

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

In the Matter of

AMERICAN RELIABLE  
INSURANCE COMPANY,

Respondent.

ORDER DESIGNATING DECISION  
AS PRECEDENTIAL

File No. DISP 06091926

The attached Decision and Order is hereby designated as a precedential decision pursuant to California Government Code Section 11425.60 (b), effective immediately.

Date: June 30, 2006

/s/

JOHN GARAMENDI  
INSURANCE COMMISSIONER

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DECISION AND ORDER

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This matter came before the Commissioner pursuant to a Notice of Noncompliance and Order to Show Cause (“Pleading”) served on Respondent by the Department of Insurance on May 9, 2006. The parties executed a Special Notice of Defense, pursuant to which the Commissioner hereby makes the following findings of fact and conclusions of law, and issues this Decision and Order.

Respondent American Reliable at all relevant times has been an insurer licensed by the Department to transact insurance in this state.

Cabrillo General Insurance Agency, Inc. at all relevant times has been a general agent of American Reliable, authorized to accept insurance applications on American Reliable’s behalf, and to enter into agreements with subproducers to write insurance with American Reliable.

Superior Access Insurance Services is a California licensed fire and casualty broker-agent and “producer” of insurance. The word "producer" is an industry term of art that refers to both insurance agents and insurance brokers. Insurance agents and insurance brokers both transact insurance by soliciting, negotiating, and/or executing insurance contracts. However, insurance agents (as defined in sections 31 and 1621)<sup>1</sup> differ from insurance brokers (as defined in sections 33 and 1623).<sup>2</sup> A producer acts as an insurance agent if it transacts

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<sup>1</sup> All statutory references are to the California Insurance Code, unless otherwise indicated.

<sup>2</sup> § 31 ““Insurance agent" means a person authorized, by and on behalf of an insurer, to transact all classes of insurance other than life insurance. ...”

insurance on behalf of an insurer, even if it also transacts on behalf of an insured. A producer acts as an insurance broker if it transacts insurance on behalf of the insured *but not on behalf of the insurance company*.<sup>3</sup> Whether a producer is an agent or a broker depends on the nature of the producer's relationship with the insurance company with which the producer places a particular client.

Under section 1731<sup>4</sup>, a producer acts as an insurance agent in a particular transaction when it is appointed as an agent of an insurer pursuant to section 1704.<sup>5</sup> A producer also acts

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§ 33 ““Insurance broker" means a person who, for compensation and on behalf of another person, transacts insurance other than life with, but not on behalf of, an insurer.”

§ 1621 “An insurance agent is a person authorized by and on behalf of an insurer to transact all classes of insurance, except life insurance. The term "insurance agent" as used in this chapter does not include a life agent as defined in this article.”

§ 1623 “An insurance broker is a person who, for compensation and on behalf of another person, transacts insurance other than life insurance with, but not on behalf of, an insurer. Every application for insurance submitted by an insurance broker to an insurer shall show that the person is acting as an insurance broker. If the application shows that the person is acting as an insurance broker and is licensed as an insurance broker in the state in which the application is submitted, it shall be presumed, for licensing purposes only, that the person is acting as an insurance broker. Nothing in this section is intended to affect any rights or remedies otherwise available under the law.”

<sup>3</sup> An insurance broker may not transact insurance on behalf of an insurer in any manner, with two exceptions. A broker can handle premium or deliver evidence of coverage on behalf of an insurer. Section 1732.

<sup>4</sup> § 1731. Licensee deemed agent

A person licensed as a broker-agent shall be deemed to be acting as an insurance agent in the transaction of insurance placed with those insurers for whom a notice of appointment has been filed with the Insurance Commissioner in accordance with Section 1704 and is then in force.

<sup>5</sup> § 1704. Notices of appointment as agent of insurer

(a) Life agents, travel agents, and fire and casualty insurance agents shall not act as an agent of an insurer unless the insurer has filed with the commissioner a notice of appointment, executed by the insurer, appointing the licensee as the insurer's agent. Every fire and casualty broker-agent acting in the capacity of an insurance solicitor shall have filed on his or her behalf with the commissioner a notice executed by an insurance agent or insurance broker appointing and agreeing to employ the solicitor as an employee within this state. Additional notices of appointment may be filed by other insurers before the license is issued and thereafter as long as the license remains in force. The authority to transact insurance given to a licensee by an insurer or fire and casualty broker-agent, as the case may be, by appointment shall be effective as of the

as an insurance agent in a particular transaction when it should be appointed as an agent, even if it is not appointed. A producer should be appointed as an agent of an insurer if the producer would be deemed an agent of that insurer under common law, i.e., if the producer represents or

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date the notice of appointment is signed. That authority to transact shall apply to transactions occurring after that date and for the purpose of determining the insurer's or fire and casualty broker-agent's liability for acts of the appointed licensee. No notice of appointment of a life agent, fire and casualty broker-agent, or travel insurance agent shall be filed under this subdivision unless the licensee being appointed has consented to that filing. Each appointment made under this subdivision shall by its terms continue in force until:

(1) The cancellation or expiration of the license applied for or held at the time the appointment was filed.

