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BEFORE THE INSURANCE COMMISSIONER

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of **ADIR INTERNATIONAL, LLC,** Appellant, From the Decision of the **TRAVELERS PROPERTY CASUALTY COMPANY OF AMERICA,** Respondent.	)	FILE AHB-WCA-16-14

DECISION

Statement of the Case

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

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

Because workers' compensation insurance is mandatory for all California employers, the Legislature charged the Insurance Commissioner with closely scrutinizing all insurance plans to protect both workers and their employers.[2] To assist the Insurance Commissioner (Commissioner) in carrying out this responsibility and to support employers seeking affordable coverage, the Insurance Code mandates that insurers publicly file with the Commissioner all rates and related information used to set workers' compensation insurance premiums.[3]

This proceeding arises out of Travelers Property Casualty Company of America's (Travelers or Respondent) use of an unfiled side agreement that modified Travelers' obligations under the approved policy. Adir International, LLC. (Adir or Appellant) contends Travelers' unfiled side agreement violates Insurance Code sections 11658 and 11735, as it modifies the premium owed and the party's obligations under the insurance policies. Appellant's argument substantially relies upon the Insurance Commissioner's precedential decision *In the Matter of Shasta Linen Supply, Inc.*,[4] in which the Commissioner held that unfiled side agreements were unlawful and void.

Respondent maintains that neither the Side Agreement[5] nor its contents were required to be filed, notwithstanding the *Shasta Linen* decision. Respondent further argues the Insurance Commissioner lacks jurisdiction over this appeal and may not grant the remedies Appellant requests. Lastly, Travelers urges the Commissioner not to void the unfiled Side Agreement.

For the reasons set forth below, the Commissioner finds that Travelers' unfiled Side

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[2] *Nielsen Contracting, Inc. v. Applied Underwriters, Inc.* (2018) 22 Cal.App.5th 1096, 1118, rehg. den. May 23, 2018 (*Nielsen Contracting*).
[3] Ins. Code, §§ 11730-11742.
[4] *In the Matter of the Appeal of Shasta Linen Supply, Inc.* (Cal. Ins. Comm'r, June 20, 2016) AHB-WCA-14-31 (*Shasta Linen*). The Commissioner designated *Shasta Linen* precedential pursuant to Government Code section 11425.60, subdivision (b).
[5] Throughout this decision "Side Agreement" refers to Travelers' unfiled ancillary agreement with Appellant. Travelers titled the document "Agreement" on its face.

Agreement is void and unenforceable pursuant to Insurance Code section 11658 and California Code of Regulations, title 10, section 2268 and misapplied Travelers' filed rates and rating plan information in violation of Insurance Code section 11735.

Statement of Issues

1. Did the unfiled Side Agreement between Travelers and Adir constitute a collateral agreement and/or endorsement in violation of Insurance Code section 11658 and California Code of Regulations, title 10, section 2268?

2. Did the unfiled Side Agreement between Travelers and Adir constitute a collateral agreement between the parties that misapplied Travelers' Insurance Code section 11735 filings?

3. If so, what is the proper remedy?

Procedural History

On March 25, 2015, Adir filed a complaint with the California Department of Insurance (CDI or Department) regarding Travelers' unfiled Side Agreements.[6] Adir complained that Travelers' attempt to compel arbitration under the unfiled agreements violated Insurance Code sections 11658 and 11750.3. Appellant requested the Commissioner issue an Order to Show Cause and hold a public hearing before the Administrative Hearing Bureau (AHB) to determine whether Travelers should be ordered to cease and desist from enforcing and applying its unfiled Side Agreements.[7] Appellant further noted it had filed a Motion in the Los Angeles County Superior Court to declare the arbitration clause unenforceable.

On May 3, 2015, the CDI issued a letter to Adir stating the Side Agreements, including their arbitration clauses, were void and unenforceable as they were not filed with the CDI.[8] On

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[6] Exh. 248. Exhibits are referred to by the numbers assigned to them in the parties' Exhibit Lists.
[7] Exh. 248-2.
[8] Exh. 116.

June 3, 2015, the CDI sent a letter to Adir declining to take action. This letter stated in its entirety as follows:

> We have reviewed the complaint and request for action that you submitted on behalf of Adir International, LLC. While we agree on the merits that the side agreement is unenforceable because Travelers did not file it with the CDI, due to resource constraints we are not in a position to bring an enforcement action at this time.[9]

On August 21, 2015, the Los Angeles Superior Court denied Adir's Motion to Declare the Arbitration Clause Unenforceable. The Court ruled the arbitration panel should determine the validity of the arbitration clause and the side agreements.[10] Adir filed a petition in the court of appeal for a writ of mandate to challenge this ruling, but on October 29, 2015, the court of appeal denied the petition. Appellant filed a petition for review with the California Supreme Court, but that petition was similarly denied on November 24, 2015.

On April 11, 2016, Adir filed an appeal with the AHB in response to Traveler's March 18, 2016 decision rejecting Adir's Complaint and Request for Action. On April 22, 2016, Chief Administrative Law Judge (CALJ) Kristin L. Rosi issued an Appeal Inception Notice.

The evidentiary hearing commenced on August 30, 2016.[11] At the hearing, Nicholas P. Roxborough, Esq. and Ryan R. Salsig, Esq. of Roxborough, Tolerance, Nye & Adreani, LLP appeared on behalf of Appellant. Asim K. Desai, Esq. and Margaret M. Drugan, Esq. of Gordon & Rees, LLP, Thomas A. Martin, Esq. of Putney, Twombly, Hall & Hirson, LLP, and Tim Moroney, Esq. of Doctor Law Group, and Jodi K. Ebersole, Esq. of the Travelers Companies, appeared on behalf of Respondent. The parties submitted documentary evidence and presented

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[9] Exh. 252-2.
[10] Exh. 253-2.
[11] Prior to the evidentiary hearing, Travelers sought to enjoin this proceeding. The Los Angeles Superior Court denied Travelers' writ of prohibition. (Los Angeles Superior Court, Case No. BC575513.)

witnesses. The evidentiary record includes witness testimony and all exhibits admitted into evidence as identified in the parties' Exhibit Lists. The parties concluded their first round of briefing in November 2016.

In March 2017, Travelers sought an order in the Los Angeles Superior Court to compel Adir to comply with the Side Agreement's arbitration provision and pay for its portion of the arbitration.[12] In April 2017, the Los Angeles Superior Court denied Travelers' request.

On June 7, 2017, the CDI entered into a Settlement Agreement in *Shasta Linen Supply, Inc.*, AHB-WCA-14-31. The Commissioner ruled in *Shasta Linen* that California Insurance Company's (CIC) EquityComp program and the accompanying Reinsurance Participation Agreement constituted a misapplication of CIC's filed rates in violation of Insurance Code section 11735. CIC filed a petition for a writ of administrative mandamus in the Los Angeles County Superior Court challenging the Commissioner's jurisdiction and ruling. The Settlement Agreement dismissed CIC's writ petition and withdrew any challenge to the Commissioner's *Shasta Linen* decision and Order, causing *Shasta Linen* to remain precedential.

On August 14, 2017, the CALJ ordered the parties to brief the following question: "Should the Commissioner find Respondent violated the Insurance Code or its applicable Regulations in the instant proceeding, what, if any, remedy is available to Appellant?" The parties finalized their second round of briefing in October 2017.

On May 3, 2018, the California court of appeal issued a decision in *Nielson Contracting, Inc. v. Applied Underwriters, Inc.* (2018) 22 Cal. App. 5th 1096. The court, citing broadly and favorably from *Shasta Linen*, held that an arbitration agreement contained in an unfiled workers' compensation insurance side agreement is unenforceable and void as a matter of law.

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[12] Los Angeles Superior Court, Case No. BC575513.

In June 2018, Adir moved for reconsideration in Los Angeles Superior Court to declare the Side Agreement's arbitration clause void and unenforceable in light of *Nielsen Contracting*. On August 23, 2018, the Los Angeles Superior Court granted Adir's motion and ruled that the arbitration provisions contained in Travelers' Side Agreements are unenforceable since they were not filed with the Insurance Commissioner.

On September 10, 2018, the CALJ closed the record and took the matter under submission.

On September 27, 2018 a Proposed Decision was submitted to the Insurance Commissioner in this matter. On November 13, 2018, the Commissioner, pursuant to the provisions of 10 CCR 2509.69, chose not to adopt the proposed decision as his decision, but to decide the case upon the record.

Findings of Fact

The Commissioner finds, by a preponderance of evidence, the following material facts.[13]

I. Adir International

Adir International, LLC is a privately-held, Delaware limited liability company, headquartered in Los Angeles, California. Adir owns and operates a retail store chain under the name Curacao. Nine Curacao stores are located in California and the remaining two are located in Arizona.[14] Adir's 11 Curacao stores employ nearly 2,000 people, with approximately 1,700 employees in California.[15]

Adir's retail stores sell electronics and other household goods mostly on store credit. Adir

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[13] References to the transcript of the evidentiary hearing are "Tr." followed by the page number(s) and, where line references are used, a ":" followed by the line number(s).
[14] Tr. 573:1-2.
[15] Tr. 573:10-17.

"carries its own paper," meaning finances its own retail installment credit and debt collection operation.[16]

Prior to 2004, Adir received its workers' compensation insurance from State Compensation Insurance Fund through a guaranteed cost policy.[17] In 2004, Adir asked its insurance broker to research other workers' compensation insurance programs, such as large deductible retrospective rating plans, self-insurance plans and less expensive guaranteed cost options.[18] After reviewing its options, Adir selected a large deductible, retrospective rating plan from Travelers.[19] Adir admits it understood the terms and conditions its policy with Travelers.[20]

II. Travelers' Workers' Compensation Insurance Policies with Adir

A. Guaranteed Cost Policies

Most California employers receive workers' compensation insurance coverage through guaranteed cost policies. Under a guaranteed cost policy, the insured pays a fixed annual premium for the policy term, regardless of subsequent loss experience. The fixed premium is the sum of the average losses and certain fees. Average losses take into account the base rate for each classification assigned to the policy and the employer's experience modification factor.[21]

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[16] Tr. 572:14-19.

[17] Exh. 291, p. 24:18-25; 25:22-25. Appellant's witness, Ms. Illson, indicated Adir's prior carrier was "State Farm" in one instance and State Compensation Insurance Fund in another. Respondent's witness testified Adir's prior carrier was State Compensation Insurance Fund. (Tr. 383:20-25.) This discrepancy is noted, but is immaterial to this proceeding.

[18] Exh. 291, p. 28:14-22.

[19] *Id.* at pp. 28:24-29:6.

[20] Exh. 291, pp. 56:8-66:15.

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

The fees are the estimated costs of providing the insurance; that is sales, underwriting, profit and other fixed costs. Thus, a company with average losses of $500,000, may be charged $750,000 in premium; $500,000 to cover expected loss payments and $250,000 in fees.

Every guaranteed cost policy and its endorsements must adhere to the Insurance Code and its applicable regulations. All rates, rating plans and other premium information charged in a guaranteed cost policy must be filed with the WCIRB and approved by the Insurance Commissioner prior to use.[22] In addition, every guaranteed cost policy must contain statutorily-required dispute resolution and cancellation language.[23]

B. Travelers' Guaranteed Cost Policy Terms

Travelers and Adir entered into eight separate guaranteed cost policies from 2004 through 2012.[24] The policies contain standard language approved by the Commissioner. For example, each policy states that Travelers' rates, rating plans and related information are filed with the Commissioner and open to public inspection.[25] Travelers further warrants that "all premium for this policy will be determined by our manual of rules, rates, rating plans and classifications" and promises that "the only agreements relating to this insurance are stated in this policy."[26]

Each policy sets out the rates that Travelers may charge Appellant.[27] Travelers filed those rates with the Commissioner before the policies' commencement.[28] For policy year 2011 to 2012, Travelers set Appellant's California Classification Code 8017 rates at $3.38 per $100 of

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[22] Ins. Code, § 11735.
[23] Ins. Code, § 11650 et seq.
[24] Exhs. 110 to 113.
[25] E.g., Exh. 2-8.
[26] E.g. Exh. 2-2, 2-4, 2-8.
[27] E.g., Exh. 2-16.
[28] Workers' compensation insurance rate filings are available on the CDI's website at www.insurance.ca.gov.

payroll, and Appellant's Code 8810 rates at $0.41 per $100 of payroll.[29] In addition, as required by law,[30] Travelers warrants in each policy that it adheres to a single uniform loss experience rating plan and applies that experience rating to each policy.[31] Appellant's California experience modification factor for policy year 2011-2012 equaled 1.79. Based on these rates and experience modification, Travelers estimated Appellant's 2011-2012 annual premium at $1,466,684.[32]

Travelers' guaranteed cost policies also include a cancellation provision and a "short rate" cancellation notice, as required by the Insurance Code.[33] Cancelation under the policy is governed by its California Cancellation Endorsement, which permits the insurer to cancel for non-payment of premium, failure to comply with state law and reporting requirements or a material change in ownership.[34] The policies provide that after cancellation, the final premium will be determined as follows:

> a. If we [Travelers] cancel, final premium will be calculated pro rata based on the time the policy was in force. Final premium will not be less than the pro rata share of the minimum premium.
>
> b. If you cancel, the final premium may be more than pro rata; it will be based on the time this policy was in force, and increased by our short rate calculation table and procedure. Final premium will not be less than the minimum premium.[35]

The short rate penalty, which discourages employers from changing insurers mid-year, is a percentage of the full-term premium based on the number of days of coverage in the canceled policy.[36]

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[29] Exh. 2-16. Travelers also set rates for the following classifications: Code 8740 at $2.11; Code 9009 at $3.77; and 9516 at $3.83.
[30] Ins. Code, § 11752.8.
[31] E.g., Exh. 2-19
[32] Exh. 2-10.
[33] E.g., Exh. 2-8.
[34] E.g. Exh. 2-60.
[35] E.g., Exh. 2-8. This provision may be found in Part Five, Section E of each of Travelers' policies.
[36] *Shasta Linen, supra,* at p. 14.

