CALIFORNIA DEPARTMENT OF INSURANCE
LEGAL DIVISION
Michael J. Levy, Bar No. 154290
Harry J. LeVine, Bar No. 105972
Christina Carroll, Bar No. 263713
45 Fremont Street, 21st Floor
San Francisco, CA 94105
Telephone: (415) 538-4109
Facsimile: (415) 904-5490
harry.levine@insurance.ca.gov

Attorneys for the California Department of Insurance

BEFORE THE INSURANCE COMMISSIONER

OF THE STATE OF CALIFORNIA

In the Matter of the Certificates of Authority of CALIFORNIA INSURANCE COMPANY and APPLIED UNDERWRITERS CAPTIVE RISK ASSURANCE COMPANY, INC. Respondents.	File No.: MI-2015-00064 NOTICE OF HEARING AND ORDER TO CEASE AND DESIST FROM ISSUANCE OR RENEWAL OF WORKERS' COMPENSATION INSURANCE POLICIES AND COLLATERAL/ANCILLARY AGREEMENTS IN VIOLATION OF INSURANCE CODE SECTIONS 11658 AND 11735 AND CALIFORNIA CODE OF REGULATIONS, TITLE 10, SECTIONS 2251 AND 2268; NOTICE OF INTENT TO SEEK RECOVERY OF COSTS (Ins. Code §§1065.1 and 1065.3)

The California Department of Insurance (CDI) brings this matter against Respondent California Insurance Company (CIC) pursuant to Insurance Code §1065.1 and §1065.3 to require it to cease and desist from issuing or renewing any workers' compensation insurance policy that is amended, supplemented, endorsed or modified by, or which includes, incorporates, attaches or uses in any manner, any form of ancillary or collateral agreement referred to as a "Reinsurance Participation Agreement" or referred to by any other name (hereafter, an "RPA") that was held by the Insurance Commissioner's Decision & Order in *In the Matter of the Appeal of Shasta Linen*

Supply, Inc., CDI File No. AHB-WCA-14-31 (*Shasta Linen*), to be the use of an unfiled and unapproved collateral agreement in violation of Insurance Code §§11658 and 11735 and California Code of Regulations, Title 10, §2268 and former §2218.

The CDI brings this matter against Respondent Applied Underwriters Captive Risk Assurance Company, Inc. (AUCRA) pursuant to Insurance Code §1065.1 and §1065.3 to require it to cease and desist from issuing or renewing any RPA that is ancillary or collateral to a workers' compensation insurance policy issued to a California employer.

I

PARTIES AND ENTITIES

A. Respondent CIC is an insurance company domiciled in California that holds, and at all times relevant hereto held, a Certificate of Authority issued by the Insurance Commissioner to transact various classes of insurance, including workers' compensation insurance. CIC is a person subject to examination and is subject to the provisions of Insurance Code Article 1.4 (commencing with Insurance Code §1010.)

B. Respondent AUCRA is an insurance company domiciled in Iowa that holds a Certificate of Authority issued by the Insurance Commissioner to transact workers' compensation insurance in California.

C. CIC is a wholly-owned subsidiary of North American Casualty Company, which is an insurer domiciled in Iowa and which holds a Certificate of Authority issued by the Insurance Commissioner to transact various classes of insurance. North American Casualty Company and AUCRA are subsidiaries of Applied Underwriters, Inc. Applied Underwriters, Inc. is a subsidiary of Berkshire Hathaway, Inc.

II

USE OF UNAPPROVED FORM AND UNFILED RATE

A. CIC sold and currently has in effect, is liable on or administers workers' compensation insurance policies that were issued to California employers. CIC is authorized pursuant to its Certificate of Authority to issue new workers' compensation insurance policies to California employers.

B. CIC's workers' compensation insurance policies specify rates that were filed with the Insurance Commissioner by CIC pursuant to Insurance Code §11735. The filed rates are based on rate information and supplementary information submitted by CIC to the Insurance Commissioner as required by Insurance Code §11735. The workers' compensation insurance policies are written on forms that were submitted to the Insurance Commissioner and to the Workers' Compensation Insurance Rating Bureau of California (WCIRB) for review in compliance with Insurance Code §11658, and if applicable, Regulation §2268.

C. The rates under CIC's workers' compensation insurance policies, as described in Paragraphs A and B above, are fixed (subject to variation by payroll amounts and permissible factors, such as experience modification factors.) The policies do not contain retrospective rating factors, large deductibles, or terms that place a substantial cost of workers' compensation claims (including loss adjustment expenses) on the employer. CIC's approved workers' compensation insurance policies are hereafter referred to as the "Guaranteed Cost Policies." The Guaranteed Cost Policies are effective for one year.

