving Rehabilitation Plan ("Plan Application"), setting out the terms under which the conservatorship would be concluded. The Commissioner describes the proposed Rehabilitation Plan as "designed to . . . complete CIC's exit from the state on terms that protect the Company, policyholders, and the public." (Plan Appl., p. 19.) To achieve that goal, he explains, the Plan

> has been structured around an Assumption Reinsurance and Administration Agreement ("Reinsurance Agreement") under which an admitted insurer authorized to write workers' compensation insurance in California will assume CIC's in-force California policies and reinsure the liabilities under expired CIC California policies. CIC will then be permitted to merge with its out-of-state affiliate, CIC II, and will surrender its certificate of authority to write insurance in California without diminishing the rights of policyholders.

(*Ibid.*)

CIC opposes approval of the Rehabilitation Plan on several grounds. First, CIC objects to Plan § 2.6, which incorporates Schedule 2.6. This section concerns litigation arising out of an illegal modification to CIC's insurance policies. (See Background and Part II, *infra*.) Under the Plan, policyholders engaged in such litigation will be offered an opportunity to settle their claims and associated litigation by electing a remedy amoung the choices outlined. Second, CIC objects to Plan § 2.2, which outlines a public bid solicitation procedure for CIC's reinsurer in California. CIC opposes the public bid process on the grounds that its affiliate, Continental Indemnity Company ("Continental") should have a right of first refusal to reinsure or purchase its California business. Finally, CIC opposes the Rehabilitation Plan's inclusion of Connecticut and New York policyholders pursuant to requests filed by the Connecticut Insurance Department and the New York State Department of Financial Services in November 2022.

The Court held two hearings on the Plan Application, on July 25, 2023 and August 23, 2023. The Court has considered all arguments made by all counsel during the hearing. The Court has also considered the pleadings filed in this matter, as well as a number of email briefs sent to the Court and

all parties, filed and sent both prior to and after the August 23, 2023 hearing. These email briefs include but are not limited to the following:

Applicant's Proposed Order Approving Proposed Rehabilitation Plan (received October 16, 2023);

Respondent's Redline Opposition to Conservator's Proposed Order Approving Proposed Rehabilitation Plan (received December 12, 2023);

Respondent's Proposed Order Approving Proposed Rehabilitation Plan Without Sections 2.6 and 2.2 Which Are Not Approved (received December 12, 2023);

Declaration of Shand S. Stephens In Support of Respondent California Insurance Company, Inc.'s Rehabilitation Plan Proposed Order (received December 12, 2023);

Respondent California Insurance Company's Redline Opposition to Conservator's Proposed Order Approving Proposed Rehabilitation Plan (filed December 12, 2023);

Email letter brief from attorney Eric K. Larson (dated August 25, 2023);

Email letter brief from attorney Cynthia J. Larsen (dated September 1, 2023);

Email letter brief from attorney Shand S. Stephens (dated September 1, 2023);

Email letter brief from attorney Shand S. Stephens (dated September 5, 2023);

Email letter brief from attorney Cynthia J. Larsen (dated September 6, 2023), with attachments thereto;

Email letter brief from attorney Shand S. Stephens (dated September 6, 2023);

Email letter brief from attorney Phil Walker (dated September 19, 2023), with attachments thereto, and with Proposed Inclusion in Draft Order;

Email from attorney Cynthia J. Larsen with a redlined version of the Revised Rehabilitation Plan to the draft Proposed Order containing post-hearing revisions (dated October 18, 2023).

Redlined version of the Revised Rehabilitation Plan to the draft Proposed Order containing post-hearing revisions (filed October 16, 2023).

Because the final briefing was filed and received by this Court on December 12, 2023, this matter was under submission to this Court as of December 12, 2023.

After a full review of the pleadings and email letter briefs and consideration of oral argument,

the Court adopts its tentative ruling approving the Plan Application. The Court APPROVES the Insurance Commissioner of the State of California's California Insurance Company Rehabilitation Plan as filed with this Court on October 16, 2023 (attached hereto as Exhibit A), for the reasons enumerated below.

BACKGROUND

As the litigation addressed by Plan § 2.6 predates CIC's conservatorship, the Court first explores the context surrounding those cases. CIC and its affiliates formerly marketed workers' compensation insurance under a program which they called "EquityComp." Workers' compensation insurance policies under EquityComp featured two components: (1) a standard "guaranteed-cost" policy that had been filed with the Commissioner as required by law, and (2) a "Reinsurance Participation Agreement" (RPA) that was not filed with or approved by the Commissioner and altered certain terms of the guaranteed-cost policy, including its pricing. (Ins. Code §§ 11658, 11735 [policy filing requirements]; Holloway Plan App. Decl.[4] ¶ 14.)[5] In 2014, Shasta Linen Supply, Inc., which held a CIC guaranteed-cost policy and an accompanying RPA, filed an appeal with the Commissioner challenging CIC's use of the RPA. An administrative law judge conducted an adjudicatory hearing and concluded that "CIC's EquityComp program and the accompanying RPA constitute a misapplication of the filed rates of CIC in violation of California Insurance Code section 11737" and that "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." (*Matter of Shasta Linen Supply, Inc.* (June 22, 2016) Cal. Ins. Comm'r, No.

[4] Joe Holloway is Deputy Insurance Commissioner, the Chief Executive Officer of CDI's [California Department of Insurance] Conservation and Liquidation Office, and Conservation Manager for CIC in conservation. (Holloway Plan App. Decl., ¶ 2.)

[5] Citations to the parties' filings in support of and opposition to the Plan Application are referenced as follows: Exhibits, declarations, and requests for judicial notice filed by the Conservator in support of the October 19, 2020, Plan Application are designated by "Plan Appl.," as in "Holloway Plan Appl. Decl." Exhibits, declarations, and requests for judicial notice filed by CIC with its November 10, 2022, Opposition to Conservator's Application for Approval of Rehabilitation Plan are designated by "Opp.," as in "Silver Opp. Decl." Similarly, filings accompanying the Conservator's February 10, 2023, Reply to Respondents Opposition to Application for Approval of Rehabilitation Plan are designated by "Reply"; filings accompanying CIC's February 16, 2023, Sur-Reply to the Conservator's Reply are designated by "Sur-Opp."; and the Commissioner's Reply to Respondent's Sur-Reply is designated as "Reply to Sur-Opp."

AHB-WCA-14-31 (*Shasta Linen*).) The Commissioner adopted the *Shasta Linen* decision and designated it a precedential decision, permitting its citation as authority in subsequent Department of Insurance ("Department") hearings. [6] (*Id.* at 70 [citing Gov. Code, § 11425.60, subd. (b)]; see also Settlement Agreement between the California Department of Insurance, California Insurance Company and *Applied Underwriters Captive Risk Assurance Company, Inc.*, dated June 7, 2017 ("Shasta Linen Settlement Agreement"), Reply Compendium, Exh. 5 at 2 [CIC agrees to precedential effect of *Shasta Linen* decision].)

Shasta Linen expressly did not address the equitable remedies available to policyholders in a court of law. (*Id.* at 68 ["Any additional remedies to which Shasta Linen is entitled based upon CIC's conduct are outside the scope of this proceeding."].)[7] Numerous cases have since been filed by policyholders or by CIC and its affiliates, which are collectively known as the "RPA litigation."

With this context, the Court turns to the facts of this case in greater detail.

A. CIC and Its Affiliates

CIC is a property and casualty insurance company that holds a certificate of authority issued by the Commissioner authorizing it to transact workers' compensation business in the State of California. (Holloway Plan Appl. Decl., ¶ 5; see generally Ins. Code §§ 700, 701, 717 [outlining certificate of authority requirement and issuance criteria].) CIC is a subsidiary of North American Casualty Company ("NACC"), which in turn is owned by AU Holding Company ("AU Holding"). Stephen M. Menzies is the founder, president, and sole shareholder of AU Holding. (Holloway Plan Appl. Decl. ¶ 5.) CIC marketed the RPA principally through its affiliate Applied Underwriters Inc. ("AUI"). Another affiliate, Applied Underwriters Captive Reinsurance Assurance Company ("AUCRA"), is an admitted insurer who serves as the purported "reinsurer" under the RPA. (*Shasta Linen*, *supra,* at 10-11.)

In *Shasta Linen*, the Commissioner found that CIC, AUI, and AUCRA were a joint enterprise

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[6] The Court shall refer to the California Department of Insurance solely as the Department. Evidence referencing the Department as "CDI" shall retain the original nomenclature.

[7] The Supreme Court has confirmed that where the Insurance Commissioner has jurisdiction to adjudicate disputes over charged rates, "administrative proceedings are not a ratepayer's exclusive remedy for the charging of an unfiled rate." (*Villanueva v. Fidelity National Title Co.* (2021) 11 Cal.5th 104, 126.)

rather than separate entities. (*Shasta Linen, supra,* at 49.) Two California Courts of Appeal have made similar findings. (*Nielsen Contracting, Inc. v. AUI* (2018) 22 Cal.App.5th 1096, 1116-1117 (*Nielsen*) [record on appeal supported conclusion that affiliated entities should be considered as one because they were "so enmeshed" and "intertwined"]; *Luxor Cabs, Inc. v. AUCRA* (2018) 30 Cal.App.5th 970, 985-986 (*Luxor Cabs*) [same].) As evidence of a joint enterprise, the Commissioner noted that AUI generated the marketing material for the EquityComp program and that AUCRA executed the RPA as a "profit-sharing" plan to override critical terms of the CIC-provided guaranteed-cost policy. (*Shasta Linen, supra,* at 26-31.)

The pertinent evidence in this case supports the Commissioner's conclusion in *Shasta Linen*. CIC and the affiliates worked collectively under shared management to implement the EquityComp program, and the companies continue to work in tandem. Under the Management Services Agreement between CIC and AUI, AUI comprehensively manages CIC's affairs by: (1) providing actuarial and claims services in connection with CIC's policies; (2) providing underwriting services; (3) paying CIC's bills and collecting its receivables; (4) managing CIC's investments; and (5) performing accounting services, including filing CIC's required financial statements and tax returns. (Holloway Plan Appl. Decl. ¶ 12, Exhs. B, C.) AUI provides CIC "necessary and appropriate personnel, administrative, office and building services." (*Id.*, Exh. B at 3.) CIC directs and supervises AUI under the terms of the Management Services Agreement. (Holloway Plan Appl. Decl. Exh. B at 1.) As of the filing of the Plan Application, the Nebraska Secretary of State's website listed Menzies, the indirect owner of CIC, and Jeffrey Silver, CIC's Secretary and General Counsel, as the only directors of AUI. (Holloway Plan Appl. Decl. ¶ 11.)

B. The Guaranteed-Cost Policy and the Reinsurance Participation Agreement

Employers usually purchase workers' compensation insurance as a guaranteed-cost policy under which the policyholder pays a fixed premium and the insurer reimburses all covered workers' compensation losses. In loss-sensitive policies, on the other hand, the employer's premium for the policy year depends on the insured's actual cost of claims. (Muzzarelli Plan Appl. Decl. ¶ 12.)[8] As the Commissioner explained in *Shasta Linen*:

[8] Giovanni Muzzarelli is a Senior Casualty Actuary at the Department.

> By definition, loss sensitive plans are 'profit-sharing.' Generally, carriers market loss sensitive programs exclusively to large employers. 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. … Loss sensitive programs are issued as endorsements to guaranteed cost policies and require the Insurance Commissioner's approval.

(*Id.* at 15-16.) The EquityComp RPA was a loss-sensitive program, sold without the Commissioner's approval in conjunction with the CIC guaranteed-cost policy.

CIC, AUI, and AUCRA intentionally failed to seek the Commissioner's approval for the RPA. Indeed, they patented the RPA as a vehicle to avoid insurance regulation, and touted the program's freedom from state regulatory constraints in the patent application. (*Shasta Linen, supra,* at 24.) The Commissioner found that AUI "structured EquityComp and the RPA to circumvent state regulators." (*Id.* at 50.) As the court of appeal subsequently explained in *Luxor Cabs*, *supra,* 30 Cal.App.5th at 986:

> Obviously, allowing an insurer to circumvent the comprehensive regulatory structure applicable to the issuance of workers' compensation insurance in this state simply by amending its approved policy forms through a side agreement with a subsidiary is contrary to the public policy underlying California's workers' compensation law and cannot be countenanced.