Policy Part One, section D states that Travelers will pay the following costs as part of any claim, proceeding or suit they defend:

> 1. reasonable expenses incurred at our request, but not lost earnings;
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> 2. premiums for bonds to release attachments and for appeal bonds in bond amounts up to the amount payable under this insurance;
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> 3. litigation costs taxed against you;
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> 4. interest on a judgment as required by law until we offer the amount due under this insurance; and
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> 5. expenses we incur.[37]

This provision further states that Travelers has a duty to defend, at its own expense, any claim or proceeding arising under the insurance.[38]

The policies are silent regarding installment payments, collection actions, attorneys' fees, and medical cost containment. Nor do the policies' provide for binding arbitration or any other alternative dispute resolution methods.

B. Retrospective Rating Endorsements

Adir's guaranteed cost policies each contained an endorsement titled "Retrospective Rating Plan Premium Endorsement – Large Risk Alternative Rating Option."[39] A retrospective rating plan, or loss sensitive plan, varies the premium an employer will pay based on the employer's actual losses during the coverage period.[40] A minimum program cost, or premium, covers the program's basic costs. The premium then increases linearly with respect to actual

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[37] E.g. Exh. 105-4.
[38] *Ibid.* See Part One, section C.
[39] E.g. Exh. 105-33.
[40] *Shasta Linen*, *supra*, at pp. 15, 22; Exh. 129, 13:15-14:14.

losses until it reaches a maximum plateau.[41] A large risk deductible option varies the program calculation even further. Under most workers' compensation insurance policies, the insurer is statutorily obligated to pay an employee's entire claim, from the "first dollar" to the last. With a large risk deductible plan, the employer agrees to reimburse the insurer for claim costs up to an agreed-upon amount.[42]

In July 1996, Travelers filed the National Council of Compensation Insurance's (NCCI) standard retrospective rating plan with the CDI.[43] Travelers did not endorse or include this rating plan or any of its terms on its Retrospective Plan Endorsement, or anywhere else in Appellant's workers' compensation insurance policy. The Retrospective Rating Plan Endorsement states in its entirety:

> This endorsement is issued because you chose to have the cost of the insurance rated retrospectively. This endorsement applies only to workers compensation and employers liability insurance when rated under the provision of the Large Risk Alternative Rating Option that we have negotiated with you.

The Retrospective Rating Plan Endorsement is silent as to alternative premium calculation, formulas, definitions, terms, rates, or the parties' obligations under the rating plan. The only rates or rating plan included in Appellant's policy were the filed guaranteed cost rates.

Each Adir policy also included a General Purpose Endorsement which provides as follows:

> It is hereby agreed that the insured and the insurer have mutually agreed to a large risk alternative rating option retrospective rating plan.[44]

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[41] *Ibid.*
[42] Exh. 129, p. 15:2-13.
[43] Tr. 443:18-24; Tr. 445:6-7. Travelers modified the rating plan in subsequent years. The modifications altered only the eligibility requirements. (Tr. 449:13-450:15.)
[44] E.g. Exh. 105-47.

Again, the endorsement is silent as to the rates, formulas, terms, and other obligations. It is undisputed that Travelers used the unfiled and unapproved Side Agreement to fill in the formula, definitions and all policy costs.[45]

III. Travelers' Side Agreements with Adir

Prior to 2012, every large risk, loss sensitive insurance plan that Travelers issued to Appellant contained an unfiled Side Agreement. Travelers never inquired with the CDI whether the Side Agreement must be filed under the Insurance Code.[46]

For each policy year at issue, Travelers and Adir entered into an unfiled 28- to 31-page Side Agreement.[47] As outlined below, the Side Agreement defines premium calculation, terms and costs, introduces a collateral requirement, permits Travelers to collect attorneys' fees, alters the cancellation terms and requires binding arbitration of disputes. When the insurance policy and Side Agreement contain conflicting terms, the Side Agreement's terms prevail.[48]

A. Cover Page

Although titled "Cover Page," this section is actually six or seven pages and contains the information necessary to compute the program's cost. Page one provides the rating plan formula applicable to Appellant's policy. This formula calculates Adir's premium as follows:

> [(Retrospective Plan Incurred Losses + Retrospective Plan Claims Handling Charges) x Retrospective Development Factor] + Retrospective Plan Basic Premium + Premium Tax

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[45] Exh. 129, p. 54:17-23.
[46] Tr. 371:9-21.
[47] See Exhs. 110, 111, 112 and 113. The agreements substantive terms were identical and variations in length were due to pagination. Travelers concedes the Side Agreements were never filed with the WCIRB or the Department of Insurance. (Exh. 129, p. 67:2-10.)
[48] Exh. 129, p. 48:11-25; Exh. 129, p. 66:18-24

The premium is subject to a maximum loss content formula and a minimum program cost formula.[49] Travelers calculated and billed Adir premium based on this formula and not on the filed guaranteed cost formula endorsed on the policy.[50] In fact, Travelers admits its billing department never sees the underlying insurance policy since billing is based entirely on the Side Agreement.[51]

The Cover Page also provides the retrospective loss limitations, as well as the retrospective development factors and Appellant's pay-in amount.[52] The Side Agreement sets Appellant's retrospective loss limitations at $500,000, meaning that the Appellant is responsible for paying the first $500,000 of every workers compensation claim.[53] Pursuant to that provision, the loss limitation includes actual workers compensation losses and allocated loss adjustment expenses (ALAE).[54] The Agreement's retrospective development factors (RDFs) vary depending on adjustment date and do not zero out until seven years after the policy expires. Travelers selects the RDFs based on their California book of business and not on WCIRB data.[55]

The Side Agreement calculates Adir's basic premium on its total audited payroll divided by 100 and then multiplied by the basic premium rate Travelers selects.[56] For policy year 2011 – 2012, Adir's premium rate was 0.8217 per $100 of payroll.[57] Travelers and Appellant negotiated the premium rate.[58] The rate was not based on Travelers' approved guaranteed cost rates. As set

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[49] E.g. Exh. 110-3. The maximum loss content is the maximum amount of losses Travelers would bill to Adir for the policy period. (Exh. 131, p. 25:7-19.)
[50] Exh. 129, p. 55:11-15; Exh. 131, p. 42:8-22.
[51] Tr. 506:9-14; Exh. 131, p. 15:9-12.
[52] E.g. Exh. 110-4.
[53] Exh. 129, pp. 56:19-57:5.
[54] ALAE are expenses incurred in the investigation and defense of workers compensation claims.
[55] Tr. 388:6-13.
[56] E.g. Exh. 110-5; Exh. 131, p. 30:16-19.
[57] Exh. 110-5.
[58] Tr. 388:23-389:9.

forth in the plan, Adir's minimum basic premium for that policy year equaled $428,004.[59] This premium calculation method differs from the formula provided in Adir's policies. Indeed, Travelers admits it did not use the policies' filed rates to calculate Adir's premium.[60]

Travelers also charged Adir a claims handling fee under the Side Agreement. Travelers calculates that fee by multiplying a loss conversion factor and the first $250,000 of each workers compensation loss.[61] For policy year 2011-2012, Adir's loss conversation factor was .085.[62]

B. Preamble & Definitions Section

Each Side Agreement also contains a "Definitions" section describing the terms which Travelers states have "special meaning."[63] Relevant to this proceeding is the Agreement's definition of "basic premium," "ALAE" and Adir's obligations.

Prior to defining applicable terms, the Agreement sets forth the understanding between the parties, as well as their rights and obligations. Specifically, Travelers states:

> The Agreement represents the agreement the parties have reached whereby we will provide to you certain insurance coverages and services for the Policies we have issued pursuant to this Agreement, which Policies are incorporated herein by reference, in consideration of your payment of the Obligations described in the Sections and Exhibits comprising this Agreement.[64]

"Basic Premium" is defined as "the amount we charge for our expenses for policies subject to a Retrospective Plan."[65] This definition varies significantly from the definition in the policies. The policies state premium equals rates times Appellant's payroll. The policy definition

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[59] Exh. 110-5; Exh. 131, p. 31:18-22.
[60] Exh. 131, pp. 42:23-43:22.
[61] Exh. 110-5.
[62] *Ibid.*
[63] E.g. Exh. 110-9.
[64] E.g. Exh. 110-9.
[65] E.g. Exh. 110-11.

does not provide for expenses, and further states that premium is determined exclusively by the filed rates, rating plan and classifications.[66]

The Side Agreement provides that ALAE means "Allocated Loss Adjustment Expense" or "claim expense" in the applicable policy, unless otherwise defined.[67] Notably, the Side Agreement defines ALAE as attorneys' fees and litigation costs, investigation costs, and medical cost containment expenses. As noted above, the underlying policies provide that Travelers will pay all such claim expenses.[68]

The Side Agreement defines "obligations" as any indebtedness or liability of any kind arising in connection with any past, present or future Agreements, Agreement Letters, and any agreement incorporated by reference, including but not limited to attorneys' fees that Travelers may incur in enforcing Adir's obligations.[69] Given that the Side Agreement incorporates the policies by reference, this provision alters the parties' obligations, since the policies require Travelers to pay all attorney's fees and litigations costs.

C. Rating Plan(s) Computation Section

The Rating Plan(s) Computation Section effectuates the rates, terms and obligations in the Cover Page. Indeed, Travelers states "we issue such Policy(ies) based upon your compliance with the terms and conditions set forth in this Section."[70]

The Side Agreement explicitly provides that the total retrospective plan premium for the underlying insurance policy shall be calculated using the Retrospective Plan Computation Formula set out in the Cover Page. This section continues by noting that retrospective plan

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[66] Exh. 2-8.
[67] E.g. Exh. 110-9.
[68] Exh. 105-4.
[69] E.g. Exh. 110-11.
[70] E.g. Exh. 110-12.

incurred losses, claims handling charges, basic premium, minimum premium and maximum loss content conform to the Cover Page. It further explains that the premium tax rate applies the Retrospective Plan Computation Formula.[71]

Lastly, this section provides that Travelers may charge Adir under ALAE's medical cost containment expense component, as explained in a separate two-page exhibit.[72]

D. Miscellaneous Charges and Payment Sections

The Miscellaneous Charges section requires Appellant to reimburse Travelers, within five days of a demand, for all costs and expenses, including attorneys' fees, incurred in connection with the collection or enforcement of any of Appellant's obligations.[73] Should Appellant fail to remit payments within five days, Travelers may charge interest at the prime rate plus two percent. The underlying insurance policy contains no such provision.

The Payments section describes how obligations shall be paid. Specifically, Appellant must make monthly estimated premium payments.[74] In the event of default, Travelers may retain any overpayments as security for future obligations.

E. Collateral and Remedies Section

This provision concerns security and default. Travelers may require letters of credit as security for Adir's obligations under the policy and Side Agreement.[75] The letter of credit shall be irrevocable, unconditional and automatically renewing and provided within 10 days after

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[71] *Ibid.*
[72] E.g. Exh. 110-13.
[73] E.g. Exh. 110-14.
[74] E.g. Exh. 110-15.
[75] E.g. Exh. 110-16.

Travelers' request. Failure to provide a letter of credit upon request results in default and termination of the policy and Agreement.[76] There is no such provision in the underlying policy.

This section also includes a detailed default provision. "Default" means failure to pay any amount due, failure to perform any obligation under any Agreement Letter or any agreement incorporated in the Side Agreement, or failure to present a Letter of Credit upon request.[77] Should Appellant default, Travelers may immediately "terminate [the] insurance program or any insurance Policy issued thereunder and cancel or non-renew any certificates of insurance." In essence, this provision permits Travelers to cancel an insurance policy if an insured fails to perform any obligation under the unfiled Side Agreement.

F. General Conditions Section

Lastly, the Side Agreement contains a detailed general conditions provision, which describes cancellation calculations and dispute resolution procedures. Section B sets forth cancellation terms and calculations, differing from those in the underlying policy. If the policy is cancelled by either party prior to expiration, for the purposes of calculating an insured's Maximum Loss Content,

> The audited Exposure Base for that Policy shall be calculated by adding the audited Exposure Base from the beginning of the Policy period to the date of cancellation and the estimated Exposure Base for the balance of the original Policy period, subject to your Minimum Maximum Loss Content. If such Policy is cancelled by either party, your Minimum Program Cost is a flat charge in the amount set forth in the Maximum Loss Content and Minimum Program Cost part of the Cover Page.