D. CIC sold, has in effect, is liable on and administers Guaranteed Cost Policies that it issued as part of a workers' compensation insurance program that is titled "EquityComp." EquityComp contains the following components and operates as follows:

i. CIC entered into a reinsurance treaty with AUCRA pursuant to which it cedes a portion of the liabilities and premiums on the Guaranteed Cost Policies to AUCRA;

ii. When CIC sells a Guaranteed Cost Policy to a California employer, it requires the employer to enter into an RPA with AUCRA, which is a three-year contract. The RPA requires the employer to fund reimbursement to CIC of a substantial part of the workers' compensation claim payments that CIC will make under the Guaranteed Cost Policy. The RPA also requires the employer to fund reimbursement (or payment) of loss reserves. Finally, the RPA requires the employer to fund reimbursement of loss adjustment expenses that CIC incurs and will incur under the Guaranteed Cost Policy.

iii. The RPA requires the employer to fund reimbursement of the claims payments, loss reserves and expenses set forth in Subparagraph (ii) above by making periodic deposits into an

account that it calls a "single cell." The "single cell" is for payment or reimbursement of claims, reserves and expenses pertaining only to the employer's Guaranteed Cost Policy. The RPA states that an employer's "single cell" is not liable for debts and obligations of other employers' "single cells." The RPA is not a contract of reinsurance.

iv. The RPA requires the use of rates other than the rates set forth in the Guaranteed Cost Policy and it supersedes the rates and premium provisions of the Guaranteed Cost Policy.

v. The RPA contains terms that are inconsistent with the Guaranteed Cost Policy, that supersede the terms of the Guaranteed Cost Policy, and are disadvantageous to the employer. The RPA contains different loss reserving factors, different loss adjustment expense factors, and different cancellation rates than the Guaranteed Cost Policy. The payments required by the RPA into the "single cell" are typically far in excess of the premiums required by the Guaranteed Cost Policy.

vi. By requiring the employer to fund the "single cell" and by using the "single cell" to reimburse CIC for claim costs, loss adjustment expenses, and other expenses, and providing that those provisions control over the Guaranteed Cost Policy, the RPA substitutes a retrospective rated policy for the terms of the Guaranteed Cost Policy.

vii. Neither CIC nor AUCRA filed the RPA rates or filed supplementary rate information with the Insurance Commissioner as required by Insurance Code §11735 prior to the issuance of the Equity Comp policies that are now in effect or are being administered.

viii. Neither CIC nor AUCRA filed or sought approval of the RPA with the WCIRB or the Insurance Commissioner as required by Insurance Code §11658, former Regulation §2218 and Regulation §2268, prior to the issuance of the Equity Comp policies that are now in effect or are being administered. The RPA has never been approved for use.

ix. As a result of the terms of the RPA, the EquityComp premiums are based on rates other than the rates and factors that CIC filed with the Insurance Commissioner.

///

///

///

III

SHASTA LINEN DECISION & ORDER

A. In 2010, Shasta Linen Supply, Inc. obtained an EquityComp policy from CIC. The policy included a Guaranteed Cost Policy and an RPA that it entered into with AUCRA.

B. Pursuant to Insurance Code §11737, sometime prior to August 2014, Shasta Linen disputed with CIC the amounts that CIC and/or AUCRA demanded that Shasta Linen deposit into its "single cell" under the EquityComp policy. CIC rejected Shasta Linen's dispute and on August 29, 2014, pursuant to Insurance Code §11737(f), Shasta Linen appealed CIC's rejection to the Insurance Commissioner in the matter identified above as *Shasta Linen*. The appeal was heard by the Insurance Commissioner's Administrative Hearing Bureau.

C. Among the issues in *Shasta Linen* were the following;

(i) whether the RPA was a collateral agreement to CIC's Guaranteed Cost Policy that was required to have been been filed with the Insurance Commissioner and the WCIRB pursuant to Insurance Code §11658 and Regulation §§2218 (now §2251) and 2268;

(ii) whether CIC could charge Shasta Linen the rates required by the RPA and could enforce the terms of the RPA.

D. On June 20, 2015, the Insurance Commissioner issued his Decision & Order which held that RPA IS an unfiled collateral agreement and is an illegal contract. The Decision & Order provides, in pertinent part, as follows:

> VIII. Conclusion
>
> [T]he Insurance Commissioner finds by a preponderance of the evidence that Shasta Linen met its burden of proof in demonstrating that it is aggrieved by CIC's misapplication of its filed rates as a result of an unfiled and unapproved collateral agreement that modified the terms and conditions of the guaranteed cost policy, in violation of Insurance Code sections 11737 [sic] and 11658 and California Code of Regulations, title 10, section 2268.
>
> Further, CIC's EquityComp program's Reinsurance Participation Agreement constitutes a collateral agreement modifying the rates and obligations of the insured and insurer, and is void as a matter of law since it was required to be filed with the Workers' Compensation Insurance Rating Bureau and filed with the Department of Insurance before its use in the State of California, pursuant to Insurance Code section 11658 and California Code of Regulations, title 10, sections 2268 and 2218.

E. Paragraph 2 of the Decision & Order provides that the Decision and Order is

precedential pursuant to Government Code section 11425, subdivision (b).