(See also *Nielsen Contracting*, *supra,* 22 Cal.App.5th at 1118 [finding that failure to file the RPA "prevent[ed] crucial regulatory oversight and thus render[ed] the unfiled agreement unlawful and void as a matter of law"]; accord *Minnieland Private Day School, Inc. v. Applied Underwriters Captive Risk Assurance Company, Inc.* (4th Cir. 2019) 913 F.3d 409, 423.) The design of the EquityComp program attracted attention nationally. Regulators in Wisconsin, Vermont, New Jersey, and New York each took steps to stop sale of policies involving RPAs. Some cited CIC and its affiliates for violating prior orders to halt such sales and imposed penalties of up to $3 million. (Holloway Plan Appl. Decl. ¶¶ 18.a-d.)

The Commissioner found that the EquityComp RPAs departed in material ways from industry-standard loss-sensitive programs, as the RPAs employed nonstandard terminology[9] and gave CIC "sole discretion" to determine several variables upon which policyholders' charges were based. (*Shasta Linen, supra,* at 22-23 ["non-linear retrospective plan" resulted in "'fundamentally new premium structure'"]; 29-31 ["loss pick containment" formula for fees created astronomical fees on low-loss policies]; 31-32 [unusual three-year term, with severe penalties for early cancellation or non-renewal]; 32, 56 [choice-

[9] The name "Reinsurance Participation Agreement" is itself a misnomer. CIC conceded in *Shasta Linen* that the RPA was not in fact a reinsurance agreement. (*Shasta Linen, supra,* at 25.)

of-law and dispute resolution procedures superseded guaranteed-cost policy provisions and required application of Nebraska law and binding arbitration in the British Virgin Islands]; 33-34 [run-off loss development factors," created valuation method "not used by other carriers"]; 34-35 [close-out distribution precluding return of amounts due policyholders for up to seven years after policy expiration at CIC's "sole discretion"].)

Moreover, policyholders that executed the RPA were unlikely to be fully aware of its terms. CIC and its affiliates withheld copies of prospective policyholders' RPAs under after policyholders had paid to enroll in the EquityComp program. At that point, refusal to sign the RPA would have resulted in cancellation of their workers' compensation coverage. (*Shasta Linen*, *supra,* at 25, 27-28; Lichtenegger Plan Appl. Decl. ¶¶ 26, 32.[10]) The RPA that policyholders signed differed materially from the representations made in the marketing materials, including as to cost of coverage. (*Id.* at 27 [Program Summary & Scenario document provided to potential policyholders included a "single-year table [that] does not represent the one-year cost of the program."].)

Obfuscation of the RPA became particularly problematic because the agreement employed undefined and non-standard terms when describing how to calculate premiums, deposits, or other payments due. It thus became virtually impossible for policyholders to calculate their monthly premiums, budget for workers' compensation insurance, or verify charges based on the RPA. (*Shasta Linen, supra,* at 29-30; Lichtenegger Plan Appl. Decl. ¶¶ 15, 20, 28-29.) The lack of transparency in billing especially concerned the Commissioner in light of the potential for billing errors; indeed, AUI ultimately conceded that Shasta Linen's bill included such billing errors. (*Shasta Linen* at 38.) Policyholders who sought assistance regarding billing errors were often stonewalled by company representatives, who claimed that billing calculation methodology was proprietary. (Lichtenegger Plan Appl. Decl. ¶¶ 20, 29.) This forced policyholders to either pay the monthly bill or face cancellation of their workers' compensation insurance. (See *id.* at ¶¶ 6, 29-30, 47.) Policyholders that were unable to pay despite the lack of transparency in monthly billing often had no choice but to execute promissory notes extended by AUI to spread out payments. (See *Shasta Linen* at 38; Lichtenegger Plan Appl. Decl.

[10] Larry Lichtenegger is a California attorney who has represented fifty-one business clients in actions against AUI, AUCRA, and CIC.

¶¶ 6, 47.)

The RPA also incentivized CIC, AUI, and AUCRA to settle claims related to employee injuries for more money than they should have been paid according to industry practices and to over-reserve case funds at policyholders' expense.[11] (Muzzarelli Plan Appl. Decl., ¶¶ 19, 29, 42 .) CIC has not disputed Muzzarelli's explanation of the financial incentives created by the RPA, and evidence suggests that CIC and its affiliates have yielded to those incentives by keeping claims open to reap investment income on policyholder funds. (Lichtenegger Plan Appl. Decl. ¶¶ 43, 56-57.) Policyholders have also reported that CIC failed to pursue subrogation when requested or investigate employees' claims of injury. (Lichtenegger Plan Appl. Decl. ¶¶ 55, 58, 62; *Shasta Linen, supra,* at 38 [AUI's inaction regarding request to investigate potential fraud cost policyholder over $100,000.]) Then, the RPA penalized dissatisfied EquityComp policyholders by applying much higher loss development factors (LDFs) to the claims of employers that chose not to renew their policies after the three-year active term, essentially penalizing them for non-renewal. (*Shasta Linen* at 58.) The Commissioner considered such a penalty akin to restricting payment of a policyholder dividend due to the policyholder's failure to renew a policy, which is considered a "coercive and illegal … unfair practice." (*Id.* at 58.)

This scheme frustrated policyholders' profit-sharing expectations. In *Shasta Linen*, the ALJ twice ordered CIC to provide the number of participants that had received profit-sharing distribution, but CIC refused to comply, leading the ALJ to draw the adverse inference that there never had been any profit-sharing distributions. (*Shasta Linen, supra,* at 35.) CIC has not disputed that inference in this Court.

C. The RPA Litigation

As CIC's Conservator, the Commissioner has reviewed all EquityComp RPA litigation and has identified three categories of cases. (Holloway Plan Appl. Decl. ¶ 15; Larsen Reply Decl.[12], ¶¶ 10-41.) The first category involves policyholder-initiated lawsuits, arbitrations, and appeals initiated in the Department's Administrative Hearing Bureau. These policyholders allege the RPA's illegality and seek

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[11] Over-reserving occurs when an insurer holds more funds in reserve than its estimate of future loss payments related to an individual claim rather than disbursing the excess funds to the policyholder. (See Muzzarelli Reply Decl. ¶ 42.)

[12] Cynthia Larsen is a California attorney and counsel of record for the Conservator.

to cancel their policies, thereby receiving a refund of their excess premium. (Holloway Plan Appl. Decl. ¶ 15; Lichtenegger Plan Appl. Decl. ¶¶ 6, 25; Larsen Reply Decl. ¶ 19.) The Commissioner argues that policyholders have been compelled into litigation to receive their refunds because AUCRA leveraged its discretion under the RPA to retain excess premiums. (Lichtenegger Plan Appl. Decl. ¶¶ 18, 22, 33.) Once policyholders receive awards in their favor, CIC and affiliates then pursue costly and lengthy appeals against those awards. (See Lichtenegger Plan Appl. Decl. ¶¶ 37, 51; Larsen Reply Decl. ¶¶ 17, 19, 23-26, 29.) The second category consists of the cross-complaints which AUCRA has filed in the first category of cases in order to enforce the RPA's terms, despite Court of Appeal precedent that has concluded that the RPA is illegal. (Lichtenegger Plan Appl. Decl. ¶ 6; Larsen Reply Decl. ¶¶ 14-15; see, e.g., *Luxor Cabs, supra,* 30 Cal.App.5th at 986; *Nielsen, supra,* 22 Cal.App.5th at 1118; *Jackpot Harvesting, Inc. v. AUI* (2019) 33 Cal.App.5th 719 (*Jackpot*).) CIC has also filed parallel cross-complaints alongside AUCRA to enforce underlying guaranteed-cost policies in the event that the EquityComp RPA is found unenforceable. (Lichtenegger Plan Appl. Decl. ¶ 6.)

The third category of litigation concerns parallel litigation initiated by AUI in Nebraska to enforce promissory notes signed by policyholders who could not afford the charges imposed by the RPA. (Lichtenegger Plan Appl. Decl. ¶¶ 6, 47, 49; Larsen Reply Decl., ¶¶ 23-27, 37.) Although these cases are almost always dismissed for lack of personal jurisdiction, the Commissioner argues that the threat of costly litigation has deterred policyholders from asserting the illegality of the RPA. (Lichtenegger Plan App. Dec., ¶¶ 46-47; Larsen Reply Dec., ¶ 37.)

D. CIC's Attempted Merger Into a New Mexico Affiliate

The Ninth Circuit has summarized the procedural history of this attempted merger as follows:

> In January 2019, Steven Menzies, as Chief Executive Officer of Applied Underwriters, Inc. and as President of CIC I, entered into an agreement with Berkshire Hathaway to purchase Berkshire's controlling interest in CIC I (the "Agreement"). The Agreement included a $50 million "breakup fee" were the transaction not consummated by September 30, 2019.
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> California Insurance Code § 1215.2(d) requires the California Insurance Commissioner to approve any sale (or merger) of a controlling interest in an admitted California insurer, and further provides the Commissioner with 60 days to approve or disapprove such transactions upon submission of the information concerning the transaction required by § 1215.2(a). These required submissions are known as "Form A" submissions. On April 9, 2019, Menzies, acting on behalf of CIC I, submitted to the California Department of Insurance ("CDI") his first "Form A," which detailed the proposed Agreement and sought official approval. However, upon review, the CDI requested further information concerning the Agreement, requiring Menzies to withdraw the first Form A submission

and to submit a second Form A on June 12, 2019. After this second Form A submission was found unsatisfactory, Menzies submitted his third (and final) Form A submission concerning the Agreement on September 7, 2019.

When it became clear the Agreement would not be approved by the Commissioner in time to avoid the $50 million "breakup fee," Menzies attempted to avoid the California regulatory process altogether by consummating the Agreement without CDI approval. Menzies sought to effect a merger (the "Merger") between CIC I, which he now purported to control, and a newly-formed New Mexico corporation, Appellant California Insurance Company ("CIC II"). This newly formed corporate insurer was not subject to California insurance regulations.

Menzies negotiated a ten-day Agreement deadline extension with Berkshire, at a cost of $10 million. On October 9, 2019, one day before the extended deadline was set to expire, the CDI notified Menzies that if the Merger were to be consummated without the approval of the CDI, "[CIC I] will cease to exist and [CIC II will be] an unlicensed insurer [ ] precluded from transacting the business of insurance in California." The uncertain fate of the Merger notwithstanding, the Agreement between Berkshire and Menzies closed on October 10, 2019, with CIC I becoming wholly owned by Menzies.

On November 4, 2019, before the CIC I/CIC II Merger could be completed, and without notice given to Appellants, the Commissioner filed an ex parte conservation application in the Superior Court of San Mateo which sought "an order appointing him as conservator of [CIC I]." The conservation application was based on the Commissioner's allegation that Menzies had not "filed and obtained written approval of the Commissioner" to consummate the Merger, in violation of California Insurance Code § 1215.2(d).

Also on November 4, 2019, again without any notice to Appellants, the Superior Court granted the Commissioner's conservation application, appointing California Insurance Commissioner Ricardo Lara as the Conservator of CIC I. In justifying lack of notice to Appellants, the Superior Court explicitly found that the Commissioner has ... established good cause to believe that the State of California would be prejudiced were it to provide respondent advanced notice of this proceeding in that [CIC I] has within its authority power to at any time complete the ostensible consummation of the transaction, which would have the effect of at least forfeiting [CIC I's] certificate of authority, rendering California policyholders ostensibly insured by an out-of-state insurer without authority to transact insurance in California.