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[76] *Ibid.*
[77] E.g. Exh. 110-17.

The Side Agreement provides that Connecticut law governs all disputes.[78] It also contains a three-page arbitration provision subjecting all disputes to binding arbitration in Connecticut.[79] This provision supplants the dispute resolution language in the guaranteed cost policies.[80]

G. Medical Cost Containment Expenses Component of ALAEs Exhibit

The Side Agreement also materially alters the definitions and parties' obligations regarding ALAE. As indicated above, each policy requires Travelers to pay all expenses incurred defending or processing any claim arising under the policy, including litigation costs. But the Side Agreements' ALAE exhibit alters this understanding, by allowing Travelers to apply a 27% charge to any savings resulting from medical bill repricing or auditing.[81] For example, if Travelers reprices a medical bill based on a state-mandated fee schedule, Adir must pay Travelers 27% of the realized savings. This provision is non-negotiable.[82]

IV. Travelers' Filing of Side Agreements with CDI

On February 14, 2011, the Insurance Commissioner issued a directive to all workers' compensation insurance carriers. The directive reminded insurers that Insurance Code section 11658 and California Code of Regulations, title 10, section 2268 prohibit the use of any unfiled policies, endorsements and collateral and/or side-agreements.[83] The Commissioner ordered insurers to submit any unfiled side agreements immediately. The Commissioner further stated that insurers' attempted enforcement of unfiled side agreements could constitute a violation of California law.[84]

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[78] E.g. Exh. 110-23.
[79] E.g. Exh. 110-19 to 110-21.
[80] Tr. 428:4-24.
[81] E.g. Exh. 110-27.
[82] Tr. 402:11-19.
[83] Exh. 10.
[84] Exh. 10-3.

Upon receiving the Commissioner's directive, Travelers met with trade associations to discuss the filing requirements. Travelers was aware the Insurance Code's filing requirements, but contends it believed its Side Agreements did not "modify" policy terms.[85]

In early 2012, nearly one year after the Commissioner's directive, Travelers submitted a proposed Side Agreement to the CDI. The original submission did not include the Cover Page, newly titled by Travelers as a "Program Summary," or the Definitions.[86] On March 19, 2012, Travelers submitted the Program Summary and Definitions. At that time, Travelers stated the Program Summary did not modify the policy and thus did not need to be filed pursuant to Insurance Code section 11658 or California Code of Regulations, title 10, section 2268.[87] On March 20, 2012, CDI attorney Christina Carroll sent Travelers an electronic message indicating the Program Summary did not need to be included in the section 11658 form filing as "it merely contains fill-in-the-blanks for premiums, deductibles, etc. as well as formulas."[88]

On April 4, 2012, Travelers filed its newly titled Insurance Program Agreement with the CDI. Identified by Travelers as "Endorsement WC 99 06 Q6," the filed Side Agreement contains the Definitions, Rating Plan(s) Computation, Payment, Defaults and Remedies, General Conditions and Medical Cost Containment Expense Component of ALAE sections included in the unfiled Side Agreements.[89]

Notably, the filed Insurance Program Agreement contains significant modifications. For instance, the filed Definitions section now explains "deductible plan loss," "incurred loss,"

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[85] Tr. 348:8-349:7; Exh. 129, p. 77:7-9.
[86] Exh. 244-1; Tr. 350:6-23.
[87] *Ibid.*
[88] Exh. 245-1; see also Exh. 128, p. 43:1-6.
[89] The filed Side Agreement also received a new title page, indicating the Side Agreement is an "Insurance Program Agreement." (Exh. 9-5)

"maximum/minimum retrospective plan premium" and "standard premium"; terms that were not described in the unfiled Side Agreement.[90] Travelers also revised the Rating Plan(s) Computation section to include a Deductible Plan Computation provision, a Non-Loss Responsive Premium section, and a Maximum Retrospective Plan Premium provision.[91] The Payment section now includes a Loss Fund provision, outlines billing and adjustment terms for losses and claims handling expenses and materially changes the plan adjustment requirements.[92] Travelers also reformed its Default and Remedies provisions to vary depending upon the type of security provided, and substantially restructured its Cancellation calculations[93] Travelers likewise amended the General Provisions section so that the filed Side Agreement no longer requires arbitration in Connecticut, nor are insureds required to consent to Connecticut law or jurisdiction.[94] Lastly, Travelers added the following language in the Legal Agreement section: "In the event of a conflict between any provision of this Agreement and any provision of any Policy, the Policy shall control."[95] This language came at CDI's behest.[96]

Analysis

Travelers contends the Insurance Commissioner lacks jurisdiction over this appeal arguing Appellant has not plead a violation that may be adjudicated under section 11737, subdivision (f). Travelers also argues its Side Agreement was not an endorsement or collateral agreement, notwithstanding its subsequent filing. Lastly, Travelers argues voiding the Side Agreement would be unduly harsh. Appellant argues the Commissioner's jurisdiction has already

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[90] Exh. 9-9. Compare with Exh. 110-11.
[91] Exh. 9-13.
[92] Exh. 9-15 to 9-18.
[93] Exh. 9-19 to 9-26.
[94] Exh. 9-27 to 9-30.
[95] Exh. 9-29.
[96] Tr. 286:11-287:5.

been determined by *Shasta Linen*, and that Travelers' Side Agreement fall squarely within the definition of an endorsement and collateral agreement. As a result, Appellant contends the Side Agreements are void as a matter of law. Each of these contentions is addressed separately.

I. The Commissioner Has Exclusive Jurisdiction Over This Appeal

Respondent's primary defense is jurisdictional. Specifically, Travelers argues the Los Angeles Superior Court has "precedential jurisdiction" as Appellant first sought relief in that tribunal.[97] Travelers also contends Appellant failed to plead a "rate or rating" issue, thereby divesting the CDI of any jurisdiction.[98] Next, Travelers asserts Adir waived CDI's jurisdiction and is collaterally estopped from seeking an appeal under Insurance Code section 11737, subdivision (f).[99] Lastly, Travelers contends the Federal Arbitration Act and the Side Agreement's language preclude the Commissioner from remedying Travelers' Insurance Code violations.[100] These arguments are without merit.

A. Applicable Law

In California, workers' compensation insurance programs are closely scrutinized and highly regulated pursuant to the Insurance Code's broad regulatory structure. The Legislature has charged the Commissioner with the authority to oversee the form and substance of all workers' compensation insurance plans, from the scope of required coverages to the amount employees pay for premiums.

The Insurance Code and its applicable regulations set forth comprehensive workers'

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[97] Travelers' Post-Hearing Brief, pp. 7-9.
[98] *Id.* at pp. 9-13.
[99] *Id.* at pp. 15-17.
[100] Travelers' Supplemental Brief Re: Remedies, pp. 5-9; Travelers' Post-Hearing Reply Brief, pp. 17-21. Travelers includes this argument for the first time in its brief regarding potential remedies. It did not make this argument during the initial round of briefing, and its inclusion in a brief for remedies is outside the scope of the CALJ's Order. Nevertheless, the Commissioner will address Travelers' contentions herein.

compensation form and rate requirements for all insurers. Insurance Code sections 11651 through 11664 detail an insurer's form and policy obligations, while Insurance Code sections 11730 through 11742 outline an insurer's rate filing requirements. These provisions, working in conjunction, mandate certain policy language and specify the form and manner in which all policies, endorsements, rates and rating plans must be filed prior to use.

1. The Statutory Rate Filing Scheme

California has an "open rating" workers' compensation regulatory system, in which each insurer sets its own rates and files them with the Commissioner. This framework is intended to curtail monopolistic and discriminatory pricing practices, ensure carriers charge rates adequate to cover their losses and expenses, and provide public access to rate information so that employers may find coverage at the best competitive rates.[101]

Insurance Code section 11735 lays out the statutory rate filing requirements. Subdivision (a) provides in part that "[e]very insurer shall file with the commissioner all rates and supplementary rate information that are to be used in this state. The rates and supplementary rate information shall be filed not later than 30 days prior to the effective date." The Insurance Code defines "rate" as "the cost of insurance per exposure base unit," subject to certain limitations.[102] And "supplementary rate information" is defined as "any manual or plan of rates, classification system, rating schedule, minimum premium, policy fee, rating rule, rating plan, and any other similar information needed to determine the applicable premium for an insured."[103] In addition, section 11735, subdivision (e) states that with regard to deductible plans, supplemental rate

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[101] See, generally, Ins. Code, §§ 11730-11742.
[102] Ins. Code, § 11730, subd. (g). Rates exclude the application of individual risk variations based on loss or expense considerations, as well as minimum premiums.
[103] Ins. Code, § 11730, subd. (j).

information shall include an endorsement that includes all of the following: (1) language that protects the rights of injured workers and ensures that benefits are paid by the insurer without regard to any deductible; (2) language that notwithstanding the deductible, the insurer shall pay all of the obligations of the employer for workers' compensation benefits for injuries occurring during the policy period; and (3) language specifying whether loss adjustment expenses are to be treated as advancements within the deductible to be reimbursed by the employer.

2. The Statutory Form Filing Scheme

Both the Insurance Code and its applicable regulations mandate that insurers file and receive approval before using any policy or endorsement in California. Specifically, Insurance Code section 11658 states:

> (a) A workers' compensation insurance policy or endorsement shall not be issued by an insurer to any person in this state unless the insurer files a copy of the form or endorsement with the rating organization pursuant to subdivision (c) of Section 11760 and 30 days have expired from the date the form or endorsement is received by the commissioner from the rating organization . . . unless the commissioner gives written approval of the form or endorsement prior to that time.
>
> (b) If the commissioner notifies the insurer that the filed form or endorsement does not comply with the requirements of law, specifying the reasons for his or her opinion, *it is unlawful for the insurer to issue any policy or endorsement in that form.*[104]

An endorsement is any form, agreement or document that amends, adds to, subtracts from, supplements, or revises a policy form and is attached to a policy form to be effective.[105] It may concern matters unrelated to the insurer's indemnity or obligations.

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[104] Emphasis added.

[105] *Adams v. Explorer Ins. Co.* (2003) 107 Cal.App.4th 438, 450-451; *Nielsen Contracting, supra*, 22 Cal.App.5th at p. 1117. In 2016, the Department amended California Code of Regulations, title 10 section 2250, subdivision (b) which codifies the Court's language that an endorsement is "form, agreement or document that amends, adds to, subtracts from, supplements, or revises a policy form and is attached to a policy form to be effective."

In addition, California Code of Regulations, title 10, section 2268 provided at the time the Side Agreement was executed that "no collateral agreements modifying the obligation of either the insured or the insurer shall be made unless attached to and make a part of the policy."[106] As such, any party's obligation concerning workers' compensation insurance that is not contained in the insurance policy itself must be made part of the policy through an endorsement. Unendorsed side agreements or obligations are prohibited.[107] Accordingly, an insurer must file and receive approval for any agreement that modifies or alters the insured's: (1) obligation to reimburse or otherwise pay the insurer for loss adjustment expenses and other policy or claim expenses; (2) indemnity or loss obligations; (3) payment or reimbursement obligations; (4) allocation of loss adjustment expenses or other fees and expenses; (5) timing of reimbursement or payments to the insurer; (6) collateral; (7) circumstances that constitute default; (8) choice of law; (9) arbitration obligation; and (10) other material obligations under any workers' compensation insurance program, plan or policy.[108]

3. Insurance Code Section 11737(f)'s Appeal Language

Insurance Code section 11737, subdivision (f), confers upon the Commissioner jurisdiction over private party appeals concerning the application of insurers' rates and rating plans. Specifically, the statute provides, in pertinent part:

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

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[106] In 2016, section 2268 was amended to delete the term "collateral agreement" and instead state "an insurer shall not use a policy form, endorsement for, or ancillary agreement except those filed and approved by the Commissioner in accordance with these regulations." The regulation was also amended to define "ancillary agreement" to include "dispute resolution agreements."

[107] *Shasta Linen*, *supra*, at p. 43.

[108] *Nielsen Contracting*, *supra*, 22 Cal.App.5th at pp. 1116-1118; *Shasta Linen*, *supra*, at pp. 43-44; see also, *American Zurich Ins. Co. v. Country Villa Service Corp.* (C.D. Cal. 2015) 2015 WL 4163008, 80 Cal. Comp. Cases 687 (*American Zurich*).

> insurance afforded or offered. ... Any party affected by the action of the insurer ... on the request may appeal ... to the commissioner, who after a hearing ... may affirm, modify, or reverse that action.