(2) The filing of a notice of termination by the insurer or employing fire and casualty broker-agent, or by the appointed life agent, fire and casualty broker-agent, travel insurance agent, or insurance solicitor.

(b) Upon the termination of all appointments, or all endorsements naming the licensee on the license of an organization licensee, and the cancellation of the bond required pursuant to Section 1662 if acting as a broker, the permanent license shall not be canceled, but shall become inactive. It may be renewed pursuant to Section 1718. It may be reactivated at any time prior to its expiration by the filing of a new appointment pursuant to this section, Section 1707, and Section 1751.3, or the filing of a new bond pursuant to Section 1662. An inactive license shall not permit its holder to transact any insurance for which a valid, active license is required.

(c) Upon the termination of all appointments of a person licensed under a certificate of convenience, such certificate shall be canceled and shall be returned by its lawful custodian to the commissioner.

(d) A fire and casualty broker-agent appointing an insurance solicitor pursuant to this section, if a natural person, must be the holder of a permanent license to act as a fire and casualty broker-agent or the holder of a certificate of convenience so to act issued pursuant to either subdivision (a) or (b) of Section 1685. If the fire and casualty broker-agent is an organization, it must be the holder of a permanent license.

(e) The filing of an incomplete or deficient action notice with the department shall require the filing of an amended, complete action notice, together with the payment of the fee therefor specified in subdivision (n) of Section 1751.

(f) A notice of appointment appointing a solicitor may be filed by a second or subsequent fire and casualty broker-agent. The broker-agent seeking to appoint the solicitor shall enter into an agreement with all other fire and casualty broker-agents with whom the insurance solicitor has an existing appointment. The agreement shall govern how the broker-agents will determine on which fire and casualty broker-agent's behalf the solicitor is working when dealing with individuals who are customers of none of the fire and casualty broker-agents with whom the solicitor has an appointment. If the agreement does not identify which broker-agent or broker-agents are liable for the act of the solicitor, all fire and casualty broker-agents with whom the solicitor is appointed at the time of the act shall be jointly and severally liable for that act.

acts on behalf of the insurer. A producer represents or acts on behalf of an insurer, *inter alia*, whenever: the insurer has given the producer discretion to issue insurance binders; the insurer has obtained the producer's express or tacit agreement to apply specific underwriting or rating factors before submitting applications to the insurer; the insurer has directed or controlled the producer in any respect or reserved the right to do so; the insurer has permitted the producer to display the insurer's name or logo on the producer's signage, stationery or business cards in a manner that implies ostensible agency; the insurer refers potential or existing insureds to the producer; the insurer refers the producer to potential or existing insureds; the insurer attempts to control the licensee's conduct by disciplining the licensee (other than by terminating), or maintaining the right to discipline him, for failing to follow the insurer's rules or for failing to meet production standards; the insurer provides the same or substantially similar training to supposed brokers as to any appointed agents; the relationship between the producer and the insurer is functionally indistinguishable from the relationship between the insurer and its appointed agents; the producer has placed the insurer's interests above that of the insured and the insurer has accepted the benefits thereof; the insurer has incentivized the producer to act on the insurer's behalf by promising to provide compensation contingent upon the producer meeting a premium volume threshold, loss ratio or level of profitability. Superior Access has transacted insurance with American Reliable as American Reliable's agent.

Superior Access arguably had written binding authority from American Reliable. Binding authority is a dispositive indicium of an agency relationship.

The underwriting of insurance applications is a function that is always performed by insurers or agents of insurers. For obvious reasons, an insurer does not want, and no insurer has ever allowed, applicants for insurance to underwrite themselves.

When an insurer provides its underwriting criteria or guidelines to a producer, solicits or instructs the producer to apply that criteria to applications, and expressly or implicitly asks or incentivizes the producer to submit compliant applications to it (or not to submit noncompliant applications to it), the insurer thereby asks the producer to perform an insurer

function, and thus to act on behalf of the insurer. When a producer acts on behalf of an insurer in a transaction, the producer acts as an agent of the insurer pursuant to sections 31 and 1631 and general agency law.