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CIC I subsequently contested, unsuccessfully, the grounds upon which the conservatorship was instituted. Specifically, on March 12, 2020, CIC I filed an application to vacate the conservatorship with the Superior Court, arguing that: 1) the conservatorship was obtained under false pretenses; 2) the conditions cited for imposing the conservatorship no longer existed; 3) the Commissioner acted arbitrarily, capriciously, and in bad faith; and 4) the conservatorship continues to harm CIC I. After an August 6, 2020 hearing at which CIC I appeared by counsel, the Superior Court denied CIC I's application to vacate the conservatorship on August 11, 2020, for the following reasons:

> Respondents attempted to take [CIC I] and its assets out of California via a merger without adequate protection of policyholders and the public and the Conservatorship was ordered on those grounds. Respondents have failed to demonstrate that the conditions necessitating conservation no longer exist. In light of Respondent's prior conduct, the Conservation Order ensures that Respondents do not again attempt to take [CIC I] and its assets out of California

> ... [and] the Commissioner's preference to pursue a Rehabilitation Plan [for CIC I] is reasonable and sufficient under the circumstances.

Following this denial, CIC I filed an application for interlocutory appellate review with the California Court of Appeal, which was also denied. The record does not demonstrate whether a writ was sought from the California Supreme Court. On October 19, 2020, the Commissioner filed a proposed Rehabilitation Plan ("Rehabilitation Plan") with the Superior Court which articulated the terms he would accept to end the conservatorship of CIC I. CIC I has refused to accept the Commissioner's stated terms, so the conservatorship proceedings remain ongoing.

After CIC I had unsuccessfully challenged the bases of the conservatorship in state court, Appellants Applied and CIC II filed separate actions in federal court, asserting causes of action under 42 U.S.C. § 1983 alleging various constitutional violations ("the federal actions"). Appellants sought, among other forms of relief, orders "declaring the Commissioner's actions, as alleged, violate [Appellants'] rights to due process and equal protection under the Fourteenth Amendment to the United States Constitution." Appellants also sought orders "directing the Commissioner to take all necessary steps to end [CIC I's] conservatorship pursuant to California Insurance Code § 1012, and enjoining the Commissioner from continuing the conservation." The district court dismissed both actions pursuant to Federal Rule of Civil Procedure 12(b)(1), with each order holding that the district court lacked jurisdiction to hear the cases under both the "prior exclusive jurisdiction" rule and the *Younger* abstention doctrine.

(*Applied Underwriters, Inc. v. Lara* (9th Cir. 2022) 37 F.4th 579, 585–587, *cert. denied* (2023) 143 S.Ct. 748 [affirming "the district court's dismissal of the federal actions"].)

Additionally, on October 7, 2019, the Department received a phone message from the New Mexico Superintendent's Office informing them that he was going to hold a hearing on approval of the merger, which he held on October 9, granting a New Mexico Certificate of Authority to CIC II and approving its acquisition of CIC. (*Id.* at ¶¶ 10, 12 & Exh. A.) CIC points out that Department representatives attended the New Mexico hearing telephonically and did not object. (Silver Opp. Decl. ¶¶ 64, 66.) However, the Commissioner explains that under the national system of insurance regulation, whether or not New Mexico wanted to give its approval to CIC II acquiring CIC, California's Commissioner would also need to approve the merger. (Reporter's Transcript of Proceedings (RT), Aug. 23, 2023, 127:13-128:19; § 1215.2.) The merger could not lawfully take place without California's approval of CIC being acquired, irrespective of New Mexico's approval. (*Ibid.*) The Commissioner also points out that on the evening of the October 9 hearing, the Department wrote Silver a letter advising

him that

> if the merger by and between CIC and California Insurance Company II is completed without obtaining the prior approval of the California Insurance Commissioner as required by California Insurance Code Section 1215.2 and 1011(c), the applicant will be in violation of California law. Additionally, once the merger is completed, CIC will cease to exist and California Insurance Company II, as an unlicensed insurer is precluded from transacting the business of insurance in California from and after the effective date of the merger unless and until it becomes admitted in California.

(Letter dated October 9, 2019, from Department attorney Laszlo Komjathy, Jr. to Jeffrey Silver regarding CIC Form A, Opp. Compendium, Ex. 86, p. 2.)

Following the New Mexico action, Menzies proceeded to close the Berkshire Hathaway buyout and the acquisition of CIC and other affiliated companies without approval of the California Form A application. (Holloway Plan Appl. Decl. ¶ 26.) At that point, were CIC to have filed with the California Secretary of State a certificate of merger, the merger of CIC into CIC II would have been completed (Conservation Appl. ¶ 13, citing Corp. Code, § 1108, subd. (d)), and CIC's Certificate of Authority to transact the business of insurance in California would have been revoked by operation of law, in which case "CIC policyholders in California will be left holding policies of a non-admitted insurer. Since CIC could not legally service those policies, policyholders, including employees with serious work-related injuries and other claimants entitled to vital and necessary insurance benefits, may not have recourse to benefits." (Conservation App., ¶ 11.) The Commissioner therefore sought the Conservation Order under Insurance Code section 1011, subdivision (c), which authorizes him to take over the business of an insurer that "has transferred, or attempted to transfer, substantially its entire property or business or, without consent, has entered into any transaction the effect of which is to merge, consolidate, or reinsure substantially its entire property or business in or with the property or business of any other person."

The next day, the Conservation Order was served on CIC through service on Silver as Secretary of CIC at the company's offices in Omaha, Nebraska, preventing consummation of CIC's merger into the New Mexico affiliate and preserving its licensure as holder of a California Certificate of Authority. (Status Report No. 1 to the Court (July 30, 2020) at 2.)

E. Procedural History of the Conservation

Following issuance and service of the Conservation Order, on January 22, 2020, CIC filed a Verified Application to Vacate the November 4, 2019, Order Appointing Insurance Commissioner as

Conservator. That application was denied by the Court following a hearing on August 6, 2020, and an Order to that effect was entered on August 11, 2020. On October 2, 2020, CIC petitioned the First District Court of Appeal for a writ of mandate seeking an order directing this Court to set aside its denial of the verified application to vacate and seeking an interlocutory stay of the conservation proceedings. On October 10, 2020, the Court of Appeal denied the request for a stay and directed the Commissioner to file preliminary opposition to the petition, which the Commissioner filed on November 2, 2020. The Court of Appeal denied CIC's petition on November 25, 2020. (Order Denying Petition, 11/25/2020, *California Insurance Company v. Superior Court for the County of San Mateo* (Ct. App. 1st Dist., Div. 4, No. A161049.)

On July 30, on the motion of the Commissioner, this Court issued its Order Setting Briefing Schedule, Hearing Date, and Procedures for Conservator's Application for Order Approving Rehabilitation Plan (Procedural Order). Pursuant to the Procedural Order, on October 27, 2022, the Commissioner gave written notice of the conservation to policyholders and other interested parties. (Notice to Policyholders, Claimants, Creditors, Shareholders, and All Other Persons or Entities Interested in California Insurance Company in Conservation, 10/27/2020.) The Order set dates for the Commissioner to file his proposed rehabilitation plan, for CIC to file its opposition, and for the Commissioner to file a reply. Those dates were revised several times, generally on stipulation of the parties. On or before January 4, 2021, interested parties filed comments with the Court, as provided by the Order.

In July 2020, CIC served discovery on the Commissioner without seeking leave of Court as required by ¶ 17 of the Conservation Order. On September 15, 2020, the Court granted the Conservator's Motion to Enforce, Motion to Quash, and Motion for a Protective Order on that ground. On March 11, 2021, CIC filed a Motion for Leave to Conduct Discovery, which the Court granted on April 26, 2021.

On October 29, 2020, CIC filed a special motion to strike the Conservation Application (anti-SLAPP motion) pursuant to Code of Civil Procedure section 425.16, to which the Commissioner responded on December 30, 2020, and Respondent filed a reply on January 6, 2021. The Court's Order Denying Anti-SLAPP Motion to Strike was entered on February 26, 2021.

On October 20, 2020, CIC affiliates AUI and ARS filed suit in the United States District Court

for the Eastern District of California against the Commissioner, seeking the federal court to enjoin the Commissioner from continuing the conservation and to end CIC's conservatorship. (*Applied Underwriters, Inc. v. Lara* (E.D. Cal. 2021) 530 F.Supp.3d 914.) A second suit in the same court was brought by CIC II on January 6, 2021, effectively seeking the same relief against this conservation. (*California Insurance Company v. Lara* (E.D. Cal. 2021) 547 F.Supp.3d 908.) Both cases were dismissed by the district court and the Ninth Circuit Court of Appeals affirmed. (*Applied Underwriters, Inc. v. Lara* (9th Cir. 2022) 37 F.4th 579, *cert. denied* (2023) 143 S.Ct. 748.)

Pursuant to the Procedural Order, as revised by Court orders, the Application presently before the Court was timely filed on October 19, 2020. On January 4, 2021, the Court received a Statement in Support of the Plan by BSA Framing, Inc., Moss Management Services, Inc., Platinum Security, Inc., and E.C. Group, Inc.; a Declaration in Support of Approval of the Plan by Ronald A. Groden; and a Notice of Non-Party Papers by CIC and Declaration by Jeffrey Silver attaching letters of opposition to the Plan. CIC's Opposition was timely filed on November 10, 2022, to which the Commissioner timely replied on February 10, 2023. CIC also filed a Request for Leave to File Supplemental Briefing and Proposed Supplemental Briefing on December 19, 2022. Separately, CIC was granted leave to file a Sur-Reply dated February 17, 2023, and the Conservator was granted leave to Reply to CIC's Sur-Reply, which was filed on February 22, 2023.

F. Conduct of CIC's Management During Conservation

Rather than wholly displacing the pre-conservation management, the Commissioner "has permitted CIC personnel to continue to perform day-to-day operations, subject to the oversight of the Conservator and his representatives." (Holloway Plan Appl. Decl. ¶ 7.) The Commissioner has described to the Court several instances in which the CIC management took action that he found to have violated the Conservation Order, including taking steps to initiate the transfer of CIC policies to an affiliate (Holloway Reply Decl. ¶¶ 6-7; December 4, 2020, Cease-and-Desist Letter from Joseph Holloway to Jeffrey Silver (December 2020 Cease-and-Desist Letter), Reply Compendium, Exh. 90) and issuing a $20 million uncollateralized loan to one of its affiliates without authorization from the Court or the Commissioner (Holloway Plan Appl. Decl. ¶ 7). The Commissioner has also advised the Court of issues regarding CIC's audited financial statements following the sudden resignation of the audit, tax, and

consulting firm that served as auditor for a combined independent audit of CIC and its affiliates after indicating it was unable to obtain "'timely and accurate information regarding significant related-party transactions, including information necessary to determine if receivables with related parties are collectible and admissible' and 'continuing with the engagement would have violated [RSM's] client acceptance and retention standards." (Conservator's Status Report Regarding Additional Management Controls (Sept. 30, 2022), at 2-3.)

G. The Requests of the States of New York and Connecticut

The initial proposed Plan, filed in 2020, only addressed the disposition of CIC's California insurance policies and RPA litigation involving California policyholders. However, in 2022, the States of Connecticut and New York wrote to the Commissioner to request that CIC policies held by their residents be included in the assumption reinsurance arrangements of Plan § 2.2. (Conservator's Notice of Submission of Requests by the States of Connecticut and New York for Inclusion of Their Policies in the Rehabilitation Plan, Exhs. A, B.) Both states noted that CIC II is not licensed to transact the business of insurance in their states, placing policyholders and their employees at risk of losing insurance coverage when the Merger is completed.

STANDARD OF REVIEW

As Conservator, the Commissioner has broad authority to conduct CIC's affairs in the interest of the conserved estate, its policyholders, and the public. (Ins. Code §§ 1037, 1043; *State of California v. Altus Finance* (2005) 36 Cal.4th 1284, 1302; *Jones v. Golden Eagle Ins. Corp.* (2011) 201 Cal.App.4th 139, 146.) This authority includes the power to rehabilitate CIC, subject to this Court's approval of a rehabilitation plan. (Ins. Code § 1043.) The Court reviews the proposed Rehabilitation Plan for abuse of discretion, to ensure that the Commissioner exercises the police power of the State in a manner "reasonably related to the public interest" and is not "arbitrary or improperly discriminatory." (*Carpenter v. Pacific Mut. Life Ins. Co. of California* (1937) 10 Cal.2d 307, 331 (*Carpenter*).) A proposed plan is arbitrary if it is "unsupported by a rational basis, [] contrary to specific statute, [involves] a breach of the fiduciary duty of the conservator as trustee, or improperly discriminatory." (*In re Executive Life Ins. Co. v. Aurora Nat. Life Assurance Co.* (1995) 32 Cal.App.4th 344, 358

(*Executive Life*).) This standard requires deference to the Commissioner's "executive judgment" as to his proposed plan of action given the facts at hand. (*Commercial Nat. Bank v. Sup. Ct.* (1993) 14 Cal.App.4th 393, 398.)