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

> Particularly when regulatory statutes provide a comprehensive scheme for enforcement by an administrative agency, the courts ordinarily conclude that the Legislature intended the administrative remedy to be exclusive unless the statutory language or legislative history clearly indicates an intent to create a private right of action [in court].[109]

B. Analysis and Conclusions of Law

1. The Legislature Vested the Commissioner with Exclusive Jurisdiction

Respondent contends that because Adir filed a complaint in the Los Angeles Superior Court seeking to invalidate the Side Agreements' arbitration provision, the Commissioner now lacks jurisdiction over this appeal.[110] Travelers' argument is without merit.

Insurance Code section 11737 sets out "a comprehensive scheme" to address workers' compensation rate filing violations. Section 11737 grants the Commissioner broad authority not only to hear private party appeals, but also to disapprove unfiled rates on his own initiative. Nothing in the statutory language or history indicates the Legislature intended to create a private right to bring civil court actions concerning the misapplication of an insurer's rating system. Therefore, the Commissioner's jurisdiction under section 11737, subdivision (f), is exclusive.

Travelers disregards the clear legislative intent granting the Commissioner exclusive jurisdiction, and instead cites *Browne v. Superior Court* (1940) 16 Cal.2d 593, for the

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[109] *Farmers Ins. Exchange v. Superior Court* (2006) 137 Cal.App.4th 842, 850; *Julian v. Mission Comm. Hosp.* (2017) 11 Cal.App.5th 360, 379, as modified on denial of reh'g. (May 23, 2017).
[110] Travelers' Post-Hearing Brief, pp. 7-9.

proposition that "where several courts have concurrent jurisdiction over a certain type of proceeding, the first one to assume and exercise such jurisdiction in a particular case acquires an exclusive jurisdiction."[111] Travelers also cites *Sea World Corp. v. Superior Court* (1973) 34 Cal.App.3d 494 in arguing that Adir waived the Commissioner's exclusive jurisdiction. Travelers' reliance on *Browne* and *Sea World* are misplaced.

In *Browne*, the guardian for an elderly woman sought to restrain the San Francisco County Superior Court from exercising jurisdiction over a writ of habeas corpus filed by the guardian's brother. The guardian argued the while the incapacitated woman was domiciled in San Francisco, Santa Barbara court had jurisdiction, as that Court had previously adjudicated her competency and had issued instructions to the guardian. The California Supreme Court held where several superior courts have concurrent jurisdiction over a certain type of proceeding, the first one to assume and exercise such jurisdiction in a particular case acquires exclusive jurisdiction. Here, however, the Los Angeles Superior Court and the Insurance Commissioner do not have concurrent jurisdiction. As noted above, section 11737, subdivision (f) exclusively charges the Commissioner with adjudicating the application of an insurer's rating plan. Such claims must be brought before the Commissioner in the first instance, not in court. Thus, the Los Angeles Superior Court could not have precedential jurisdiction over this appeal's subject matter.

In *Sea World*, an employee applied to the Workmen's Compensation Appeals Board for benefits for a work-related injury, and on the same day filed a court action against the employer on the theory that the injury had not occurred at work. Sea World moved for summary judgment, and when summary judgment was denied, filed a writ of prohibition to restrain the court action

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[111] *Id.* at p. 597.

on the grounds that the court lacked jurisdiction. The Court of Appeal held that where the employer invoked the Superior Court's jurisdiction in a motion for summary judgment, the employer had waived, or was estopped from asserting, the court's lack of jurisdiction.[112] *Sea World* is easily distinguishable.

Since the Insurance Commissioner has exclusive jurisdiction pursuant to section 11737, subdivision (f), neither the Los Angeles Superior Court nor the arbitrator could have reviewed the manner in which Travelers applied its filings. As a result, they would have had no authority to modify or reverse Travelers' actions under section 11737, subdivision (f). Consequently, since both the theory Appellant asserts, and the remedy it seeks in this appeal, fall within the Commissioner's exclusive jurisdiction, Adir did not waive its rights. Finding otherwise would leave Appellant with no forum in which to seek redress.

Further, the Superior Court itself rejected Travelers' jurisdictional arguments. In June 2016, Travelers filed a Petition for a Writ of Prohibition to enjoin Adir from pursuing its statutory appeal before the Department of Insurance. In that petition, Travelers raised the same "concurrent jurisdiction" issues. On August 24, 2016, the Court denied Travelers' writ, holding that it was improper.

Accordingly, the Insurance Commissioner has exclusive jurisdiction over this appeal in accordance with Insurance Code section 11737, subdivision (b) and Appellant has not waived that jurisdiction.[113]

2. Appellant Sufficiently Pled Insurance Code Violations

Travelers also contends Adir did not plead an Insurance Code section 11735 violation,

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[112] *Id.* at pp. 502-503.
[113] *Shasta Linen*, *supra*, at p. 47.

and as such the CDI lacks jurisdiction. This argument rests, in part, upon Travelers' conclusion that Insurance Code section 11658 violations may not be adjudicated in a private party appeal under section 11737, subdivision (f).[114] Travelers' arguments are not persuasive.

Travelers points to Appellant's pre-hearing brief to conclude that Adir is alleging only a section 11658 violation. In response to testimony by Travelers' witness, Appellant stated: "Adir's appeal is not based on Insurance Code section 11735. Adir's challenge has always has been based on Travelers' failure to comply with Insurance Code section 11658 and related form-filing requirements." But this statement does not accurately reflect Appellant's previous filings in this proceeding.

Adir's appeal, which includes its Complaint and Request for Action, specifically alleges Travelers' unfiled Side Agreements violate both Insurance Code section 11658 and 11735.[115] Similarly, Appellant's amended appeal, filed June 2, 2016, asserts "the Side Agreements Travelers is attempting to enforce are invalid under Insurance Code section 11658 and related regulations and constitute and [sic] unfiled rating plan under Insurance Code section 11735.[116] Travelers was aware of these contentions and its responses address Appellant's section 11658 and 11735 allegations.[117] In addition, while the parties spent much time arguing over the scope of this proceeding, the CALJ stated from the outset that the issue to be determined was "whether the side agreements between Adir and Travelers constitute a collateral agreement pursuant to [Regulation 2268] such that they must be filed and approved by the Commissioner in accordance with Insurance Code section 11658, and whether those side agreements misapplied Traveler's

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[114] Travelers' Post-Hearing Brief, pp. 9-13.
[115] See Complaint and Request for Action, dated April 11, 2016.
[116] Adir's Supplemental Appeal, dated June 2, 2016.
[117] Travelers' Responses to Adir's Appeal and Supplemental Appeal, dated June 22, 2016.

filed rates."[118] When Travelers objected to the proceeding's scope, the CALJ reminded Respondent that Adir's complaints challenged Travelers' form filing and the application of its filed rates and rating plan.[119] Thus, it is clear that Adir pled from the outset both section 11658 and section 11735 violations. In any event, nothing in the applicable statute or regulations requires flawless pleading. The Commissoner must consider the pleadings as a whole and Appellant need only plead facts entitling it to some relief.[120]

Travelers also contends section 11737, subdivision (f) does not permit the Commissioner to decide section 11658 form filing violations. Travelers' argument ignores the Commissioner's precedential decision in *Shasta Linen*. There, the Commissioner determined he had jurisdiction under section 11737, subdivision (f) to find that an unfiled and unapproved collateral agreement violated section 11658.[121] Similarly, Appellant asserts Respondent misapplied its rating plan by illegally enforcing an unfiled side agreement in violation of section 11658. Accordingly, the Commissioner has jurisdiction to hear and decide this case under Insurance Code section 11737, subdivision (f).[122]

3. Appellant is Not Collaterally Estopped from Appealing Under Insurance Code Section 11737(f)

Travelers also contends Adir is collaterally estopped from appealing under Insurance Code section 11737, subdivision (f) because of its civil action in the Los Angeles Superior Court.[123] This argument is unpersuasive.

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[118] Tr. 18:1-8.
[119] Tr. 24:11-16.
[120] *Gressley v. Williams* (1961) 193 Cal.App.2d 636, 639; *Dole v. City of Mountain View* (1976) 55 Cal.App.3d 110, 105.
[121] *Shasta Linen, supra*, at p. 69.
[122] This issue is discussed more fully in Section IV below.
[123] Travelers' Post-Hearing Brief, pp. 14-17.

Collateral estoppel bars relitigation of issues argued and decided in prior proceedings when certain threshold requirements are met.[124] Those requirements are: (1) the issue sought to be precluded from relitigation is identical to that decided in a former proceeding; (2) the issue was actually litigated in the former proceeding; (3) the issue was necessarily decided in the former proceeding; (4) the decision in the former proceeding was final and on the merits; and (5) the party against whom preclusion is sought is the same as, or in privity with, the party to the former proceeding.[125] Travelers fails to meet most of these requirements.

First, the issue Travelers seeks to preclude in this proceeding differs from that decided by the Superior Court. The issue before the superior court was whether Adir's challenge to the arbitration provision should be heard by the court or the arbitrator.[126] As stated above, the court ruled in Adir's favor that the arbitration clause was unenforceable, and Adir has not taken an inconsistent position here. Nevertheless, that is not the question raised in this proceeding. Even assuming the identical issues were presented in both proceedings, the superior court did not decide whether the Side Agreement, as a whole, violated section 11658. Instead, the superior court's ruling was limited to issues concerning the Side Agreement's arbitration clause.

Travelers also admits the court's decision is not final.[127] But in an effort to meet this requirement, Travelers argues that a final judgment includes any prior adjudication of an issue "that is determined to be sufficiently firm to be accorded conclusive effect." Travelers cites

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[124] *Hernandez v. City of Pomona* (2009) 46 Cal.4th 501, 511. See also, *Murray v. Alaska Airlines* (2010) 50 Cal.4th 860, 867.
[125] *Hernandez v. City of Pomona, supra,* 46 Cal.4th at p. 511.
[126] Order Declaring Arbitration Clause Void, filed August 23, 2018, Los Angeles Superior Court, Case No. BC575513, at p. 6.
[127] Travelers' Post-Hearing Brief, p. 15.

Sandoval v. Superior Court (1983) 140 Cal.App.3d 932 and *Border Business Park v. City of San Diego* (2006) 142 Cal.App.4th 932 for support. Its reliance on those cases is misplaced.

Sandoval was the second of two product liability suits against a manufacturer of a cotton picking machine. In the earlier suit, the injured plaintiff obtained a verdict and judgment in the trial court, and the parties settled during the pendency of the defendant's appeal. Their agreement provided the settlement was not to be construed as an admission of liability, and dismissed the action. In a second action by a different plaintiff, the trial court denied the plaintiff's motion for partial summary judgment as to liability on the ground that the prior litigation was never final. On appeal, the court of appeal held that the liability determination was final for issue preclusion purposes because the defendant had settled in a manner favorable to the plaintiff and dismissed its appeal.[128]

Border Business Park also involved multiple civil proceedings. In the first lawsuit, the plaintiff asserted a breach of contract claim to which the defendant demurred.[129] The trial court granted the demurrer and the defendant did not appeal that ruling. In a subsequent appeal, the defendant argued the demurrer did not bar relitigation of the breach of contract claim because the demurrer was not a final judgment for collateral estoppel purposes. The court of appeal, citing *Sandoval*, explained that prior adjudication of an issue may be deemed "sufficiently firm" if: (1) the decision was not avowedly tentative; (2) the parties were fully heard; (3) the court supported the decision with a reasoned opinion; and (4) the decision was subject to an appeal.[130] The court of appeal concluded that having decided not to pursue the remedy available, the defendant could

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[128] *Sandoval v. Superior Court*, *supra*, 140 Cal.App.3d at pp. 935, 939.
[129] *Border Business Park, Inc. v. City of San Diego*, *supra*, 142 Cal.App.4th at p. 1561.
[130] *Id.* at p. 1565; *Sandoval v. Superior Court*, *supra*, 140 Cal.App.3d at p. 936.

not contend the order was not a final adjudication on the issues it addressed.[131] Neither of these cases supports Travelers' contention.

Unlike in *Sandoval* and *Border Business Park*, where the trial courts' rulings were appealable, the superior court's decision on Travelers' motion to compel arbitration does not meet the finality test. It is well settled that an order to compel arbitration is not appealable.[132] Rather it may be reviewed on appeal from the final judgment confirming the arbitration award.[133] Because the order to compel arbitration was not appealable, and no judgment issued concerning the arbitration award, the decision is not "sufficiently firm" to be accorded conclusive effect. Accordingly, Appellant is not collaterally estopped from pursuing this appeal.

4. The Arbitration Provision Does Not Preclude the Commissioner from Enforcing the Insurance Code

Lastly, Travelers contends the Federal Arbitration Act (FAA)[134] and the Side Agreement's unfiled arbitration provisions preclude the Insurance Commissioner from asserting jurisdiction over this proceeding or issuing any remedy for Insurance Code violations. In support of these assertions, Travelers cites federal case law favoring arbitration and the superior court's decision regarding Traveler's motion to compel arbitration.[135] Neither argument is persuasive.