American Reliable, via Cabrillo, provided its underwriting guidelines to Superior Access, instructed Superior Access to apply those criteria to applications, and directed and incentivized Superior Access to submit compliant applications to it and not to submit noncompliant applications to it. American Reliable, via Cabrillo, thereby asked Superior Access to perform an insurer function, and thus to act on behalf of American Reliable. Consequently, Superior Access was American Reliable's agent.

In any transaction involving three parties, an intermediary between the other two parties is deemed to be the agent of any party that directs or controls the intermediary. If the intermediary is subject to the direction and control of both other parties, the intermediary is a dual agent. Pursuant to sections 31 and 1631, a dual agent is deemed to be an insurance agent, not an insurance broker. American Reliable, via Cabrillo, directed and controlled Superior Access with respect transactions of insurance by Superior Access with American Reliable. Superior Access therefore acted as an agent of American Reliable.

One factor that can establish agency is the frequency and regularity of the relationship between the producer and the insurer.

A broker is, in essence, employed in each instance as a special agent for a single purpose, while the very definition of agent indicates an ongoing and continuous relationship. ... [B]rokers and insureds are ordinarily involved in what can be viewed as a series of discrete transactions, while agents and insurers tend to be under some duty to each other during the entire length of the relationship." 3 Couch on Insurance (3d ed. 1997) § 45:1, pp. 45-3 to 45-4, fns. omitted

Superior Access had an ongoing and continuous relationship with American Reliable via Cabrillo, and was thus an agent of American Reliable, rather than a broker for the insured.

A producer may not charge or collect a fee in addition to the premium for placing insurance with an insurer for which the producer is acting as an insurance agent. This prohibition derives from several legal principles:

(a) Under California case law, all money received by an insurance agent for a transaction of insurance is deemed constructively received by the insurer, i.e., the money is considered premium.

(b) Property and casualty premium rates must be approved by the Department, per section 1861.01(c) (sections 11735(a) and (c) for workers' compensation policies). When a fee that is in addition to the premium (i.e., which fee has not been approved by the Department as part of an insurer's rate filing) is received by an agent and imputed to the insurer, the insurer effectively will have charged and collected more premium than permitted under its approved rate.

(c) Property and casualty premium rates may not be unfairly discriminatory, per section 1861.05(a). When one agent charges and collects a fee, and another agent of the same insurer selling the same type of policy either charges and collects no fee or a different fee, the insurer effectively will have charged unfairly discriminatory rates.

(d) Insurance premium is taxable by the State. When an agent collects a fee, and that fee is not reported as premium by the insurer for which the agent was acting, the insurer will fail to pay its proper premium tax.

From at least September 2003, American Reliable permitted Superior Access, while acting as American Reliable's agent, to collect fees from American Reliable policyholders. These fees were in addition to the premium American Reliable was entitled to charge based on its approved rates. American Reliable constructively received the fees, which fees are therefore premium. American Reliable did not receive the Department's prior approval to collect or have Superior Access collect these fees.

By permitting Superior Access to charge and collect fees, American Reliable constructively charged and collected premium in excess of the premium permitted under the rate filings approved for it by the Department, in violation of section 1861.01(c).

Because Superior Access charged fees while other American Reliable agents did not, for policies subject to the same rate, rating plan or rating system, American Reliable insureds were subjected to unfair rate discrimination, in violation of section 1861.05(a). American Reliable willfully or negligently permitted the rate discrimination to occur.

The above findings establish that American Reliable used a rate, rating plan or rating system in violation of Chapter 9 of Part 2 of Division 1 of the Insurance Code, and provide grounds for a fine of \$5,000 for each policy in which Respondents permitted a fee to be charged by Superior Access, pursuant to section 1858.07(a).

The above findings establish that American Reliable has conducted its business and affairs in a manner that is hazardous to policyholders and the public, and constitute grounds for the Commissioner to issue an Order, pursuant to sections 1065.1 and/or 1065.3, requiring Respondents to:

- a. Exercise due diligence to prevent its agents from charging a fee for a transaction of insurance;
- b. Reimburse the Department \$5,000 for its costs in investigating and prosecuting this matter;
- c. Refund all fees illegally collected by Superior Access and constructively received by American Reliable;

#### ORDER

Respondent is ordered to:

- a. Use due diligence to assure that none of its agents charges a fee for a transaction of insurance;

- b. Pay the Department \$5,000 to reimburse it for its costs in investigating and prosecuting this matter, pursuant to the Special Notice of Defense;
- c. Pay the Department \$10,000 as a monetary penalty, pursuant to the Special Notice of Defense;
- d. Refund all fees collected by Superior Access associated with the placement of a policy with Respondent, in accordance with the agreement contained in Special Notice of Defense;
- e. Otherwise comply with the Special Notice of Defense.

Date: June 30, 2006

/s/

JOHN GARAMENDI  
INSURANCE COMMISSIONER

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