The Court notes that in this case, many of the facts cited by the Commissioner are based on findings in an adjudicatory Department hearing conducted by an administrative law judge in *Shasta Linen*, at which parties were represented, testimony and documentary evidence was received, and express findings and conclusions were made in a decision the Commissioner designated as precedential. Such findings provide a rational basis for actions based on them. Legal conclusions are reviewed by the Court independently, with appropriate deference to the expert agency's construction of the statutes it is empowered to enforce. (See *PacifiCare Life & Health Ins. Co. v. Jones* (2018) 27 Cal.App.5th 391, 417 ["careful consideration, combined with the Commissioner's expertise in the area, weighs in favor of according significant deference to the Commissioner's interpretation of [statutory] terms"].)

ANALYSIS

The parties dispute two primary components of the Rehabilitation Plan: Plan § 2.2, which contemplates a public bid solicitation process for CIC's reinsurer of California policies, and Plan Schedule 2.6 (incorporated as Plan § 2.6), which empowers CIC's California policyholders to settle their RPA claims prior to the transfer of their policies to the selected reinsurer. The Court evaluates each component in turn.

I. Section 2.2: The Assumption Reinsurance and Administration Agreement

A. The Commissioner Has Authority to Reinsure Policies of a Conserved Business

As Conservator, the Commissioner may reinsure the business of a conserved company. (Ins. Code § 1043; see also § 1037, subds. (d) & (e).) Assumption reinsurance agreements are commonly used in the insurance industry to transfer policies and liabilities from one insurance company to another. (Holloway Plan Appl. Decl. ¶ 22.) Where a company seeks to withdraw from the California insurance market, the Insurance Code specifies that a departing insurer must reinsure its policies before exiting the state. (Ins. Code § 1071.5 ["Every insurer which withdraws as an insurer . . . from this State shall, prior to such withdrawal, discharge its liabilities to residents of this State . . . [and] shall cause the

primary liabilities under such policies to be reinsured and assumed by another admitted insurer."].) Prior to cancelling the departing insurer's California certificate of authority, the Commissioner must examine the insurer's books and records to confirm that the insurer has no outstanding liabilities to California residents or policies which have not been reinsured by an admitted insurer. (*Id.* at § 1072.) While the Commissioner may waive this requirement in his discretion if a departing company is solvent, he is not required to do so. (*Ibid.*) Moreover, as federal law reserves to the states the authority to regulate the business of insurance, the Commissioner may include out-of-state policies in reinsurance agreements pertaining to a domiciled insurer. (See 15 U.S.C. §§ 1011-1015.)

B. The Assumption Reinsurance Agreement Has a Rational Basis

Exhibit A to the Plan sets out the form of this Assumption Reinsurance Agreement. The Commissioner will invitie qualified insurers to bid on CIC's in-force policies and the liabilities incurred under expired policies. Expressions of interest must indicate the financial terms under which the bidder would agree to assume the portfolio. (Plan § 2.2, subd. (a)(2).) The Commissioner will retain a qualified actuary to evaluate the accuracy of the information provided. (*Ibid.*) The Commissioner may then negotiate policy terms before selecting the reinsurer, taking into consideration the interests of policyholders, creditors, and shareholders consistent with the public interest. (*Id.* at § 2.2, subd. (a)(4).) Appointment of CIC's reinsurer will require Court approval. (*Id.* at § 2.2, subd. (a)(7).) Upon Court approval, the Commissioner will sell CIC's portfolio to the reinsurer, with net proceeds of the sale going to CIC. (Plan Appl. at 22.) In exchange for assuming CIC's liabilities, the reinsurer will receive all future premiums on active policies plus the unearned premium reserves attributable to future coverage. (See Muzzarelli Plan Appl. Decl. ¶ 18 [premium reserves are unearned where attributable to future coverage].) The reinsurer will also be assigned CIC's rights under third-party reinsurance agreements which cover CIC's liabilities that are to be reinsured. (Plan Appl. at 22.)

If the Commissioner does not find any prospective insurer to be qualified to reinsure CIC's portfolio, the Plan permits the Commissioner to consider any expressions of interest from CIC affiliates. (Plan Appl. at 21.) CIC has indicated that its affiliate Continental, which is operated by Menzies as President/CEO and Silver as Secretary, with both individuals serving as Directors (Plan Appl. RJN, Exh. 7), is prepared to assume the portfolio of policies (Holloway Plan Appl. Decl. ¶ 24). The Commissioner

has determined that it would be inappropriate to shift CIC's existing policies to Continental, as Continental and CIC are operated by the same management. (Plan Appl. at 21.) Rather, the Commissioner would require that applicants who are affiliates of CIC, including Continental, to contract for claims administration with an independent third-party administrator ("TPA") appointed by the Commissioner as Conservator. (Plan § 2.2, subd. (a)(3), (a)(5); Holloway Plan Appl. Decl. ¶ 24.) This requirement is borne of the Commissioner's concerns regarding the integrity of CIC's management and ongoing claims-handling issues with policyholders. These concerns provide a rational basis for the assumption reinsurance agreement and TPA described in Plan § 2.2, as discussed further below.

C. The Plan's TPA Provision Is Not Arbitrary.

1. Substantial Evidence Supports the Commissioner's Concerns Regarding the Integrity of CIC's Management.

California law has long held that "the business of insurance is affected with a public interest," and that the state has "an important and vital interest in how insurers operate." (*Carpenter, supra,* 10 Cal.2d at 329.) Accordingly, the Legislature has expressly tasked the Commissioner with evaluating "[t]he competence, experience, and integrity" of insurance companies' management. (Ins. Code §§ 1215.2, subd. (d)(5), 717.) The record reflects the validity of the Commissioner's concerns regarding CIC's management. Substantial evidence shows that CIC's management routinely evaded the Commissioner's regulatory authority both pre- and post-conservation.

The Insurance Code, in the context of a proposed sale such as Menzies' acquisition of CIC's controlling interest from Berkshire Hathaway, expressly tasks the Commissioner with evaluating "[t]he competence, experience, and integrity" of the acquiring company's management. (Ins. Code §§ 1215.2, subd. (d)(5); 717.) As described above by the Ninth Circuit, CIC proceeded to acquire its controlling interest from Berkshire Hathaway before the Commissioner could complete his review of the proposed transaction. In so doing, CIC consciously evaded the Commissioner's regulatory authority and standard regulatory processes. (*Applied Underwriters, Inc., supra,* 37 F. 4th at 585-85 ["Menzies consummated the transaction with Berkshire without the Commissioner's approval, and then attempted to bypass the California insurance regulatory regime altogether by merging CIC I with New Mexico-domesticated California Insurance Company ('CIC II')"].)

The record supports the Commissioner's position that CIC's leadership has repeatedly violated

the Conservation Order. For example, the Conservation Order broadly prohibits CIC from "transacting any of the business of CIC," including the transfer or use of CIC assets, without the "express written authorization of the Conservator" unless that business "is necessary to continue to administer" in-force insurance policies in the ordinary course of business. (Conservation Order, Exh. 1 ¶ 15.) However, in March 2020, CIC made a $20 million uncollateralized loan to Applied for the development of its new corporate headquarters in Omaha. (Opening Br. at 17.) The parties do not dispute that CIC completed this transaction without the Commissioner's involvement or approval. This loan clearly exceeded the scope of the Conservation Order, and making the loan without the Commissioner's knowledge provides a rational basis for the Commissioner's concerns regarding CIC's management.

Moreover, in December 2020, the Commissioner learned that CIC had issued letters on behalf of itself and its affiliates to CIC policyholders, advising them that their CIC policies would be transferred to Continental in violation of the Conservation Order, forcing the Commissioner to direct CIC to withdraw the letters and halt the transfer of policies to Continental. (Holloway Reply Decl. ¶ 6; Dec. 2020 Cease-and-Desist Letter, Reply Compendium, Exh. 90.) CIC does not deny that they failed to obtain the Commissioner's consent as to these actions, and the experience led the Department to doubt CIC's "willingness to deal with the [Commissioner] about such issues in an open manner and in good faith." (Holloway Reply Decl. ¶ 9.) The Court cannot find the Commissioner's concerns about CIC's management to be arbitrary or irrational in light of such evidence.

Additionally, RSM US LLP, the firm retained by CIC and its affiliates as an independent auditor, notified the Commissioner in July 2022 that it had withdrawn as auditor because it had been unable to obtain "timely and accurate information" regarding CIC and the affiliates' financials. (Conservator's Status Report Regarding Additional Management Controls (Sept. 30, 2022) at 2-3.) Following RSM's resignation, CIC sought to retain Armanino LLP, which the Department determined was *not* independent of CIC and its affiliates, to complete the audit. (*Id.* at 4.) Although counsel for Respondents attested before this Court that Armanino had completed its audit of CIC and the affiliates, the Court has not received any audited financial statements in evidence. On this record, the Court considers the Commissioner's concerns about CIC's management arising from the absence of an independent audit rational.

CIC argues that the TPA provision is arbitrary because a conservator should "yield[] the control and direction to the regular officers of the company" where possible. (*Caminetti v. Sup. Ct.* (1941) 16 Cal.2d 838, 843.) The Court finds CIC's reliance on *Caminetti* unpersuasive. While conservation of a financially troubled insurer may aim to avoid insolvency and ensure that the company can be returned to the control of its regular officers, the Insurance Code provides the Commissioner as Conservator with broad discretion to fashion rehabilitation plans, which may preclude reinstating prior management that caused the company's distress. California law does not require a rehabilitation plan to continue to employ delinquent management of a conserved insurer. Rather, courts have denied the requests of pre-conservation management to be reinstated after willingly changing their offending business practices where management has not shown any corresponding change in their state of mind which would preclude further transgressions. (See *Caminetti v. Guaranty Union Life Ins. Co.* (1942) 52 Cal.App.2d 330, 335 ["To follow to its conclusion appellant's argument that there could be no hazard to policyholders so long as the business is solvent would be to sanction the withdrawal of policyholders' money in the payment of excessive salaries without restriction. This is not the law."].) The Court finds that the Commissioner's concerns regarding CIC's management are not arbitrary. The Commissioner has a rational basis for ensuring the independence of the TPA in light of CIC's management's conduct.

2. Substantial Evidence Supports the Commissioner's Concerns Regarding CIC's Ability to Fairly Treat Policyholders

The Commissioner has insisted on a TPA to administer claims because the RPA has created perverse incentives for handling claims under workers' compensation plans. Normally, an insurer tries to reduce the amount paid out on claims, while the injured employee-claimant seeks a higher payment. However, the RPA incentivizes the insurer to increase payouts on claims, at the expense of the policyholders. It is undisputed that under the RPA, unlike in a standard linear retrospective plan, a dollar paid or reserved on a claim may yield more than a dollar of premium to the insurer. In other words, overpaying and over-reserving can benefit CIC and harm poicyholders. The RPA increases the cost of claims and therefore the amount of collateral that CIC requires from the policyholder. CIC then enjoys investment returns on the over-reserved funds. (Muzzarelli Plan Appl. Decl. ¶¶ 21-24, 29; Muzzarelli Reply Decl. ¶ 41; see also *Shasta Linen, supra*, at 38.)

The evidence before the Court reveals that CIC has, in practice, unfairly applied the RPA in a

way to maximize its own benefit at policyholders' expense. Policyholders engaged in RPA litigation with CIC have repeatedly noted that CIC keeps claims "open" to maximize the investment returns which CIC derives on those claims. (Lichtenegger Plan Appl. Decl. ¶¶ 33, 56.) The Department, in reviewing analyses prepared by CIC's actuary, found that "[t]heir analyses, consistent with [the Department's], found the group to be holding more reserves than their expected losses." ((Muzzarelli Reply Decl. ¶ 42.) This showing that CIC has kept claims open past the point of unexpected losses raises the inference that CIC had a policy of over-reserving for profit.