As discussed above, the superior court recently held the Side Agreement's arbitration provision is unenforceable, as it was not filed with the Insurance Commissioner prior to use. Relying on *Nielsen Contracting*, the superior court reversed its prior ruling that the FAA did not interfere with the section 11658's application, and stated "[t]his new law requires the court to

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[131] *Ibid.*
[132] *Ashburn v. AIG Financial Advisors, Inc.* (2015) 234 Cal.App.4th 79, 94; *Nelsen v. Legacy Partners Residential, Inc.* (2012) 207 Cal.App.4th 1115, 1121.
[133] *Ashburn v. AIG Financial Advisors, Inc., supra*, 234 Cal.App.4th at p. 94.
[134] 9 U.S.C. § 2.
[135] Travelers' Supplemental Brief Re: Remedies, pp. 5-9; Travelers' Post-Hearing Reply Brief, pp. 17-21.

reverse its August 21, 2015 order. The arbitration provisions in the side agreements here are unenforceable."[136]

Travelers' case law support is equally unpersuasive. Under the FAA's savings clause, an arbitration agreement is not enforceable if a party establishes a state law contract defense, such as fraud, duress or illegality.[137] Although arbitration agreements are not invalidated by "defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue," the agreement's enforceability remains subject to all other contract defenses.[138] And the superior court determined that such a defense was not met. Accordingly, the FAA does not preclude the Insurance Commissioner from determining whether the unfiled Side Agreements are unlawful and therefore unenforceable.[139]

II. Respondents Violated Insurance Code Section 11658 by Using an Unfiled and Unapproved Endorsement and Collateral Agreement

Having rejected Travelers' jurisdictional arguments, the Commissioner turns to the Side Agreements' legality. Travelers argues the unfiled agreements did not violate Insurance Code section 11658 because "prior to Commissioner Jones taking office on January 1, 2011, it never was a stated position of the [CDI] that such agreements needed to be filed because there was no statute or regulation clearly requiring the filing and approval of such ancillary agreement."[140] Travelers further argues the unfiled Side Agreements did not modify the parties' obligations and

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[136] Order Granting Adir's Motion to Declare Arbitration Clause Void, dated August 23, 2018, Los Angeles Superior Court, Case No. BC575513, at p. 4.
[137] *AT&T Mobility LLC v. Concepcion* (2011) 563 U.S. 333, 339; *Nielsen Contracting, supra*, 22 Cal.App.5th at p. 1107.
[138] *McGill v. Citibank N.A.* (2017) 2 Cal.5th 945, 962; *Nielsen Contracting, supra*, 22 Cal.App.5th at p. 1107.
[139] In addition, governmental regulations cannot be evaded by private contract. (*Alpha Beta Food Markets v. Retail Clerks Union Local 770* (1955) 45 Cal.2d 764, 771.)
[140] Travelers' Post-Hearing Brief, pp. 17-21.

thus were not required to be filed pursuant to Regulation 2268.[141] In support, Travelers relies on its own definition of endorsements. Travelers' arguments are unconvincing.

A. Applicable Law

Insurance Code section 11658 provides that a workers' compensation insurance policy or endorsement "shall not be issued to any person in this state" unless filed and approved by the Commissioner. An endorsement is any form, agreement or document that amends, adds to, subtracts from, supplements, or revises a policy form and is attached to a policy form to be effective.[142] Put another way, "any amendment to or modification of any existing policy of insurance that may vary any term or condition of the policy" in an endorsement that must be filed and approved before use.[143] It may concern matters wholly unrelated to the description of the insurer's indemnity and insurance obligations.[144]

California Code of Regulations, title 10, section 2268, in force at the time the Side Agreements were executed, provided: "No collateral agreement modifying the obligation of either the insured or the insurer shall be made unless attached to and made a part of the policy." This regulation is clear on its face that any obligation concerning the workers' compensation insurance that is not contained in the policy must be made part of the policy. Unfiled and unattached side agreements are prohibited.[145]

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[141] *Id.* at pp. 22-24.
[142] Cal. Code Regs., tit. 10, § 2250; see also, *Nielsen Contracting, supra*, 22 Cal.App.5th at p. 1117.
[143] *Nielsen Contracting, supra*, 22 Cal.App.5th at p. 1117; *Adams v. Explorer Ins. Co., supra*, 107 Cal.App.4th at pp. 450-451.
[144] *American Zurich, supra*, 2015 WL 4163008 at p. *12.
[145] *Shasta Linen, supra*, at p. 43; *American Zurich, supra*, 2015 WL 4163008 at p. *16.

B. Analysis and Conclusions of Law

1. Travelers' Side Agreement Was an Unfiled Endorsement to Adir's Policies

Travelers asserts its Side Agreement is not an endorsement and thus did not require filing pursuant to section 11658.[146] Travelers contends that because the Insurance Code defines "insurance" as "a contract undertaken to indemnify another against loss, damage or liability," endorsements must be defined as documents that shift the risk of loss. Travelers further contends that since the Side Agreement did not shift the risk of loss or modify the policy, it is not an endorsement. Both the Insurance Commissioner and California courts reject these arguments.

a. Endorsements Modify the Policies' Terms and Conditions

Contrary to Travelers' assertions, an endorsement is an amendment or modification to an existing policy that alters or varies *any term or condition* of the policy.[147] In fact, the court of appeal in *Nielsen Contracting*, recently rejected an identical argument and reaffirmed that an endorsement "may alter or vary any term or condition of the policy."[148] An endorsement need not concern an insurer's indemnity or insurance obligations.[149] Indeed many endorsements relate solely to administrative matters, unrelated to risk of loss or indemnity. For example, the arbitration clause in *Nielsen* did not relate to indemnity obligations but was nonetheless required to be filed under section 11658.[150]

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[146] Travelers' Post-Hearing Brief, pp. 24-26.
[147] *Nielsen Contracting, supra*, 22 Cal.App.5th at p. 1117; *Adams v. Explorer Ins. Co., supra*, 107 Cal.App.4th at pp. 450-451; *Shasta Linen, supra*, at p. 54; *American Zurich, supra*, 2015 WL 4163008 at pp. *5, *12.
[148] *Nielsen Contracting, supra*, 22 Cal.App.5th at p. 1117.
[149] *American Zurich, supra*, 2015 WL 4163008 at p. *12.
[150] Adir's policies contained cancellation endorsements, blanket waiver endorsements and non-renewal endorsements, none of which relate to Travelers' indemnity obligations. E.g. Exh. 2-43, 2-45, and 2-60. Travelers' witness confirmed as such. (See Exh. 129, pp. 41-43.)

In light of the comprehensive regulatory scheme and unambiguous state and federal case law on this issue, there is no reason to adopt Travelers' narrow definition.[151]

b. The Side Agreement Modified the Parties' Obligations

There is no question that Travelers' Side Agreement modified the policies' terms and conditions, as well as the obligations of the insured and insurer. Even a cursory review of the policy and Side Agreement mandate this conclusion. First, the language of the policies and the Side Agreements establish that the Side Agreements were part of Appellant's insurance program and intended to modify the parties' obligations. Each underlying insurance policy specifically provides that "the only agreements relating to this insurance are stated in this policy."[152] But the Side Agreement then expressly incorporates Adir's workers' compensation insurance policy. Indeed, the Side Agreement

> represents the agreement the parties have reached whereby [Travelers] will provide to you certain insurance coverages and services for the Policies we have issued pursuant to this Agreement, which Policies are incorporated herein by reference, in consideration of your payment of the Obligations described in the Sections and Exhibits comprising this Agreement.[153]

As such, the Side Agreement's intent was to modify the policies' terms and conditions. Travelers' witnesses admitted as much, stating repeatedly that the Side Agreement's terms govern premium, billing, risk of loss, cancellation, and indemnification.[154]

Second, the Side Agreement significantly modifies the parties' financial agreements and premium terms. While the policy provides that Appellant's premium will be determined by the

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[151] Travelers has been aware this definition for well over a decade. In *Travelers Cas. And Sur. Comp. v. American Intern. Surplus Lines Ins. Co.* (S.D. Cal. 2006) 465 F.Supp.2d 1005, 1025, the federal court held that "endorsements are modifications to the basic insuring forms in the policy and may alter or vary and term or condition of the policy."

[152] E.g. Exh. 2-4.

[153] E.g. Exh. 8-9.

[154] Exh. 131, p. 15:7-12; Tr. 202:5-10.

filed base rate for each classification, payroll amounts and the experience modification factor, the Side Agreement sets forth a detailed formula that includes claims handling fees, loss development factors and incurred losses. This materially alters Appellant's premium obligation. It is uncontroverted that the Side Agreement's terms governed Appellant's insurance payments. Indeed, Travelers' witnesses testified that the policy terms are irrelevant in determining premium and fees under the Side Agreement.[155]

In addition, the Side Agreement provides a collateral requirement, modifies the ALAE responsibility, and introduces retrospective development factors. For example, while the policy calls for Travelers to pay all claims-handling and incurred expenses, the Side Agreement shifts this responsibility to the Appellant. And while the policy calls for Travelers to pay all litigation costs, the Side Agreement overrides this obligation by requiring Appellant to pay attorneys' fees, defense costs and other expenses. The Side Agreement also provides that Adir shall be responsible for ALAE including medical cost-containment expenses and other claims-handling fees, which is a material change from the policy's language on this issue. Further, the Side Agreement permits Travelers to demand collateral, unlike the policy.

The Side Agreement also alters the default provision of Appellant's insurance policy. The filed and approved California Cancellation Endorsement on Appellant's policy provides that Travelers may cancel Appellant's policy for one of 12 specified reasons, including failure to report payroll, failure to pay premium and material misrepresentations.[156] Travelers' Side Agreement adds other default provisions. For instance, if Appellant "fails to perform any Obligation or to satisfy any requirements under any Agreement Letters, any agreements

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[155] Tr. 506:9-12; Exh. 131, pp. 29:8-30:19; Tr. 202:5-10.
[156] E.g. Exh. 2-60.

incorporated herein by reference or other similar agreement(s)," Travelers may terminate the insurance program or any insurance policies issued thereunder.[157] In essence, the Side Agreements permits Travelers to cancel Appellant's insurance if Appellant fails to comply with any of the Side Agreement's unfiled and unapproved terms.

Lastly, the Side Agreement altered the parties' dispute resolution provisions. Disputes under Appellant's policy are exclusively governed by Insurance Code section 11737, subdivision (f), which provides for an appeal right to the CDI. This language is mandated by the Commissioner's Regulations and must appear in every California workers' compensation insurance policy.[158] The policy is silent on choice of law and binding arbitration. On the other hand, the Side Agreement includes a three-page arbitration provision mandating the arbitration of premium and claims-handling disputes. The Side Agreement further requires Appellant to consent to Connecticut jurisdiction and dictates that Connecticut law applies to the Side Agreements and policies. Travelers intended these provisions to supersede those of the underlying policy. Indeed, the arbitration provision applies to "disputes that may arise . . . about the parties' rights and duties relative to the payment of premium and other charges under this Agreement and the Policies."[159]

Given that the Side Agreement modified several policy provisions, it was an endorsement. By issuing that unfiled and unapproved endorsement, Travelers violated Insurance Code section 11658.

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[157] E.g. Exh. 8-17.

[158] Cal. Code Regs., tit. 10, § 2509.43, subd. (d) requires that every policy incepting after May 23, 1999 provide insureds notice of their statutory appeal rights with the Insurance Commissioner. The form of that notice is set forth in Regulations section 2509.77. There is no evidence Travelers included this mandatory form with Appellant's policies.

[159] E.g. Exh. 8-19 to 8-20.

2. Travelers' Side Agreement Was an Unfiled Collateral Agreement

Travelers next contends the Side Agreement was not a collateral agreement pursuant to Regulations section 2268.[160] Specifically, Travelers argues the Regulations' language was unclear and further contends the Side Agreement does not modify the obligations of the insured or insurer. These arguments are without merit.

Regulations section 2268, in effect at the time Adir's Side Agreements were executed, provided that "no collateral agreements modifying the obligation of either the insured or the insurer shall be made unless attached to and made a part of the policy." Any and all obligations of either party under the workers' compensation insurance policy must be set forth in the policy or contained in a filed and approved endorsement attached to the policy. Unendorsed side agreements are strictly prohibited.[161] Not only has the Court of Appeal stated that section 2268's language is plain and unambiguous, but the court has also adopted the Commissioner's interpretation of section 2268.[162] As such, the regulatory language is clear.

It is also clear that the Side Agreements modified and altered the parties' obligations. An agreement must be filed if it changes the insured's (1) obligation to reimburse or otherwise pay the insurer for loss adjustment expenses and/or claims or other policy-related expenses; (2) indemnity or loss obligations; (3) payment or reimbursement obligation; (4) allocation of loss adjustment expenses or other fees and expenses; (5) timing of reimbursements or payments to the insurer; (6) collateral; (7) circumstances that constitute default; (8) choice of law; (9) arbitration

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[160] Travelers' Post-Hearing Brief, pp. 22-24.
[161] *Shasta Linen*, *supra*, at p. 43; *American Zurich*, *supra*, 2015 WL 4163008 at p. *15 [the term "side agreement" is synonymous with "collateral agreement."]
[162] *Nielsen Contracting*, *supra*, 22 Cal.App.5th at p. 1116 ["Although we are not bound by the *Shasta Linen* decision, we find its analysis persuasive on the prohibition of unfiled "collateral" or "side-agreements."]; *American Zurich*, *supra*, 2015 WL 4163008 at p. *15.

obligation; and (10) other material obligations under any workers' compensation insurance program, plan or policy.[163] As discussed in Section II(B) above, the Side Agreement modified Appellant's reimbursement obligation, added choice of law and arbitration provisions, altered the default and cancellation terms, added indemnity and loss obligations, and added a collateral requirement. Each of the provisions standing alone modified Appellant's obligations under the policy. Taken together, they wholly rewrote Appellant's insurance program. Thus, the Side Agreement was a collateral agreement under section 2268. Both Travelers' failure to file the Side Agreement prior to use and its failure to attach the agreement to Appellant's policy, violate that section.