IV

CONDITIONS PRECEDENT FOR ISSUANCE OF ORDERS PURSUANT TO INSURANCE CODE §§1065.1 AND 1065.3

CIC has worker's compensation insurance policies in force that have an RPA, or is continuing to administer policies that have an RPA, including EquityComp policies. AUCRA entered into RPAs that are in effect that were made part of Equity Comp policies issued by CIC. The *Shasta Linen* Decision & Order determined that the RPA is an unfiled collateral agreement in violation of Insurance Code §11658 and Regulation §2268 and is an illegal contract.

Neither the RPA that was at issue in *Shasta Linen* or any ancillary or collateral agreement that is substantially similar to that RPA has been approved by the Insurance Commissioner. On April 16, 2016 and May 19, 2016, AUCRA filed a modified RPA form with the WCIRB and the Insurance Commissioner, respectively. The Insurance Commissioner notified AUCRA on June 16, 2016 that the modified form is not approved for use.

As of April 1, 2016, the requirement for filing and approval of collateral agreements (now referred to as ancillary agreements) is contained in Regulation §2251(a) and §2268(b).

The CDI has reasonable cause to believe that CIC, by issuing or renewing workers' compensation insurance policies with California employers that have the RPA form that was at issue in *Shasta Linen* or that have an ancillary or collateral agreement that is substantially similar to that RPA form, and AUCRA, by issuing or renewing the RPA form that was at issue in *Shasta Linen* or an ancillary or collateral agreement that is substantially similar to that RPA form, will commit or engage in acts, practices or transactions that would constitute grounds rendering each of them subject to conservation and liquidation proceedings as follows:

A. Insurance Code §1011(e); by violating "any law of the state"; to wit, Insurance Code §§11658 and 11735 and Regulation §§2251 and 2268 and former Regulation §2218;

B. Insurance Code §1011(h); by failing to comply with the requirements for issuance of a certificate of authority; to wit, Insurance Code §717, subpart (e) ("competency, character, and integrity of management") and subpart (h) ("fairness and honesty of methods of doing business.")

V

ORDERS TO BE ISSUED AFTER HEARING TO CEASE & DESIST

The CDI seeks issuance of the following orders upon proof of the matters alleged herein:

A. An order that CIC shall cease and desist from violating Insurance Code §§11658 and §11735 and Regulation §§2251 and 2268 and shall not issue any EquityComp policy, or any other workers' compensation insurance policy, that has an RPA, or has a substantially similar unfiled ancillary or collateral agreement, unless and until such time, if ever, that the RPA or a substantially similar ancillary or collateral agreement is approved by the Insurance Commissioner;

B. An order that CIC shall cease and desist from violating §11658 and §11735 and Regulation §§2251 and 2268, and former Regulation §2218, and shall not renew any EquityComp policy, or any other workers' compensation insurance policy, that has an RPA, or has a substantially similar unfiled ancillary or collateral agreement, unless and until such time, if ever, the RPA or a substantially similar ancillary or collateral agreement is approved by the Insurance Commissioner, such approval being on a prospective basis only and without prejudice to the rights and remedies of an employer as to whom an RPA was previously issued in violation of Insurance Code §§11658 and 11735 and Regulation §§2218, 2251 and 2268.

C. An order that AUCRA shall cease and desist from violating §11658 and §11735 and Regulation §§2251 and 2268 and shall not enter into an RPA or a substantially similar unfiled ancillary or collateral agreement that is to be attached to an EquityComp policy or attached to any other workers' compensation insurance policy, unless and until such time, if ever, the RPA or a substantially similar ancillary or collateral agreement is approved by the Insurance Commissioner;

D. An order that AUCRA shall cease and desist from violating §11658 and §11735 and Regulation §§2251 and 2268, and former Regulation §2218 and shall not renew an RPA or a substantially similar unfiled ancillary or collateral agreement that is attached to an EquityComp policy or is attached to any other workers' compensation insurance policy unless and until such time, if ever, the RPA or a substantially similar ancillary or collateral agreement is approved by

the Insurance Commissioner, such approval being on a prospective basis only and without prejudice to the rights and remedies of an employer as to whom an RPA was previously issued in violation of Insurance Code §§11658 and 11735 and Regulation §§2218, 2251 and 2268.

E. Such orders as may be reasonably necessary to correct, eliminate, or remedy the conduct, conditions or grounds set forth in this "Notice of Hearing and Order to Cease and Desist ... "

VI

NOTICE OF INTENT TO RECOVER COSTS

The CDI seeks an order to direct CIC and AUCRA to fully reimburse the Insurance Commissioner for the costs of investigating, examining, and prosecuting this matter, pursuant to Insurance Code §1065.3.

VII

NOTICE OF HEARING

Pursuant to Insurance Code §1065.1, CIC and AUCRA are notified that a hearing shall take place on a date and time to be set by the CDI, which unless otherwise agreed upon, shall be not less than 20 days and not more than 30 days from the date of service of this "Notice of Hearing and Order to Cease and Desist ... "

Date: June 28, 2016

CALIFORNIA DEPARTMENT OF INSURANCE

By _____

Harry J. LeVine
Attorney IV