CIC has challenged this evidence, highlighting that "[i]n audits performed by the California Department of Industrial Relations (DIR) in 2013 and 2019, CIC ranked second and fourth in the state, respectively, in workers' compensation claims handling practices." (Opp. at 42, citing Silver Opp. Decl. ¶ 81, Exhs. 89-90, & Donegan Opp. Decl.)[13] Ironically, this assertion validates the Commissioner's concerns. As the Commissioner noted, Respondent's high ratings in DIR audits are entirely consistent with overpayment of claims because those audits are, by law, conducted to detect *underpayments*, not overpayments. (Lab. Code, § 129, subd. (a).) Indeed, the DIR reports do not track claims overpayment, as insurers are assumed to have no reason to overpay claims. (See Opp. Compendium, Exh. 89, at 1 ["Of foremost importance is the payment of all indemnity owed to the injured worker for an industrial injury."], Exh. 90, at 2 [same].) Likewise, although CIC correctly notes that Department examinations of their work did not raise claims handling concerns, the Department's examinations focus on "identify[ing] and remedy[ing] underpayments." (O'Connell Reply Decl. ¶ 9.) Again, it is not surprising that, as the Commissioner asserts, an examination to detect underpayments turned up no concerns regarding overpayment.

CIC has also challenged the Commissioner's reliance on specific allegations of claims mishandling by Lichtenegger to support the TPA. The Court notes that the parties dispute Lichtenegger's conclusions drawn from his clients' claims files, which are not in evidence as they implicate the right to privacy. (Lichtenegger Plan Appl. Decl. ¶¶ 8, 60.) The Court accords deference to the Commissioner in his reliance on Lichtenegger's direct experience with CIC's reimbursement delays. At any rate, evidence that is in the record corroborates Lichtenegger's assertions. For example, although CIC claims that they

[13] Michael Donegan is CIC's claims handling declarant.

paid Savers $200,000 in settlement checks in May 2016 (Donegan Opp. Decl. ¶ 26), contemporaneous communications from a Savers manager show that the claim was not settled as of June 17, 2016. (Michael Strumwasser Reply Decl. ¶ 10, Exh. A ¶ 4.)[14] The manager recounted that an Applied employee still "refused to make a settlement offer on this claim and that [their manager] agreed that the claim was not appropriate for settlement. I recall that I found Applied's position to be unreasonable based on my years of experience overseeing workers' compensation claims, and I remember that the claim took a long time to settle compared to my experience with similar claims." (Strumwasser Reply Decl. Exh. A, ¶ 4.) Other policyholders recounted similar experiences:

> Our experience with CIC is that there was never any urgency by CIC or its affiliates to close claims and no clear desire on their part to reduce claims payments, which we came to conclude was because they could pass high claims costs onto us. As a result, based on how the RPA operated, we began to receive monthly invoices far higher than anything we had ever seen before despite having similar claims experiences to what we had in the past. On two occasions, we received monthly invoices of over one million dollars, and we had never seen anything close to that with previous insurers, nor have we had such an invoice with an insurer since we left CIC. With CIC, sometimes our claims would go down but our monthly invoices continued to go up.

(*Id.* at Exh. B ¶ 5.) This all amounts to substantial evidence to support the Commissioner's concerns about CIC and its affiliates' ability to handle claims in a manner that is fair to both claimants and policyholders. Accordingly, there is a rational basis to include a TPA in the plan in the event that a CIC affiliate is selected as CIC's reinsurer.

D. The Commissioner Has A Rational Basis for Denying Continental Priority in Assuming CIC's Business

CIC proposes that, in lieu of the Commissioner's competitive bidding process for its reinsurer described above, the Commissioner should simply transfer CIC's business to its affiliate Continental, or at the very least, that Continental "should have a right of first refusal if it is willing to match the highest bidder to the Conservator." (Opp. at 46.) CIC maintains that this is necessary because over 85 percent of its business is in California, and selling that "business to a third party would effectively gut the company and is directly contrary to the general purpose of conservation proceedings, and the Conservator's stated goals." (*Id.* at 45.) CIC again claims that a rehabilitation plan is supposed to enable the conserved entity to "resume title and possession of its property and the conduct of its business."

[14] Michael Strumwasser is a California attorney and counsel of record for the Conservator.

(*Caminetti, supra,* 16 Cal. 2d at 843; Ins. Code § 1012.) The Court may vacate the conservation order if, after a full hearing, it appears to the court that the grounds for the conservation order no longer exist, and "that the [conserved entity] can properly resume title and possession of its property and the conduct of its business." (Ins. Code § 1012.) However, the "business" contemplated by the Insurance Code is the operation of an insurance company under a California COA. As CIC has chosen to forfeit their Certificate of Authority, no rehabilitation plan can preserve its ability to insure its California policyholders. Under the proposed Plan, regardless of the reinsurer or the proportion of its business remaining in California, CIC will emerge from conservation with the fair market value of its business reinsured and with its intellectual property (the talent and knowledge of its management and employees). As the Commissioner has emphasized, the Plan is not intended to destroy CIC, but to enable CIC to withdraw from the California insurance market in a manner compliant with the Insurance Code.

The Court concludes that there is a rational basis for the Commissioner's concerns regarding CIC's management and their ability to fairly handle claims. The Commissioner has the authority to require a TPA under the Plan if a CIC affiliate is selected as CIC's reinsurer. Accordingly, the Commissioner's decision to refrain from transferring the policies to Continental, or to give Continental a right of first refusal, is not an abuse of discretion. Plan § 2.2 as written is reasonably related to the public interest.

II. Schedule 2.6: Settlement of RPA Litigation

A. Applicable Law Empowers the Commissioner's Resolution of RPA Litigation Via Schedule 2.6

1. The Commissioner as Conservator May Settle Pending and Subsequent Litigation of a Company Under Conservatorship

As Conservator, the Commissioner possesses the authority to "compound, compromise or in any other manner negotiate settlements of claims" against the conserved business "upon such terms and conditions as the commissioner shall deem to be most advantageous to the estate." (Ins. Code § 1037, subd. (c).) The Insurance Code puts forth a "legislative expression of policy favoring claims by settlement" where "[o]f necessity, if required to satisfy the public interest, the Commissioner possesses considerable discretion in settling claims." (*In re Executive Life, supra,* 32 Cal.App.4th at 374-75, 381.)

This discretion extends to settlement of claims where "the particular settlement materially contributes to an appropriate near global settlement which benefits the estate," so long as the settlement is "reasonably related to the public interest in rehabilitating the insurer" and is not arbitrary or improperly discriminatory. (*Id.* at 376, 381.)

CIC argues that the Commissioner lacks the power to settle pending RPA litigations because they are not yet "liabilities" as defined in the Insurance Code. (See Ins. Code § 1071.5 ["Every insurer which withdraws as an insurer . . . from this state shall, prior to such withdrawal, discharge its liabilities to residents of this State."].) In support of this argument, counsel for CIC presented in oral argument an excerpt from what he identified as "Paper No. 5" of "the statutory accounting principles which govern the definition of assets and liabilities for insurance companies," which purportedly stated that reserves for future losses "are not liabilities because . . . the allegations in a lawsuit don't meet any of the three essentials of the definition of liabilities." (RT Aug. 23, 2023, 10:3-13.) Counsel was apparently referring to the third criterion, listed on his presentation in court, which requires that "the transaction or other event obligating the entity has already happened."

However, counsel for CIC misrepresented the authority proffered to support his position. Counsel for the Commissioner quoted the remainder of the Paper, which provides that such liabilities include "but [are] not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims, and reserves for incurred but not reported claims." (*Id.,* 116:18-117:19.) This refutes CIC's argument by clarifying that reported claims and reserves for claims that have not yet been reported are conventionally treated as liabilities.[15] As CIC is withdrawing from the California insurance market, the Insurance Code requires CIC to settle outstanding liabilities, such as pending litigation, before exiting the state. (See Ins. Code 1071.5 ["Every insurer which withdraws as an insurer . . . from ths State shall, prior to such withdrawal, discharge its liabilities to residents of this State."].)

[15] "Paper No. 5" was no introduced into evidence or referenced in the parties' briefing. However, since CIC's counsel identified the document as reflecting state law, and since the Commissioner's counsel confirmed the authenticity of the full passage, the Court will take judicial notice of the passage in its entirety, as represented in the Commissioner's counsel's presentation, under Evidence Code section 452, subdivisions (b) and (h).

2. CIC's Arguments Against The Commissioner's Authority Are Unpersuasive

CIC's contention that Section 2.6 is barred by the June 2, 2017 Shasta Settlement between CDI, CIC, and AUCRA settling the *Shasta Linen* administrative action disregards the Commissioner's express reservation of rights:

> 5. Reservation. Nothing in this Agreement limits the power of the Commissioner to initiate any legal administrative proceeding, to take any action permitted by law and to seek and obtain all relief and remedies available (including any fine or penalties) or to adjudicate the right of others, as otherwise permitted by law.

(*Shasta Linen* Settlement Agreement at 2.)

As the Commissioner correctly argues, CIC cannot plausibly maintain that the Commissioner is in breach of a contract by taking action that is expressly reserved to him by the contract. Moreover, the First District has spoken on the good faith dispute recited in the *Shasta Linen* settlement "that [it] is ultimately for the courts to decide . . . as to the remedy authorized by the California Insurance Code and whether the RPA is void as matter of law under the California Legislature's comprehensive regulatory scheme and relevant case law." (*Luxor Cabs, supra*, 30 Cal.App.5th at 970, 984 – 987.)

CIC also argues that Schedule 2.6 is irrational because CIC's conservation is not predicated on its insolvency. This position is unfounded. The Insurance Code does not require a company's insolvency to contemplate the set aside of funds described under Schedule 2.6. (See Ins. Code §§ 1037, 1043 [outlining non-insolvency related bases for conserving a company].)

CIC's argument that Schedule 2.6 serves no rational basis because the *Shasta Linen* Settlement approved a "functionally identical" RPA for sale to California employers misstates the evidence on the record. The Settlement mandated that CIC and affiliates revise the RPA's marketing materials to contained "improved disclosures in the materials provided by CIC/AUCRA to potential clients to lessen this chance for misunderstanding." (Muzzarelli Decl. ¶ 25.) Further revisions to the RPA negotiated between the parties in 2017 required changes in the agreement's calculation methods. (*Id.* at ¶ 28.) Significantly, these revisions also required CIC to value policyholders' accounts annually, limiting CIC's ability to hold onto initial

payments and reap the investment income from those funds. (Groden 2021 Decl. at 11-12, fn. 4.)[16]

CIC offers no legal authority for its argument that the Commissioner is usurping the authority of California's courts. Thus, it is deemed to be without foundation and requires no discussion. (See *Do It Urself Moving & Storage, Inc. v. Brown, Leifer, Slatkin & Berns* (1992) 7 Cal.App.4th 27, 35, superseded by statute on other grounds in *Union Bank v. Sup. Ct.* (1995) 31 Cal.App.4th 573, 583.) The Court will, however, note that the Ninth Circuit confirmed the centrality of this Court, holding that CIC's affiliates must yield to this Court's prior exclusive jurisdiction even in civil rights suits brought under federal law. in *Applied Underwriters v. Lara*, which held that even federal civil rights lawsuits by Respondent's affiliates must yield to this Court's prior exclusive jurisdiction. (*Applied Underwriters v. Lara, supra,* 37 F.4th at 587, 592-593.)

B. There Is a Rational Basis For Schedule 2.6 in Its Entirety

Schedule 2.6 draws on restitution principles to enable select policyholders to compromise their claims against CIC. The Commissioner believes this is a fair and equitable process that reflects the rights of the respective parties and that a substantial majority of eligible policyholders will choose an option. (Holloway Plan App. Dec., ¶ 27)

The options will be available to three groups of policyholders: (1) those engaged in RPA litigation at the time of the Conservation Order; (2) those against whom CIC believes it has claims for payments and whom CIC will identify in a Schedule of Subsequent Litigation, with CIC permanently barred from suing any not listed; and (3) the 10 policyholders who are not currently parties to litigation, but received notice of the opportunity and have submitted their claims to the Conservator within the time provided, which has since closed. (Sched. 2.6, art. I, ¶¶ 5, 19, 23, 24, 32, art. VII.) Policyholders in all three groups will be given the opportunity to resolve the dispute through the three options of Schedule 2.6.