3. Case Law Supports the Finding that the Side Agreement is an Endorsement and Collateral Agreement

The conclusion that Travelers' Side Agreement constitutes an unlawful collateral agreement and unfiled endorsement is supported by precedential CDI decisions as well as judicial decisions from state and federal courts.

In *American Zurich Insurance Company v. Country Villa Service Corporation*, 2015 WL 4163008, a California federal court considered an insurance program and situation nearly identical to Travelers'. There, Zurich attached a large deductible endorsement to Country Villa's insurance policy and further specified the large deductible plan's terms in an unfiled side agreement. The two-page endorsement defined relevant terms and indicated that Country Villa agreed to reimburse Zurich, up to the deductible amount, the sum of (1) all covered benefits and damages Zurich paid for the injured workers' benefit, (2) all ALAE and (3) all assessments incurred by Zurich related to the deductible amounts. The court held Zurich's failure to file its

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[163] *Id.* at pp. 43-4.

side agreement violated section 11658 and section 2268, notwithstanding the attached and approved large deductible endorsement.[164]

The Insurance Commissioner has also consistently held that side agreements, such as Travelers', are collateral agreements that must be filed pursuant to section 11658 and Regulations section 2268. In *Shasta Linen*, the Insurance Commissioner found a Reinsurance Participation Agreement (RPA) between an affiliate of the insurer and the insured to be an unfiled endorsement and unlawful collateral agreement in violation of Insurance Code section 11658 and Regulation section 2268.[165] While the parties had entered into a series of guaranteed cost insurance policies, the insurer also required the insured to sign the RPA, whose terms governed the parties' insurance relationship. Just as in this proceeding, the RPA's terms superseded the policies' terms or added new obligations. Having determined the RPA modified and supplanted the policies' terms, the Commissioner determined the RPA violated section 11658 and thus was void as a matter of law.[166] In so concluding, the Commissioner stated:

> The legal requirement for modifying any workers' compensation insurance obligation is to endorse the agreement to the insurance policy. This is done by filing the agreement with the WCIRB, which in turn will file it with the Insurance Commissioner, and endorse it to the insurance policy after the requisite time or approval. Unfiled side agreements are prohibited and shall not be used without complying with these requirements; otherwise, they are not permitted in this state and are void as a matter of law.[167]

Finally, the court of appeal has recently endorsed *Shasta Linen* in holding that unfiled arbitration and delegation clause provisions violate section 11658 and are thus void as a matter of law. *Nielsen Contracting* involved a nearly identical RPA to that found in *Shasta Linen*. In

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[164] *American Zurich, supra*, 2015 WL 4163008 at pp. *5-6.
[165] *Shasta Linen, supra*, at pp. 60-61.
[166] *Id.* at p. 69.
[167] *Id.* at p. 66.

that proceeding, the insurer sought to enforce the RPA's binding arbitration provision. The insured argued the RPA violated the Insurance Code and its applicable regulations because it had not been filed and attached, as required by section 11658 and regulation 2268, and thus could not be enforced. Just as in *Shasta Linen* and *American Zurich*, the court found that the side agreement modified and supplanted many of the policies' terms and added an otherwise unmentioned provisions.[168] Finding *Shasta Linen's* analysis persuasive, the court held that:

> [u]nder the plain language of section 11658 and Regulations section 2268, defendants were required to file the delegation clause and arbitration provision with the Insurance Commissioner because these provisions were collateral side agreements that materially modified the earlier approved CIC policies.[169]

These cases demonstrate Travelers was required to file and receive approval prior to issuing the Side Agreement.[170] Travelers' failure to do so violates Insurance Code section 11658 and Regulations section 2268.

III. Travelers' LRARO Endorsement and Subsequent Filing of the Side Agreement Does Not Extinguish its Insurance Code Violations.

Travelers next argues that CDI's approval of Travelers' Retrospective Rating Plan - Large Risk Alternative Rating Option (LRARO) endorsement, the Commissioner's February 2011 directive, and Travelers' subsequent filing of the Side Agreement relieve Travelers of liability under the Insurance Code and its applicable regulations. Travelers relies on unrelated legislative history and CDI's statements about the "Cover Page" to support its arguments. These arguments are without merit and have been consistently rejected by the courts.

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[168] *Nielsen Contracting, supra*, 22 Cal.App.5th at p. 1102.
[169] *Id.* at p. 1116.
[170] Travelers cites to cases overruled or deemed erroneous by *Nielsen Contracting* and *American Zurich*. Accordingly, the Commissioner will not consider those cases.

A. Filing of a Blank LRARO Endorsement Does Not Satisfy Regulatory Requirements

Travelers contends that by approving its two-sentences long Large Risk Alternative Rating Option endorsement the CDI approved Travelers' use of a retrospective rating plan and Side Agreement.[171] According to Travelers, "there are multiple ways to document agreement of formulas and terms for the LRARO accounts. While a Retrospective Premium Endorsement is certainly one way to provide such documentation, Travelers chose a different option – documenting the use of the LRARO rate plan in the policy and reflecting the agreement of the parties outside of the policy."[172] Travelers' position is, however, inconsistent with the Insurance Code, the regulations and case law.

First, Travelers' position ignores both Insurance Code section 11658 and Regulations sections 2218 and 2268[173] which require the filing and attachment of all policy forms, endorsements, terms and collateral agreements that modify the parties' obligations. The filing of a LRARO endorsement does not relieve Travelers of its obligation to file the Side Agreement if the Side Agreement modifies the policy's terms. Indeed, nothing in the statute or regulations so hold. Read together, the statutes and regulations require Travelers to file all policy forms, side agreements, rates, rating plans and supplemental rate information.[174] They do not permit Travelers to file minimal policy or rate information, and then modify or alter such terms with

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[171] Travelers' Post-Hearing Brief, pp. 25-26; Travelers' Post-Hearing Reply Brief, pp. 8-9.
[172] *Id.* at p. 8.
[173] Regulations section 2218, subdivision (a) provides that "*All* workers' compensation insurance forms must be submitted in duplicate to the [WCIRB] for preliminary inspection. The Bureau shall review such forms and submit them to the Commissioner for final action." (emphasis added.)
[174] *Nielsen Contracting, supra*, 22 Cal.App.5th at p. 1118 ["the Insurance Commissioner is charged with closely scrutinizing insurance plans to protect both workers and their employers {citation omitted). To accomplish this objective, the Legislature mandated that the Commissioner have full access to insurance information though mandated filing requirements."]

unfiled collateral agreements. Such action is expressly prohibited by the Insurance Code and is contrary to the code's comprehensive regulatory scheme.

Second, Travelers' argument ignores relevant case law on this point. In *American Zurich Insurance Company v. Country Villa Service Corporation, 2015 WL 4163008*, the Court found the insurers' unfiled and unattached side agreements governed integral aspects of the insurance relationship and that their sheer length and complex terms made it clear they were more than just the program's mechanics.[175] This holding directly contradicts Travelers' argument that "the Program Agreement was documentation of the financial parameters agreed to pursuant to the LRARO plan and the LRARO endorsement on the policy."[176]

Accordingly, Travelers' LRARO endorsement does not absolve Travelers from complying with all other regulatory filing requirements. Contrary to Travelers' conclusion, there is only one way to document program terms and formulas. The Insurance Code and regulations mandate the filing of *all* policies, endorsements, collateral agreements, rates, rating plans and supplemental rate information. The Insurance Code also mandates that *all* documents that modify or alters the parties' obligations be approved and attached to the insurance policy prior to use. This is the only method of Insurance Code compliance, and failure to follow these rules constitutes a violation of the statute and regulations.

B. The Insurance Commissioner's February 2011 Directive Does Not Extinguish Travelers' Insurance Code Violations

Travelers contends the Commissioner's February 2011 directive to insurance carriers extinguishes any Insurance Code violations. [177] In support, Travelers points to the

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[175] *Id.* at p. *15.
[176] Travelers' Post-Hearing Brief, p. 25.
[177] Travelers' Post-Hearing Brief, pp. 17-21; Travelers' Post-Hearing Reply Brief, pp. 14-17.

Commissioner's letter which provided that "as to collateral agreements that have not been attached and made part of existing or expired policies, please notify your insurer membership that those collateral agreements may remain in place."[178] Travelers, however, omits other crucial language from the letter and ignores its own inaction.

The Commissioner issued his directive in February 2011 and Travelers waited nearly one year before presenting its Side Agreement to CDI and the WCIRB. During that time, Travelers met with other insurers to discuss a collective response to the Commissioner's directive. Also during that one year, Travelers issued Appellant its final Side Agreement, knowing that such agreement had not been filed or attached as required by California law.

The Commissioner's February 2011, directive expressly addressed those insurers who continued to enforce unfiled and unattached policies, endorsements or collateral or side-agreements.[179] As the Commissioner stated, while "some insurers may not be aware of this provision, have ignored it, or may have determined that it is not applicable and have failed to submit collateral agreements to the WCIRB," the collateral agreement insurers are currently using must be attached to the policy.[180] The Commissioner stated that unfiled and unattached collateral agreements may remain in place "but shall be subject to review by the Department if those agreements are to be unilaterally enforced by the insurer against any of its insureds."[181]

> In particular, insurers need to be aware of the potential for violation of California law that may occur if those collateral agreements are enforced. These may include possible unenforceability of the collateral agreements for failing to attach them to the policy or submit them pursuant to Insurance Code section 11658 and 11750.3, enforcement actions by the Insurance Commissioner against the insurer for unfair practices and issuance of Cease and Desist Orders,

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[178] Travelers' Post-Hearing Reply Brief, p. 14; Exh. 10-3.
[179] Exh. 10.
[180] Exh. 10-3.
[181] *Ibid.*

> and inability of the insurer to cancel the insurance policy for the insureds violation of any terms of the unattached agreement pursuant to Insurance Code Section 676.8.[182]

Nothing in the Commissioner's directive relieved insurers from liability under the Insurance Code. Under the language above, it did the opposite. Further, Travelers received the Commissioner's directive at the time is was issued and thus knew that continued use of unfiled collateral agreements would constitute a violation of California law.[183] Travelers' attempt now to relieve itself of willful Insurance Code violations lacks merit.

C. The Side Agreement Needed to be Filed at All Relevant Times

Travelers spends a significant portion of its opening brief arguing that prior to February 2011, "it was never the stated position of the [CDI] that such agreements needed to be filed because there was no statute or regulation clearly requiring the filing and approval of such ancillary agreements."[184] This is wrong. Since 1995, Insurance Code section 11658 has required insurers to file all policies or endorsements for approval prior to use. Since 1968, Regulations section 2268 has prohibited the use of unfiled and unattached collateral agreements. As the Court of Appeal reiterated in *Nielsen Contracting*, "the plain language of section 11658 and Regulations section 2268" require insurers to file any collateral side agreements that modify the approved insurance policy.[185] Given *Nielsen's* finding that "section 11658 and Regulations

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[182] *Ibid.*
[183] Exh. 129, pp. 73-74.
[184] Travelers' Post-Hearing Brief, p. 17. Travelers supports this contention by producing the legislative history from unadopted legislation, and requests the Department take official notice of that legislative history as well as Travelers' accompanying declaration. Travelers' request for official notice is denied. A request for official notice of published material is unnecessary. Citation to the material is sufficient. (*Quelimane Co. v. Stewart Title Guar. Co.*, (1998) 19 Cal.4th 26, 46, fn. 9.) To the extent Travelers is seeking to admit unpublished legislative materials, the request is denied. The Commissioner also rejects the filing of Ms. Lillge's declaration. Travelers was provided an opportunity to present witnesses at the time of trial and failed to call Ms Lillge. Permitting her testimony now, without the opportunity for cross-examination, would violate Appellant's due process rights. In addition, such testimony is irrelevant to this proceeding.
[185] *Nielsen Contracting, supra*, 22 Cal.App.5th at p. 1116.

section 2268 are clear and unambiguous," examination of separate code sections or failed legislation is inappropriate and unnecessary.[186] That Travelers chose to ignore the statute's unambiguous mandate or chose to interpret the requirements differently does not render the regulatory scheme unclear.[187] Accordingly, Travelers' argument fails.