Schedule 2.6 offers three options, all of which are based on individualized calculations of a "restitution amount," i.e., the amount the policyholder paid CIC minus the amounts it owes under that

[16] Ronald A. Groden is a non-party to this litigation.

option. The restitution amount may be positive or negative. If it is positive, the policyholder paid CIC more than it owes under the option, so CIC must pay that amount, with interest, if that option is chosen. If it is negative, the policyholder paid less than it owes under that option, so the policyholder must pay that amount to CIC, with interest. (Muzzarelli Plan Appl. Decl. ¶¶ 31-33.)

The *Option 1 Restitution Amount* is straightforward: It is simply the amount paid to CIC and its affiliates minus the amount owed under the CIC guaranteed-cost policy. (*Id.* at ¶¶ 31, 33, 39.)

The *Option 2 Restitution Amount* is more complex because Option 2 is based on the cost of a commercially available retrospective policy. Under such policies, the premium is determined by the ultimate losses under the policy, which include both paid losses and amounts set aside in reserves on open claims and on claims not yet reported. Schedule 2.6 prescribes how the losses are calculated from CIC's data. However, because the propriety and accuracy of claims payments and reserves, which come from CIC's books, may be disputed, those quantities are subject to review if challenged by a policyholder. Schedule 2.6 uses the California Retrospective Rating Plan ("Cal Retro") filed by the Workers' Compensation Insurance Rating Bureau as the commercially available retrospective policy whose pricing is the standard under Option 2. The Option 2 Restitution Amount is the amount the policyholder paid minus the premium that would have been charged under the Cal Retro plan. (*Id.* at ¶¶ 31, 40-44, 47-53.)

The *Option 3 Restitution Amount* is the amount paid to CIC minus the amount due under the RPA. Because the RPA is a retrospective policy, the amount due is determined by the losses under the policy. Because some policyholders dispute those losses, they may be challenged and reviewed. (*Id.* at ¶¶ 31, 45-46, 47-53.)

Schedule 2.6 outlines its process. First, the Commissioner appoints an Independent Consultant, who will translate the formulas in Schedule 2.6 into a template to circulate for comments. The Independent Consultant will then finalize the formula template after receiving and considering comments. (Sched. 2.6, art. VI.) CIC then submits to the Independent Consultant a data file, conforming to the template, for each eligible policyholder ("Claimant"), from which the Independent Consultant calculates the Option 2 Restitution Amount and Option 3 Restitution Amount.[17] The Independent

[17] The Option 1 Restitution Amount does not depend on the formula template data.

Consultant then sends the Commissioner a written Settlement Offer with the three Settlement Amounts, which the Commissioner tenders to the Claimant, who then has 30 days to select an offer or decline all of them. (*Id.* at ¶ VI(6).) Alternatively, the Claimant may request review of the paid losses or reserves by the Independent Consultant (*id.* at art. VII), which extends the time to respond to the Settlement Offer. (*Id.* at ¶ VI(6).) If the review results in a change in the losses, the Independent Consultant recalculates the Settlement Offer, from which the Claimant makes its election. (*Id.* at ¶ VII(4).) Each of the policyholder-specific data elements employed in the calculations—premiums, losses, coverage periods, payment dates, and so on—come from CIC's data. (*Id.* at ¶ VI(2), (3).)

There is a rational basis for Schedule 2.6 in its entirety. The RPA litigation is related to the grounds for CIC's conservation, and substantial evidence supports the Commissioner's belief that CIC faces significant liability in RPA litigation. CIC has otherwise failed to show that Schedule 2.6 is arbitrary or improperly discriminatory.

1. The RPA Litigation Is Related to the Grounds for CIC's Conservation

The parties agree that CIC's conservation arises from its attempted merger with CIC II as outlined above. They do not agree as to whether CIC's involvement in RPA litigation incentivized that merger. CIC argues that the inclusion of Schedule 2.6 renders the Rehabilitation Plan arbitrary and lacking in a rational basis because the Commissioner did not identify that litigation as grounds for the conservation in his Ex Parte Application to this Court. The Commissioner disputes that the original grounds for the conservation limit the provisions of a subsequent rehabilitation plan and still argues that Schedule 2.6 meets even CIC's reading of the law.

CIC argues that the Commissioner's discretion to address CIC's affairs is confined to the "purposes of the conservatorship proceeding." (*Caminetti, supra,* 16 Cal.2d at 843.) But that does not necessarily mean that a rehabilitation plan is limited to the purposes known and pled on the day a conservation order is sought. The Court may only terminate a conservation after finding, following a full hearing, that "the ground for the order directing the commissioner to take title and possession does not exist or has been removed and that the person can properly resume title and possession of its property and the conduct of its business." (Ins. Code § 1012.) As such, the Court assesses the pre-conservation management's ability to take back the company at the time the company would be *released* from the

conservation, not at the time of the order *imposing* the conservation. The RPA litigation clearly constitutes conduct which the Court must consider prior to terminating CIC's conservation as contemplated by the Insurance Code.

Even under CIC's logic, the RPA litigation provided grounds for the conservatorship. The Conservation Application referred to CIC's use of "unfiled contract amendments" as an "illegal scheme," part of CIC's "pattern of flouting California regulatory processes designed to protect California policyholders." (Conservation Appl. ¶ 17.) These facts form the basis of policyholders' claims against CIC in RPA litigation. And, as discussed above, CIC's merger with CIC II will not comply with California law if CIC is able to complete the merger and exist the California insurance market without settling outstanding liabilities.

The Court finds that settlement of RPA litigation is related to the grounds for CIC's conservation. The Commissioner's decision to settle RPA cases in the conservation is not arbitrary, not lacking in a rational basis, and not contrary to law.

2. Substantial Evidence Supports the Commissioner's Belief that CIC Faces Significant Liability in RPA Litigation

The Commissioner determined that CIC faces significant legal exposure in ongoing and pending RPA litigation because, in the Department's analysis, the RPA is unlawful and void. (*Shasta Linen, supra,* at 67-68; Code Civ. Proc. §§ 1598, 1608.) While the Court declines to adopt the Commissioner's legal conclusion, substantial evidence supports the Commissioner's belief that the RPA and related conduct form the basis for numerous different legal theories of recovery that could jeopardize CIC's conserved estate.

Substantial evidence supports CIC's liability under contract law principles. (See *Jackpot Harvesting, supra,* 33 Cal.App.5th at 735 ["Generally a contract made in violation of a regulatory statute is void."].) Even if the RPA is unenforceable as a matter of law, California courts have enforced illegal contracts to avoid unjust enrichment to the defendant drafter. (See, e.g., *Tri-Q, Inc. v. Sta-Hi Corp.* (1965) 63 Cal.2d 199, 219 [enforcement required to "prevent the guilty party from reaping the benefit of his wrongful conduct, or to protect the public from the future consequences of an illegal contract"]; *Kyablue v. Watkins* (2012) 210 Cal.App.4th 1288, 1293 [enforcement of illegal contract

would prevent a "disproportionately harsh penalty upon the plaintiff."].) Likewise, substantial evidence supports CIC's violation of the implied covenant of good faith and fair dealing, whose breach in the context of an insurance contract dispute may support punitive damages in a parallel tort action. (See *Gomez v. Volkswagen of America, Inc.* (1985) 169 Cal.App.3d 921, 927 ["'[W]e have emphasized the 'special relationship' between insurer and insured, characterized by elements of public interest, adhesion, and fiduciary responsibility.'"] [quoting *Egan v. Mutual of Omaha Ins. Co.* (1979) 24 Cal.3d 809, 820].) The record before the Court is replete with instances where CIC and its affiliates have delayed settling open claims to stall distributing funds to policyholders. (Lichtenegger Plan Appl. Decl. ¶¶ 56-58; Strumwasser Reply Decl., Exh. A ¶ 4 & Exh. B ¶ 5; *Randazzo* Decision, Larsen Decl. Exh. 44 at 13; *Shasta Linen, supra,* at 38 [Applied's inaction following policyholder's report of potential fraud cost policyholder over $100,000].) Such conduct by a workers' compensation insurer in administering a retrospective program is a recognized breach of the covenant of good faith and fair dealing. (See, e.g., *California Lettuce Growers v. Union Sugar Co.* (1955) 45 Cal.2d 474, 484 ["where a contract confers on one party a discretionary power affecting the rights of the other, a duty is imposed to exercise that discretion in good faith and in accordance with fair dealing"]; *Courtesy Ambulance Service v. Superior Court* (1992) 8 Cal.App.4th 1504 [over-reserving may give rise to tort action for breach of covenant of good faith, exposing workers' compensation insurer to punitive damages].)

There is a rational basis for the Conservator's conclusion that CIC also faces liability under all three grounds for relief in California's Unfair Competition Law (UCL, Bus. & Prof. Code, § 17200 *et seq.*) Under the UCL, insurers may be liable to private plaintiffs for conduct that violates laws other than the Unfair Insurance Practices Act (UIPA, § 790 *et seq.*; *Zhang v. Sup. Ct.* (2013) 57 Cal.4th 364, 368.) As outlined in *Shasta Linen,* CIC's failure to file and secure approval of the RPA in violation of the Insurance Code may expose CIC to liability under the UCL's illegality prong. (See *Shasta Linen, supra,* at 62, 64; Ins. Code §§ 11658, 11735; Cal. Code Regs., tit. 10, §§ 2218, 2268 [requiring filing of forms and rates and prohibiting use of forms and rates that have not been filed and approved by the Commissioner].) Subsequent appellate proceedings have found CIC's conduct unlawful on similar grounds. (See, e.g., *Jackpot Harvesting, supra*, 33 Cal.App.5th at 736 ["We conclude that the Request to Bind is such a collateral agreement, triggering section 11658 and Regulations section 2268's

regulatory approval requirement."]; *Luxor Cabs, supra*, 30 Cal.App.5th at 986; *Nielsen, supra,* 22 Cal.App.5th at 1118; accord *Minnieland Private Day School, Inc. v. Applied Underwriters Captive Risk Assurance Company, Inc.*, 913 F.3d 409, 423 [holding that the RPA is an insurance contract subject to regulatory approval under Virginia's insurance laws].) Substantial evidence supports CIC's potential liability as to the RPA as an unlawful business practice within the meaning of the UCL.

There is a rational basis for the Commissioner's contention that policyholders can hold CIC liable for the RPA as an "unfair" business practice under the UCL. (See, e.g., *Daugherty v. American Honda Motor Co., Inc.* (2006) 144 Cal.App.4th 824, 839 ["[a]n act or practice is unfair if the consumer injury is substantial, is not outweighed by any countervailing benefits to consumers or to competition, and is not an injury the consumers themselves could reasonably have avoided"]; *Smith v. State Farm Mutual Automobile Ins. Co.* (2001) 93 Cal.App.4th 700, 719 [an unfair policy "offends an established public policy or when the practice is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers"; *Scripps Clinic v. Sup. Ct.* (2003) 108 Cal.App.4th 917, 940 [an unfair practice violates a "public policy which is . . . 'tethered' to specific constitutional, statutory, or regulatory provisions."] [internal citations omitted].)