D. Subsequently Filing the Program Agreement Did Not Render the Unfiled Side Agreement Lawful

Travelers next argues that the filed and approved Program Agreement is substantially similar to Travelers' unfiled Side Agreement, rendering the Side Agreement's terms legal. Travelers provides no statutory or case law support for this proposition, nor could the Commissioner locate any case holding that subsequent compliance with a statute or regulation relieves the party of liability for earlier noncompliance. At any rate, the filed Program Agreement and unfiled Side Agreements are not substantially similar. The most prominent difference is that in the event of a conflict, the policy takes precedence over the Program Agreement but not the unfiled Side Agreement.[188] The Program Agreement also modified the Side Agreement's medical cost containment expense provision, the choice of law and arbitration provisions, and collateral and default provisions. Put simply, the Program Agreement is markedly different from the unapproved Side Agreement, and its filing does not excuse Travelers' prior Insurance Code violations.

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[186] *Id.* at p. 1120; see also *Microsoft Corp. v. Franchise Tax Bd.* (2006) 39 Cal.4th 750, 758; *People v. Johnson* (2002) 28 Cal.4th 240, 247 ["resort to the legislative history is unnecessary where, as here, the statutory language is clear and unambiguous.]

[187] Travelers admits it was aware of the statutory and regulatory filing requirements prior to issuing the Side Agreements. (Tr. 348:6-22.)

[188] Exh. 9-29.

E. Exclusion of the "Cover Page" From Section 11658 Filings Did Not Relieve Travelers of its Section 11735 Rate Filing Requirements

Travelers asserts the CDI cannot penalize Travelers for failing to endorse the Side Agreement's Cover Page since those pages "were never required to be filed pursuant to Insurance Code section 11658."[189] In support, Travelers cites CDI electronic messages stating as such. Travelers' assertion is irrelevant.[190]

The Cover Pages memorialize the formulas used to determine an insured's overall premium. They set forth claims-handling expenses, loss limitations, minimum and maximum costs, ALAE computation as well as retrospective loss development factors and premium tax obligations. There is no question that such information must be filed with the Insurance Commissioner. That obligation arises under Insurance Code section 11735's rate filing provisions, not under section 11658's form filing requirements.

Section 11735, subdivision (a) requires insurers to file all rates, rating plans and supplemental rate information for approval prior to use. Rates filed pursuant to section 11735 shall be in the form and manner prescribed by the Insurance Commissioner.[191] This procedure is separate and distinct from section 11658's form filing requirements and does not require WCIRB participation. With regard to deductible agreements, section 11735, subdivision (e) provides:

> (e) *Notwithstanding Sections 11657 to 11660,* inclusive, supplementary rate information filed with the commissioner for purposes of offering deductibles to policyholders for all or part of benefits payable under the policy shall be deemed complete if the filing contains all of the following:

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[189] Travelers' Post-Hearing Brief, pp. 32-33.
[190] Adir disagrees with CDI's statements regarding the filing of Cover Pages under Insurance Code section 11658. (Adir's Post-Hearing Reply Brief, pp. 15-16) Because CDI's statements speak only to the Cover Pages, the Commissioner need not address the validity of CDI's statements.
[191] Ins. Code, § 11735, subd. (b).

> (1) A copy of the deductible endorsement that is to be attached to the policy to effectuate deductible coverage.
>
> (2) Endorsement language that protects the rights of injured workers and ensures that benefits are paid by the insurer without regard to any deductible. The endorsement shall specify that the nonpayment of deductible amounts by the policyholder shall not relieve the insurer from the payment of compensation for injuries sustained by the employee during the period of time the endorsed policy was in effect. The endorsement shall provide that deductible policies for workers' compensation insurance coverage shall not be terminated retroactively for the nonpayment of deductible amounts.
>
> (3) The endorsement shall provide that notwithstanding the deductible, the insurer shall pay all of the obligations of the employer for workers' compensation benefits for injuries occurring during the policy period. Payment by the insurer of any amounts within the deductible shall be treated as an advancement of funds by the insurer to the employer and shall create a legal obligation for reimbursements, and may be secured by appropriate security.
>
> (4) The endorsement shall specify whether loss adjustment expenses are to be treated as advancements within the deductible to be reimbursed by the employer.[192]

It is clear the Legislature intended the deductible-related provisions contained in section 11735 to be in addition to the mandatory filing requirements of section 11658. Read as a whole, section 11735 requires the disclosure of all information necessary to calculate deductibles and requires that deductible endorsements include that information.

By Travelers' own admission, CDI's form-filing unit reviewed the Side Agreement not for compliance with section 11735, but only for compliance with section 11658.[193] Nothing in

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[192] Ins. Code, § 11735, subd. (e).

[193] Tr. 284:10-21.

[Q; And what was our understanding when – with respect to talking about them being strictly financial in nature, what was your understanding of that?
A: I took her answer to mean that they did not need filing approval with the CDI.
Q: Okay. And filing under 11658, right?
A: Right.
Q: Okay, We're not talking about rate filings here; we're talking about form filings pursuant to Insurance Code 11658?

CDI's communications references compliance with section 11735, nor did Travelers seek an opinion regarding its compliance with section 11735. Thus, section 11735 required Travelers to file the Cover Page information and Travelers is not relieved of responsibility for failing to do so.[194]

IV. Respondents' Insurance Code Violations Constitute a Misapplication of Travelers' Filed Rating Plan

Travelers' use of an unfiled and unattached Side Agreement to apply its section 11735, subdivision (a) filed rates misapplies its rate filings, giving rise to a claim under section 11737, subdivision (f). In addition, Travelers' use of an endorsement that does not comport with section 11735, subdivision (e)'s requirements is unlawful and gives rise to a claim under section 11737, subdivision (f). Put different, by applying unfiled and unattached terms and rates, Travelers misapplied its section 11735 rating plan filings.

A. Applicable Law

Insurance Code section 11737, subdivision (f), confers upon the Commissioner jurisdiction over private party appeals concerning the application of insurers' section 11735 filings. Section 11735, subdivision (a), requires insurers to file all rates and supplementary rate information, without exception, before using them in California. In addition, section 11735, subdivision (e) states that with regard to deductible plans, rate filings shall include an

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A. That was my understanding, yes.]

[194] The distinction between the form and rate filings is neither technical nor frivolous. Insurance Code section 11735's filing and public inspection requirement protect the state's workforce by ensuring benefits are available to those injured or sickened in the course of their employment. The filing requirement ensures the Commissioner has the rate information necessary to determine that insurers charge amounts that are not discriminatory, not monopolistic, cover their losses and expenses, and do not threaten their solvency. In addition, section 11735's public inspection requirement provides broad access to filed rate information allowing employers to find coverage at the best competitive rates. When rate information is transparent, policyholders are better able to compare coverage and reduce their costs. And insurers are less likely to gain a monopolistic advantage when all carriers' pricing information is public.

endorsement that includes all of the following: (1) language that protects the rights of injured workers and ensures that benefits are paid by the insurer without regard to any deductible; (2) that notwithstanding the deductible, the insurer shall pay all of the obligations of the employer for workers' compensation benefits for injuries occurring during the policy period; and (3) language specifying whether loss adjustment expenses are to be treated as advancements within the deductible to be reimbursed by the employer.

B. Analysis and Conclusions of Law

1. Travelers Misapplied Its Filed Rate By Charging Them Under an Illegal, Unfiled Form

California's comprehensive workers' compensation statutory and regulatory framework requires insurers to charge filed rates using filed forms. An insurer correctly applies its section 11735 rate filing when it charges *only* its rates using policies and endorsements filed under Insurance Code section 11658 and Regulations section 2268. Charges under unfiled forms are not valid. In addition, a filed rate or rating plan must be validly endorsed on the policy to be used. Thus, by charging Appellant under the illegal, unfiled Side Agreement, Respondent misapplied its rate filings.

2. Travelers Misapplied Its Filed Rating Plan By Violating Insurance Code section 11735(e)

Travelers also misapplied its filed rating plan by violating Insurance Code section 11735, subdivision (e). Section 11735, subdivision (e) mandates that certain supplementary rate information be endorsed on deductible policies. Travelers did not endorse its supplementary rate information on Appellant's policy. For example, Appellant's policies did not contain a filed endorsement specifying whether loss adjustment expenses are to be treated as advancements

within the deductible to be reimbursed by the employer.[195] The filed endorsements were also silent on Travelers' obligation to compensate injured employees notwithstanding Appellant's failure to pay its deductible amounts.[196] That information was included only in the unfiled Side Agreement. By modifying its filed rating plan using unfiled, illegal deductible terms and supplementary rate information, Travelers misapplied that rating plan.

V. Rate Disapproval Procedures Are Not Applicable to This Proceeding

Travelers argues that use of unfiled rate information is not unlawful unless the Commissioner follows the rate disapproval procedures laid out in Insurance Code section 11737, subdivisions (a) and (d).[197] Finding the use of unfiled rate information unlawful under subdivision (f) is neither equivalent to, nor predicated on, rate disapproval.[198]

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

Travelers further argues that use of unfiled rate information remains lawful unless the

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[195] Ins. Code, § 11735, subd. (e)(4).
[196] Ins. Code, § 11735, subd. (e)(2).
[197] Travelers' Response to Adir's Appeal and Supplemental Appeal, filed June 22, 2016, pp. 31-32.
[198] See *Shasta Linen, supra,* at p. 45 ["The authority to hear grievances of employers for misapplication of rates … is separate from the Commissioner's authority to disapprove rates."]

rates are first disapproved. Their argument implies that if use of unfiled rates were *per se* unlawful, the Commissioner's authority to disapprove those rates would be superfluous. According to that argument, disapproval must be a prerequisite to finding unfiled rates unlawful. But the argument overlooks statutory language and relevant case law.

First, rate disapproval allows the Commissioner to forestall the use of unlawful rates prior to private party appeals. If the Commissioner learns an insurer is using an unfiled rate, he may stop the unlawful activity by disapproving the rate on his own initiative, rather than waiting until a private party appeal.[199] Thus, rather than being superfluous, the rate disapproval mechanism serves an important policy aim.

Second, California courts have not accepted Travelers' argument. In *South Tahoe Gas Co. v. Hofmann Land Improvement Co.*,[200] the plaintiff public utility sought to enforce a higher contractual rate than the rate it had filed with the Public Utilities Commission ("PUC"). The defendant countered that the contract was illegal and violated state law and PUC regulations since it charged an unfiled rate. Much like Insurance Code section 11735, Public Utilities Code section 489 requires the utility to file its rates and rating information. And similar to Insurance Code section 11737, Public Utilities Code section 728 permits the PUC to disapprove a utility's rates. Although there was no indication the PUC acted under section 728, the Court of Appeal agreed that a charge in excess of the filed rate was illegal.[201] In essence, the Court's ruling confirms that rate disapproval proceedings are not a prerequisite to finding the use of unfiled rates unlawful.

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[199] Of course, the fact the rates are unfiled makes it likely the Commissioner will not learn of their unlawful use until an aggrieved private party raises an appeal, in which case rate disapproval would be too late to benefit the appellant.
[200] *South Tahoe Gas Co. v. Hofmann Land Improvement Co.* (1972) 25 Cal.App.3d 750.
[201] *Id.* at p. 755.

VI. The Side Agreements Are Void As a Matter of Law.

Having found the Side Agreements to be unfiled and unattached collateral agreements and/or endorsements, and having determined that the issuance of such agreements misapplied Travelers' filed rating plan, Appellant argues the Side Agreements are void as a matter of law, as they violate the Insurance Code's regulatory scheme.[202] Travelers counters with a number of arguments. First, Travelers argues unfiled collateral agreements are not void as a matter of law under section 11658 and Regulations section 2268, and that the Commissioner may not find a contract void or unenforceable in private party appeals.[203] Second, Travelers argues "voiding" the agreements would be unduly harsh given that Appellant understood the Side Agreement's terms and obligations.[204] Lastly, Travelers argues the Commissioner may only "void" the Side Agreement through a rate disapproval proceeding.[205] Appellant's arguments are unpersuasive.[206]

A. The Insurance Code's Plain Language and Relevant Case Law Render the Side Agreement Void, Irrespective of Any Action of the Commissioner.

As a threshold matter in addressing this issue, the parties conflate legal analysis about the status of an unfiled endorsement, with the imposition of remedies that flow from that analysis. Under section 11737 subdivision (f), the Commissioner may determine whether an insurer has

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[202] Appellant's Post-Hearing Brief, pp. 32-33; Appellant's Post-Hearing Reply Brief, pp. 18-19.
[203] Travelers' Supplemental Reply Brief Re: Remedies, pp. 7-8; Travelers' Supplemental Brief Re: Remedies, pp. 2-4.
[204] Travelers' Post-Hearing Brief, pp 33-35; Travelers' Post-Hearing Reply Brief, pp. 24-25.
[205] Travelers' Response to Adir's Appeal and Supplemental Appeal, filed June 22, 2016, pp. 31-32.
[206] Travelers misinterprets the Settlement Agreement in the *Shasta Linen* writ petition, saying the Commissioner "pronounced to the public" that the remedy in a matter arising under section 11737 is for the courts to decide. Travelers refers to a recital in the Agreement that "[T]he Dispute ... is ultimately for the courts to decide." That is simply an acknowledgement by the parties – in a recital that has no operative effect in the agreement -- that courts "ultimately" review actions by administrative agencies pursuant to appropriate standards of review. Travelers also quotes a sentence that states "There is a good faith dispute ..." whether an unfiled side agreement is void. That is a true statement; there was a dispute between the Commissioner and the respondents. Even if the Settlement Agreement provided that only a court could decide the *Shasta Linen* issues – which it does not do– the court decided the issues in *Nielsen.*

misapplied its filed rates. In view of that determination, the Commissioner may "affirm, modify, or reverse" the action of an insurer or rating organization on appeal by a person aggrieved by the manner in which the rating system has been applied. In *Shasta Linen,* the Commissioner did not find that an unfiled side agreement was "voidable." Rather, he found it was "void as a matter of law." That was a legal conclusion, not the imposition of a remedy. The result of that finding was that the *filed* policy determined the obligations of the insurer and the insured and the unfiled side agreement had no effect.[207] In *Nielson,* the court of appeal agreed with the Commissioner's ~~that~~ legal conclusion that the— agreement is "void as a matter of law."[208] Nothing in *Nielson* suggests that the agreement's resulting failure was borne of judicial discretion—the agreement failed as void ab initio because it was illegal.

Travelers incorrectly argues that the Commissioner's determination of the proper application of Travelers's filed rates must implement rate modifications imposed by the void unfiled side agreement. The Commissioner's decision to reverse Travelers' misapplication of its rates and to require Travelers to apply only its filed rates, unmodified by the void unfiled agreement, is a proper exercise of the Commissioner's express authority under section 11737 subdivision (f) to "affirm, modify, or reverse" Travelers's decision.

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[207] Travelers argues that the Commissioner did not void side agreements in its settlement of *In the Matter of ... California Insurance Company and Applied Underwriters Captive Risk Assurance Company, Inc. (CIC/AURCRA) CIC/AUCRA* is not *Shasta Linen.* But that was not a matter arising under section 11737. Rather, the Commissioner issued a cease and desist order against the respondents under sections 1065.1 and 1065.3 to require the respondents "to cease and desist from issuing or renewing any workers' compensation insurance policy ... " that had a side agreement in violation of sections 11658, 11735 and former Regulation 2218. And further, distinguishable from this matter, it addressed the respondents' company-wide practices, not a dispute between the respondents and a particular insured. Travelers similarly argues that Commissioner's Settlement Agreement in *In the Matter of ... Zurich American Insurance Company et al.* (CDI Case No. DISP–2011-00811) did not void unfiled side agreements. In *Zurich,* like *CIC/AUCRA,* the Commissioner issued a cease and desist order under sections 1065.1 and 1065.3 that was not a case arising from an appeal under section 11737.

[208] *Nielsen,* at 1115. "Although we are not bound by the *Shasta Linen* decision ... we find its analysis persuasive on the prohibition of unfiled 'collateral' or 'side-agreements.' [internal citation omitted] *Nielsen* at 1116.

1. The Insurance Code's Comprehensive Regulatory Scheme Supports Finding the Side Agreements Void

Section 11737, subdivision (f), grants the Commissioner broad authority to award remedies in workers' compensation appeals. As previously noted, the statute authorizes him to "affirm, modify, or reverse" an insurer's action concerning the application of its rating system. The statute contains no language restricting remedies the Commissioner may order. Nor has any California court inferred such restrictions from the statute. Indeed, the breadth of the Commissioner's authority is consistent with his comprehensive role to "require from every insurer a full compliance with all the provisions of [the Insurance Code]."[209]

While Travelers argue that remedies under rate disapprovals may only be applied prospectively, remedies for findings of unlawfulness under subdivision (f) may either be prospective or retrospective.[210] In fact, nothing in subdivision (f) suggests the Commissioner's decision to modify or reverse an insurer's action may apply only on a going-forward basis. That subdivision principally concerns past harm, in that it authorizes a private party "aggrieved" (past) to request action by an insurer to review the manner in which its rating system "has been applied" (past) in connection with the "insurance afforded or offered" (past). Since a prospective remedy would do nothing to address past harm, logically remedies under subdivision (f) may be retrospective.

Finally, because subdivision (f) does not limit the available remedies, the Commissioner's remedies may include refusing to enforce unlawful modifications to contracts, and sever unlawful provisions, as appropriate.[211] The California Supreme Court's holding in

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[209] Ins. Code, § 12936.
[210] *Shasta Linen, supra,* at p. 53.
[211] *Id.* at pp. 65-66.

Marathon Entertainment, Inc. v. Blasi[212] clarifies this authority. There, an actress brought a claim a before the California Labor Commissioner, seeking to void a contract with her manager on the grounds the agreement violated the Talent Agency Act. The Labor Commissioner found a violation and declared the contract void even though the statute specified no remedy. The Court explained that since "the Legislature has not seen fit to specify the remedy for violations" of the act, "the full voiding of the parties' contract is available, but not mandatory; likewise, severance is available, but not mandatory."[213] The Court further stated those remedies could be imposed at the administrative level, as well as by the courts.[214]

As the Commissioner stated in *Shasta Linen*, unfiled side agreements are prohibited and shall not be used without complying with statutory and regulatory requirements. Unfiled side agreements "are not permitted in this state and are void as a matter of law."[215]

2. Case Law Compels Finding the Side Agreements Void as a Matter of Law

In *American Zurich*, the court determined that Zurich's failure to file its IDA with the WCIRB and the Insurance Commissioner violated Insurance Code section 11658. The court, relying on section 11658, subdivision (a)'s statement that a workers' compensation insurance policy or endorsement "*shall* not be issued by an insurer" unless filed and approved, and subdivision (b)'s language that issues an unapproved policy or endorsement "is unlawful," concluded that "Section 11658 is clear: the unfiled and unapproved IDAs are illegal under Section 11658 and therefore void as a matter of law."[216]

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[212] *Marathon Entertainment, Inc. v. Blasi* (2008) 42 Cal.4th 974, 996.
[213] *Ibid.*
[214] *Id.* at pp. 996, 998.
[215] *Shasta Linen, supra*, at p. 66.
[216] *American Zurich, supra*, 2015 WL 4163008 at p. *16.

The California Court of Appeal agrees. In *Nielsen Contracting,* the court noted that the Commissioner is charged with closely scrutinizing insurance plans to protect workers and their employers. To accomplish this objective, the Legislature required that the Commissioner have full access to insurance information through the mandatory rate and form filing requirements. "It follows that a violation of these requirements prevents crucial regulatory oversight and thus renders the unfiled agreement unlawful and void as a matter of law."[217] In so holding, the court rejected the argument that this remedy is not provided for in the Insurance Code. Instead, the court found ample notice to the insurer since "the statutes here specifically provide that an agreement that has not been appropriately filed is unlawful."[218] Accordingly, the court voided the Side Agreement's arbitration and delegation clauses.

California case law is clear. Unfiled side agreements are unlawful and void as a matter of law. Travelers' argument to the contrary is without merit.

B. No Compelling Reason Exists to Enforce the Side Agreements

Insurance Code section 11737, subdivision (f) provides that the Commissioner may "affirm, modify or reverse" the insurer's action that is the subject of the insured's appeal. In this matter, the Commissioner may "affirm, modify or reverse" Travelers' application of the Side Agreements. A contract made in violation of a regulatory statute is generally void.[219] Courts will not normally enforce an illegal agreement or one against public policy, as the public importance of discouraging prohibited transactions outweighs equitable considerations of possible injustice between the parties.[220] Because workers' compensation insurance is usually mandatory, the

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[217] *Nielsen Contracting, supra,* 22 Cal.App.5th at p. 1118.
[218] *Id.* at p. 1119.
[219] *Malek v. Blue Cross of California* (2004) 121 Cal.App.4th 44, 70; *Asdourian v. Araj* (1985) 38 Cal.3d 276, 291.
[220] *Asdourian v. Araj, supra,* 38 Cal.3d at p. 291

~~Insurance~~ Commissioner is charged with closely scrutinizing insurance plans to protect workers and employers alike. Sections 11658 and 11735's filing requirements enable the Commissioner to perform that duty. Insurers who use unfiled rates or unfiled side agreements frustrate public policy.[221] It would defeat the purpose of Insurance Code sections 11658 and 11735 by allowing an insurer to bypass the Commissioner's mandatory review process by simply adding or modifying the policy's terms in a separate, unexamined side agreement.[222] As the Court of Appeal recently stated:

> These prohibitions would have no meaning if the insurer could enforce contracts despite having violated the disclosure and approval requirements. Allowing the insurer to make material modifications to the filed and approved dispute resolution mechanism without the knowledge of the Rating Bureau or the Insurance Commissioner would effectively remove any regulatory oversight of this process.[223]

Accordingly, public policy supports reversing Travelers' action in its entirety, because Travelers' Side Agreements are void, and requiring Travelers to apply only its filed rates.

While Travelers incorrectly contends the Commissioner lacks the power adjudicate the lawfulness of the unfiled agreement, Travelers inconsistently argues the Commissioner should exercise equitable authority and enforce the illegal agreement anyway. But Traveler's has not demonstrated grounds for the Commissioner to only "modify," and not reverse, Travelers' prior decision. Analogously, in compelling cases, illegal contracts will be enforced in order to 'avoid unjust enrichment and a disproportionately harsh penalty upon the plaintiff.[224] In each case, the extent of enforceability and the kind of remedy granted depend upon a variety of factors,

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[221] *Shasta Linen, supra,* at p. 67.
[222] *American Zurich, supra*, 2015 WL 4163008 at p. *17.
[223] *Nielsen Contracting, supra*, 22 Cal.App.5th at p. 1118.
[224] *Malek v. Blue Cross of California, supra*, 121 Cal.App.4th at p. 707.

including the policy of the transgressed law, the kind of illegality and the particular facts.[225] Travelers did not demonstrate that declining to permit enforcement of the Side Agreements would result in unjust enrichment to the Appellant. There is no risk of unjust enrichment because "an insurer's issuance of an illegal contract, even if it results in enrichment to the insured, does not result in *unjust* enrichment, since the insured did nothing wrong and the insurer should have known of its own legal duties."[226] Further, Appellant is still responsible under the actual insurance policies for any premiums.

Nor did Travelers demonstrate that reversing its decision is unduly harsh regardless ~~of~~ whether Appellant understood its terms.[227] Travelers it knew of California's filing requirements and admits it entered into the final Adir Side Agreement *after* receiving a reminder from the CDI that such unfiled agreements were unlawful. Additionally, permitting Travelers to enforce these Side Agreements would encourage illegal activity -- i.e., the use of unfiled collateral agreements.[228]

Conclusions of Law

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

1. Pursuant to Insurance Code section 11737, subdivision (f), the Commissioner has exclusive jurisdiction to adjudicate Appellant's claim that Travelers' unfiled Side Agreements misapplied Travelers' filed rating plan by violating Insurance Code sections 11658 and 11735, as well as California Code of Regulations, title 10, section 2268.

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[225] *Ibid.*; *American Zurich, supra*, 2015 WL 4163008 at p. *16.
[226] *Id.* at p. *16; accord *Shasta Linen, supra,* at pp. 67-68.
[227] *Russell v. Soldinger* (1976) 59 Cal.App.3d 633, 646 [an illegal contract be ratified by any subsequent act.]
[228] *American Zurich, supra*, 2015 WL 4163008 at p. *17; accord *Shasta Linen, supra,* at p. 68.

2. Travelers' Side Agreements constitute endorsements that must be filed and approved pursuant to Insurance Code section 11658. Travelers violated section 11658 by failing to file those Side Agreements.

3. Travelers' Side Agreements constitute collateral agreements that were required to be filed and attached and made part of the policy pursuant to California Code of Regulations, title 10, section 2268. Travelers violated California Code of Regulations, title 10, section 2268 by failing to attach its Side Agreements to Appellant's policies.

4. Travelers' LRARO endorsement and subsequent filing of its Side Agreement does not extinguish its Insurance Code violations.

5. Travelers' use of the unfiled Side Agreements in violation of Insurance Code section 11658 and California Code of Regulations, title 10, section 2268 resulted in a misapplication of Travelers' filed rating plan. Travelers failed to properly attach its retrospective rating plan to Appellant's policy as required by Insurance Code section 11735, subdivision (e), as well as section 11658.

6. Because the Side Agreements applied unfiled terms, conditions, obligations and supplementary rate information, contravening Insurance Code sections 11658 and 11735, as well as California Code of Regulations, title 10, section 2268, the Side Agreements are unenforceable and void as a matter of law. The unfiled Side Agreements violate public policy and no compelling reason exists to enforce them.

ORDER

IT IS ORDERED:

1. To the extent Appellant has remitted to Travelers funds in excess of the total amount that may be validly charged under Appellant's guaranteed cost policies, Travelers shall refund the excess to Appellant within 30 days after the date this proposed decision is adopted.

2. It is further ordered that the entirety of this Decision is designated precedential pursuant to Government Code section 11425.60, subdivision (b).

Dated: November 20, 2018

DAVE JONES
Insurance Commissioner