Substantial evidence supports the Commissioner's conclusion as to CIC's risk for liability under the UCL's unfairness prong. CIC's use of unfiled, unapproved forms and rates contravenes the Insurance Code's filing and public inspection requirement crafted to ensure that employers find coverage at competitive rates thanks to broad access to filed rate information. (Ins. Code §§ 11735, subd. (b); 11742, subd. (a).) The transparency-enforcing mechanisms also help protect the state's workforce by ensuring benefits are available to employees who are injured or sickened over the course of employment. (*Arriaga v. County of Alameda* (1995) 9 Cal.4th 1055, 1065.) Other aspects of the RPA support the Commissioner's conclusion that the RPA may be an unfair business practice. As previously noted, policyholders did not receive the RPA until after they were bound into the EquityComp program, only then realizing that they would have to wait an additional three years following expiration of the RPA to receive a refund of their excess premium and fees. (*Shasta Linen, supra,* at 34.) Moreover, the RPA obligated employers to continue depositing collateral until the RPA was terminated on a date to be determined by AUCRA at its "sole discretion." (*Id.* at 31-32; Lichtenegger Plan Appl. Decl. ¶ 16.) CIC

and affiliates relied on this provision to delay policyholder returns for years, during which time it could invest those funds and collect the investment income. (*Shasta Line*n, supra, at 31, 35; Lichtenegger Plan App. Dec., ¶¶ 17-19, 34, 37, 52, 56-58 [detailing cases in which clients had to wait to receive return of excess funds].) A policyholder anxious to recover its excess funds was, in effect, left with no recourse aside from litigation, unless it was willing to settle with CIC for amounts far below what it was owed under the RPA. (Lichtenegger Plan Appl. Decl. at ¶¶ 52, 54.)

The Commissioner also determined that CIC faces liability under the UCL's bar on fraudulent practices. (See *Zhang, supra,* 57 Cal.4th at 380 ["Under the UCL, it is necessary only to show that the plaintiff was likely to be deceived, and suffered economic injury as a result of the deception."] [citing *Kwikset Corp. v. Sup. Ct.* (2011) 51 Cal.4th 310, 322].) In *Shasta Linen*, the Commissioner found that the EquityComp marketing materials prepared by AUI misrepresented the amounts a prospective policyholder could expect to pay, and other arbitration decisions are in accord. (*Shasta Linen, supra*, at 27; *Randazzo* Decision, Reply Compendium, Exh. 44 at 11-12.) The Commissioner has concluded that these practices, among others, give rise to substantial claims under the "fraudulent practices" prong of the UCL.

CIC argues that Schedule 2.6 is unnecessary because courts can assess CIC's liability under any of the theories at hand, and "[t]here is no evidence anywhere in the record, let alone substantial evidence, that CIC faces or ever faced material financial liability in connection with the RPA litigation such that resolution of the RPA litigation through the Plan is necessary for preservation of the conserved estate." (Opp. at 21:23 – 22:2.) CIC has not provided any legal authority to support its argument that a "material financial liability" standard should be applied here, so the Court need not consider its argument. (See *Do It Urself, supra,* 7 Cal.App.4th at 35 "[a] point which is merely suggested by [a party's] counsel, with no supporting argument or authority, it deemed to be without foundation and requires no discussion."] [internal citations omitted].) CIC's argument that Schedule 2.6 represents a global settlement which precludes CIC from asserting appropriate defenses to outstanding RPA litigation is likewise unavailing. CIC has not raised any across-the-board defenses which it has, or could have, raised. Such an argument therefore appears to be another tactic through which CIC seeks to disregard its obligation under the Insurance Code to discharge its liabilities to California residents prior to

withdrawing from the California insurance market at the conclusion of this conservatorship. (See Ins. Code § 1071.5 [noting that this obligation applies to every withdrawing insurer].)

Given the breadth of the UCL and the evidence of acts and omissions by CIC and its affiliates that create liability under the UCL violations and breaches of contract, the Commissioner has sought to settle RPA cases. (Plan Appl. at 32.) The Court does not conclude that the Commissioner's determinations are arbitrary, lack a rational basis, are contrary to law, or constitute an abuse of discretion.

3. Substantial Evidence Shows that CIC Has Made Litigation Onerous for Policyholders

As discussed with respect to Plan § 2.2, the Commissioner as conservator possesses the power to rehabilitate CIC's relationship with its policyholders. Substantial evidence on the record supports the Commissioner's assertion that CIC has engaged in improper conduct towards its policyholders in RPA litigation in several ways.

There is a rational basis for the Commissioner's conclusion that CIC and affiliates have forced policyholders to litigate in a number of different forums based on the structure of the RPA's arbitration provisions. The RPA subjects all disputes to binding arbitration in the British Virgin Islands, under Nebraska law, and requires that all arbitration awards must be enforced in Nebraska courts. (*Shasta Linen, supra*, at 32, 56.) The Commissioner in *Shasta Linen* described this modification as "extremely disconcerting since the Insurance Code prohibits the use of arbitration provisions without written notice to the policyholder that such a provision is negotiable." (*Id.* at 56.) There is evidence that the arbitration provisions have created obstacles to resolving policyholder disputes in at least two ways. First, adjudicators have found the arbitration provision unenforceable under Nebraska law, as Nebraska Revised Statue 25 – 2602.01 forbids arbitration of "any agreement concerning or relating to an insurance policy." (Final Award in *Applied Underwriters Captive Risk Assurance Company, Inc. v. O'Connell Landscape Maintenance, Inc.*, ICDR Case No. 01-16-0005-0136, dated August 27, 2018, Reply Compendium, Exh. 85 at 2.) Still, CIC and affiliates sought arbitration of disputes even when the arbitrators themselves have found that they "do not have jurisdiction to hear the merits of this dispute" under governing law. (*Ibid.*) Second, even if a policyholder elected to arbitrate its disputes, some

arbitrators nevertheless decided that only the Commissioner had the authority to declare the RPA void. (See Final Award in *O'Connell Landscape Maintenance, Inc. v. Applied Underwriters Captive Risk Assurance Company, Inc., et al.*, JAMS Case No. 1100084561, dated December 4, 2017, Reply Compendium, Exh. 83 at 7 [determining that only the Commissioner can claim that the RPA is unenforceable].) By requiring policyholders to resolve their disputes before an arbitrator, only to have the arbitration clause be found unenforceable or for the arbitrator to conclude that they cannot decide the dispute, CIC and affiliates have trapped policyholders in circular litigation at great cost.

Substantial evidence also supports the Commissioner's contention that CIC and affiliates have required policyholders to individually litigate the legality of the RPA. (Lichtenegger Plan Appl. Decl. ¶ 27 ["In each and every case on behalf of my client policyholders, AUI, AUCRA and CIC have insisted on relitigating the illegality of the EquityComp program both before the courts as well in appeals to the CDI."].) CIC maintains that whether the RPA is void is still an open question (see Opp at 19–21). While the Court declines to adopt the Commissioner's position as to the illegality of the RPA, the Court notes that in the years of litigation that ensued following the 2017 *Shasta Linen* Settlement Agreement, not one California court of appeal or superior court that has considered the RPA has issued any ruling conflicting with the Commissioner's decision in *Shasta Linen* that the RPA was void and unenforceable as a matter of law. (Larsen Reply Decl. ¶ ¶ 9, 13.)

Moreover, Nebraska courts have dismissed countersuits by CIC's affiliates for over fifteen years for lack of jurisdiction over non-Nebraska policyholders. (See, e.g., Order on Defendants' Motion to Dismiss in *Applied Underwriters Captive Risk Assurance Company, Inc. v. RDR Builders, LP, et al.*, Dist. Ct. Douglas County, NE, Case No. CI 17-5424, dated March 13, 2018 *("RDR* Order"), Reply Compendium, Exh. 59 at 11; *Applied Underwriters, Inc. v. Dinyari, Inc.* (Neb. Ct. App., May 20, 2008, No. A-07-058) 2008 WL 2231114, at *7 ["Based on our de novo review, we conclude that [California policyholder] Dinyari did not have sufficient minimum contacts with Nebraska to satisfy the due process requirements for the exercise of personal jurisdiction."] ; *Applied Underwriters, Inc. v. Emp'r Outsource Serv., Inc.*, 2007 WL 1470454, at *5 (Neb. Ct. App. May 22, 2007) [Illinois policyholder who executed payment plan promissory note with AUI did not establish minimum contacts with Nebraska sufficient to establish personal jurisdiction in Nebraska].) CIC does not dispute that its affiliates regularly sued its

California policyholders in Nebraska despite repeated findings of lack of personal jurisdiction. (Lichtenegger Plan Appl. Decl. ¶ 50; Larsen Reply Decl. ¶¶ 23–27, 37–38; *Applied Underwriters Captive Risk Assurance Co., Inc. v. E.M. Pizza, Inc.* (Neb. Ct. App. 2019) 923 N.W.2d 789 (*E.M. Pizza.*)) Troublingly, AUI appealed every instance where the trial court granted a motion to dismiss, and all appeals were unsuccessful. (Larsen Reply Decl. ¶ 25; Reply Compendium, Exhs. 56-73.) One policyholder, O'Connell Landscaping, was sued at least four times in Nebraska (not including an arbitration action), and each case was dismissed. (Larsen Reply Decl. ¶ 25, 34–38.) The Court need not conclude that these Nebraska suits were filed to retaliate against policyholders, but the Court finds the Commissioner's decision to consider this pattern rational.

Commissioner's counsel characterizes this tactic as a "common practice of CIC and its affiliates that serves to increase the costs of litigation." (Larsen Reply Decl. ¶ 17.) There is substantial evidentiary support for this assertion. Indeed, CIC does not dispute that it has regularly initiated litigation against California policyholders in Nebraska, nor does it dispute that these actions come at a "tremendous cost[] to the policyholders." (Lichtenegger Plan Appl. Decl. ¶ 43.) Neither does CIC dispute that its lengthy appeals have prolonged the time that it can enjoy the investment income on policyholders' money. (*Ibid.*) The record contains evidence that CIC has incentives to prolong litigation through the appellate process to continue accruing investment income. For example, in the *Barker Management* and *Bayless Engineering* cases, policyholders who agreed to arbitrate their disputes—and who won "substantial" awards from their respective arbitrators—saw years-long delays in receiving payment. *(Id.* at ¶ 38.*)* Still, today, Bayless has yet to receive its award. (*Id.* at ¶ 39; Larsen Reply Decl. ¶ 22, 33; Stephens Opp. Decl. ¶ 64.) Additionally, after the Ninth Circuit affirmed the federal district court's confirmation of an arbitration award against AUCRA for $550,093 plus interest, AUCRA failed to pay the award, walking back its promise to post bond as stipulated. (Lichtenegger Plan Appl. Decl. ¶ 38; Larsen Reply Decl. ¶ 30; Barzelay Opp. Decl. ¶ 7. Seven weeks later, when CIC entered conservation, CIC's counsel claimed that AUCRA could not pay the award because CIC was in conservation. (Larsen Reply Decl. ¶ 30; Stephens Opp. Decl. ¶ 64.)

CIC has objected to the Commissioner's reliance on the Lichtenegger Declaration. The Court notes that Lichtenegger's sworn allegations are consistent with other evidence before this Court,

including the Commissioner's own conclusions in *Shasta Linen*, the arbitrator's findings in the *Randazzo* decision, and sworn statements of the Department's senior casualty actuary. Although CIC has sought to impeach Lichtenegger, this impeachment evidence does not demonstrate that the Commissioner abused his discretion or otherwise acted arbitrarily by relying on Lichtenegger's representations of his own experience. Nor does the Court conclude that it was an abuse of discretion, irrational, or arbitrary for the Commissioner to consider this aforementioned evidence as indicative of potentially larger and more endemic issues that demand rehabilitation. A certain amount of disagreement between insurers and their policyholders is not uncommon, nor is it particularly out of the ordinary to have those disagreements spill into litigation. But the repetitive and prolonged nature of the RPA litigation is atypical. CIC does not contend that this litigation is in any way ordinary. The Commissioner had a rational basis to conclude that CIC's sale of the RPA led to disputes outside the ordinary course of business between insurance companies and policyholders.

The Comissioner additionally has a rational basis for his conclusion that allowing the resolution of these disputes to continue in the manner that they had been occurring would not be fair and appropriate to all parties involved. Substantial evidence shows that CIC made resolving disputes excessively onerous on policyholders in a way that deterred them from actually enforcing their legal rights. It is consistent with the Commisioner's duty to protect the interests of CIC's estate, its policyholders, other beneficiaries, and the public by proposing a mechanism for settling this litigation.

4. CIC Has Otherwise Failed to Show that Schedule 2.6 Is Arbitrary

CIC has offered several arguments against Schedule 2.6. The Court finds each argument unpersuasive. Schedule 2.6 is not arbitrary, nor is it irrational, as CIC claims.

CIC's argument that it has had substantial litigation success is unpersuasive. The Commissioner's argument in reply that analyzes the litigation successes is more persuasive and grounded in rational basis:

> The rosy picture Respondent portrays of its "substantial litigation successes" (Opp. at 16) is incomplete and misleading. As the Declaration of Cynthia Larsen (Larsen Decl.) thoroughly documents, Respondent's "victories"—primarily, defeating class certification and an unpublished federal decision whose reasoning has been rejected by California state courts—are the exception, not the rule [where: (1)] Almost Two Dozen California Superior Courts Have Handed Substantive Litigation Defeats to Respondent;

> [(2)] Unpublished Federal Court Orders Are Not Instructive and Only Confirm the Benefits of Schedule 2.6; [(3)] Respondent's Losses in Arbitral Forums Far Exceed Their "Victories"; [and (3)] California Appellate Precedents Make Clear the RPA Is Unlawful and Void[.]

(Reply at 14:15 – 19:4.)

First, CIC's citations to cases where it defeated **class certification** are irrelevant here. (Opp. at 17:8 – 18:20; see, e.g., *Pet Food Express, Ltd. v. Applied Underwriters, Inc.* (E.D. Cal., Sept. 12, 2019, No. 2:16-CV-01211 WBS AC) 2019 WL 4318584, at *2 ["denied the motion to certify on superiority grounds"], *Shasta Linen Supply, Inc. v. Applied Underwriters, Inc.* (E.D. Cal., Jan. 29, 2019, No. 2:16-CV-1211 WBS AC) 2019 WL 358517, at *6 - *7 ["the court will deny plaintiffs' motion for class certification" because manageability and superiority "weigh against class certification"], *Shasta Linen Supply, Inc. v. Applied Underwriters, Inc.* (E.D. Cal., Apr. 17, 2019, No. 2:16-CV-1211 WBS AC) 2019 WL 3244487, at *2 [denied granting leave to file a renewed motion for class certification where same issues of manageability and superiority were present "in the context of this newly proposed class"].)

Second, CIC's citation to it prevailing on summary judgment of the UCL claim in *Pet Food Express* (Opp. at 18:5-12) is not well taken since on demurrer, a Sacramento Superior Court judge found,

> Review of *Pet Food Express* has not persuaded this Court to change its tentative demurrer ruling. There are several reasons for this decision.
>
> First, the *Pet Food Express* decision is an unpublished district court decision and not binding precedent that this Court must follow.
>
> Second, *Pet Food Express* addressed related legal issues but not the precise legal issues set forth in the demurrer, and it addressed these issues in a different procedural posture from the demurrer in this case. Plaintiffs in this case demur to the First Cause of Action of the FACC on the ground that the RPA is void and unenforceable as a violation of Insurance Code section 11658. *Pet Food Express* addressed the lack of evidence of economic loss to plaintiffs - not an issue raised by this demurrer, which must weigh allegations rather than consider evidence. *Pet Food Express* also addressed a factual issue, the marketing of a version of the RPA that was approved by the Insurance Commissioner, that is not raised by the allegations contained in the First Cause of Action of the FACC.
>
> Third, this Court does not find the manner in which the district court distinguished *Luxor* and *Nielsen* - essentially confining its interpretation of their holdings to their precise facts - to be persuasive. Those cases, which by contrast to *Pet Food Express* squared addressed section 11658, are binding on this Court.

(Conserv. Reply Evid., Exh. 29 at 7. See also Reply at 15:22 – 16:5.)

Third, CIC's citation to "a favorable judgment in one of the only RPA litigations tried to a

California Superior Court" (Opp. at 18:19 – 19:2.) is not well taken. As the Commissioner points out, CIC's citation to a Statement of *Intended* Decision in *Roadrunner Management Services, Inc. v. Applied Underwriters, Inc.* (Ventura Sup. Ct. case no. 692017-0049339 -CU-CO-VTA) ("*Roadrunner*") is not final. (CIC Evid., Exh. 31.) Notably, CIC admits that this "has not been converted to a final judgment due to the timing of this conservation and the resulting injunction and stay of litigations." (Opp. at 19:28, fn. 6.) As "[a] tentative ruling is, by definition, not final," the Court declines to accord weight to this proffered authority. (*People v. Hatt* (2018) 20 Cal.App.5th 321, 324; Reply at 17:26-28, fn. 11) Further, as the Commissioner argues, "*Pet Food* does demonstrate one salient point: the perils of piecemeal litigation and its inevitable multiplicity of inconsistent results." (Reply at 15:6-7.)

The Court likewise finds CIC's assertion of the litigation privilege and constitutional objections unpersuasive. A conservation is a "special proceeding" (*Applied Underwriters, supra,* 37 F.4th at 589) that vests the Commissioner with "discretion to settle disputes concerning relative priorities of claimants in appropriate circumstances." (*Executive Life, supra,* 32 Cal.App.4th at 370). The Commissioner has not has exceeded his power to settle claims against a conserved company as Conservator in a way that violates CIC's constitutional rights or the litigation privilege. The Court likewise finds CIC's assertion that Schedule 2.6 unfairly discriminates against its interests by favoring policyholders without merit.

CIC has objected to Schedule 2.6 as applied to its affiliates, claiming that the Insurance Code only empowers the Commissioner to settle cases pending against the "person" in conservation. (See Ins. Code § 1037.) The Commissioner has explained that resolving RPA litigation via Schedule 2.6 necessarily involves CIC's affiliates because they are inextricably intertwined in the RPA scheme and the subsequent enforcement against policyholders, including as to promissory notes extended by AUI. (Plan Appl. at 8, 11, 25-26.) Accordingly, the Plan treats these entities as a joint enterprise with shared identities of interest for purposes of settling suits and claims related to the RPA.[18]

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[18] The Commissioner states that entities considered a joint enterprise are also jointly and severally liable. (See *Gopal v. Kaiser Foundation Health Plan, Inc.* (2016) 248 Cal.App.4th 425, 431 ["Under California law, if [several business] entities are a single enterprise, they are each liable for all of the acts and omissions of the other components of the enterprise"]; *Toho-Towa Co., Ltd. v. Morgan Creek Productions, Inc.* (2013) 217 Cal.App.4th 1096, 1108 ["'single-business-enterprise' theory is an equitable doctrine applied to reflect partnership-type liability principles when corporations integrate their resources and operations to achieve a common business purpose"].)

The Commissioner's inclusion of CIC's affiliates in this part of the Plan falls squarely within his authority as Conservator and this Court's jurisdiction, both of which reach non-conserved entities that share an identity of interest with the conserved estate. (*Garamendi v. Executive Life Ins. Co.* (1993) 17 Cal.App.4th 504, 523.) The Court notes that CIC and its affiliated entities have regularly been treated as a single enterprise by the Commissioner, trial courts, arbitrators, and California and federal courts of appeal. (See *Shasta Linen, supra*, at 49-50 [CIC, AUCRA, and AUI are "inextricably intertwined" and "enmeshed"]; *Nielsen, supra*, 22 Cal.App.5th at 1113-16 [record on appeal supported conclusion that affiliated entities should be considered together because they were so enmeshed and intertwined]; *Luxor Cabss, supra*, 30 Cal.App.5th at 985-86 [same]; *Applied Underwriters, supra*, 37 F.4th at 592.) CIC claims that these findings are "inapposite" because they did not apply an "alter ego" test and did not recite facts that to support piercing the corporate veil. (Opp. at 40.) However, the alter ego doctrine, which "arises when a plaintiff comes into court claiming that an opposing party is using the corporate form unjustly and in derogation of the plaintiff's interests" (*Mid-Century Ins. Co. v. Gardner* (1992) 9 Cal.App.4th 1205, 1212), simply has no bearing on whether this Court exercises *in rem* jurisdiction over the assets of third parties that have an "identity of interests" with the conserved entity, CIC. (*Garamendi*, 17 Cal.App.4th at 516). Indeed, as the Ninth Circuit noted when finding that federal suits by AUI and CIC II were barred by this Court's prior *in rem* jurisdiction over assets of those CIC affiliates, "*Garamendi v. Executive Life* [citation] further supports the *in rem* classification here." (*Applied Underwriters*, 37 F.4th at 592.)

The Court notes that Schedule 2.6 does not require the affiliates to do anything or pay any amount. If Schedule 2.6's formulas require payment to a policyholder, *CIC* would make that payment, *not* the affiliates. (Sched. 2.6 ¶ VI.7.) Likewise, if Schedule 2.6 results in payment by the policyholder, the policyholder pays CIC, after which an eligible affiliate can seek indemnity from CIC. And again, nothing in the Plan affects the ability of CIC's affiliates to pursue relief against CIC or CIC II once the Plan is implemented.

CIC's objections to specific components of Schedule 2.6 are unpersuasive. CIC mischaracterizes Schedule 2.6 Option 2 as "rewrit[ing]" the RPA based upon an imaginary proxy company. (Opp. at 8, 29.) The Commissioner has a rational basis to rely on an open-market measure for quantum meruit

restitution under Option 2, as CIC's own measures of loss-sensitive policies were roughly 33 percent above market average. (See Reply Compendium, Exh. 92, 238:20-25.) Moreover, as the Commissioner points out, "a determination of fair market value is necessarily hypothetical." (*Long Beach Memorial Medical Center v. Kaiser Foundation Health Plan, Inc.* (2021) 71 Cal.App.5th 323, 346.) The Commissioner therefore had a rational basis to conclude that, what matters for purposes of determining the reasonable market value of a loss-sensitive policy is "the price that a *hypothetical* willing buyer would pay a *hypothetical* willing seller for the services." (See *id.* at pp. 345-346 [trial court did not err in jury instruction for quantum meruit claim defining "reasonable value" of services provided as "the price that a *hypothetical* willing buyer would pay a *hypothetical* willing seller for the services," italics added].)

Finally, with respect to New York's request that the remedies of Schedule 2.6 be made available to its policyholders engaged in litigation over the RPA, given the Commissioner's oversight, the Court will not entertain that request at this time. If the Commissioner wishes to propose New York's inclusion, he may make a subsequent application for amendment of the plan, including citation of authority showing that Schedule 2.6's remedies represent remedies available under New York law.

CONCLUSION

In light of the Court's determination that the Rehabilitation Plan meets the standard as articulated in the Standard of Review section above, the Court confirms that:

(1) the terms and conditions of this Plan and the other Transaction Documents, and the transactions contemplated hereby and thereby are enforceable;

(2) that this Plan, and the other Transaction Documents are fair, just and reasonable to Policyholders, creditors, the shareholder of CIC, and the public;

(3) that all executory portions of the Transaction Documents are approved and made valid, binding and enforceable in the event of a future insolvency of CIC; and

(4) that the reinsurers of Cedants (other than the Reinsurer) are not prejudiced by and have no lawful basis to avoid or terminate their contractual obligations to Cedants pursuant to such reinsurance agreements as a result of the transactions contemplated herein or in the Transaction Documents.

ACCORDINGLY, IT IS HEREBY ORDERED THAT

All Objections not otherwise ruled on in this Order are OVERRULED and preserved on appeal. (See *Reid v. Google, Inc.* (2010) 50 Cal.4th 512, 534.) The Commissioner's Request for Judicial Notice is GRANTED as to Exhibits 1 –7 and 10 and GRANTED, BUT NOT FOR THE TRUTH OF THE MATTERS ASSERTED THEREIN, as to Exhibits 8 and 9.

The Commissioner's Application and Application for Order Approving Rehabilitation Plan is GRANTED and the Rehabilitation Plan is adopted as amended. A true and correct copy of the approved, amended Rehabilitation Plan is attached to this Order as Attachment 1 and incorporated herein by this reference.

The Court's Order Appointing Insurance Commissioner as Conservator and Restraining Orders remain in full force and effect until expressly lifted or amended by subsequent order of the Court. The Court shall continue to exercise sole and exclusive jurisdiction over this Rehabilitation Plan and any claims pending against CIC.

Dated: 4-3-2024

Honorable Susan L. Greenberg