

**NEW JERSEY DEPARTMENT OF
BANKING AND INSURANCE**

APPLIED UNDERWRITERS, INC.,
APPLIED UNDERWRITERS CAPTIVE
RISK ASSURANCE COMPANY, INC., and
CONTINENTAL INDEMNITY COMPANY,

Petitioners,

v.

NEW JERSEY DEPARTMENT OF
BANKING AND INSURANCE,

Respondent.

Docket No. _____

PETITION

Petitioners Applied Underwriters, Inc. ("AUI"), Applied Underwriters Captive Risk Assurance Company, Inc. ("AUCRA"), and Continental Indemnity Company ("CNI," and collectively, "Applied"), by and through their undersigned attorneys, submit this petition against respondent New Jersey Department of Banking and Insurance ("DOBI") and hereby allege as follows:

PRELIMINARY STATEMENT

1. This contested case arises out of DOBI's attempts to regulate and eliminate, through New Jersey's workers' compensation laws, a captive reinsurance program that is offered in virtually every state as a way to reduce the cost of workers' compensation insurance and incentivize employers to improve their workplace safety practices for their employees.

2. Captive reinsurance programs, which have been in existence for many years and which effectively are a form of self-insurance, encourage employers to adopt strong workplace safety practices so as to minimize their workers' compensation costs. They do not come without risks, however, as adverse claims experience can cause the employer's costs ultimately to

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increase. Nevertheless, the conventional wisdom is that the potential benefits outweigh the risks, as DOBI itself has recognized in actively encouraging employers to develop their own captive insurance programs rather than purchase insurance in the commercial market. See https://www.nj.gov/dobi/division_insurance/captive/index.html.

3. As of 2017, the National Association of Insurance Commissioners (“NAIC”) reflects twenty-four (24) captives domiciled in New Jersey with over \$400 million in premiums placed into the New Jersey captives.

4. As of 2017, the NAIC data reflects total premium into captives in the United States was \$81 billion.

5. Captives have been formed to write almost every kind of insurance coverage available, including but not limited to workers’ compensation, general liability, automobile liability, medical malpractice, hospital liability, pollution, professional liability, errors and omissions, property, warranty, contractual liability, reputational risk, crime, fidelity, surety, marine and cyber.

6. Setting up a captive insurance program is not without its own costs, and many small-to-medium-size businesses cannot afford to do it on their own. Recognizing this gap in the industry, Applied sought to fill it with the EquityComp® Program (the “Program”), a workers’ compensation insurance program specifically designed for employers who otherwise could not afford to set up their own captive reinsurance program. The Program gives those employers the opportunity to share in the profits of underwriting their workers’ compensation insurance policies if they have positive claims experience. As with any such program, however, the employers would retain some risk that they would have to pay more for workers’ compensation if their claims experience was above a certain threshold.

7. Over the past several years, DOBI has received complaints from a handful of Program participants who, as a result of adverse claims experience, ultimately were required to pay additional costs under the terms of the Program. A substantial majority of New Jersey-based Program participants, however, have never complained about their participation in the Program.

8. Apparently as a result of these complaints, and following an investigation in which Applied fully cooperated and during which Applied voluntarily agreed not to market the Program, DOBI threatened in a May 2018 letter (attached hereto as **Exhibit 1**) to revoke CNI's license to conduct insurance business in this state in connection with the Program. DOBI further demanded that Applied unwind any contracts with New Jersey participants who allegedly were "harmed by the programs"

9. DOBI's threatened actions are based on an erroneous understanding of the Program, misapply New Jersey workers' compensation law, and violate section 531 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which precludes state insurance regulators from rewriting the terms of an out-of-state reinsurance contract, as DOBI attempts to do here.

10. Through this Petition, Applied seeks a determination that the Program is a valid captive reinsurance arrangement under New Jersey law and that CNI, as a licensed provider of guaranteed cost workers' compensation insurance in this state, on approved forms and rates, has not violated N.J.S.A. §§ 34:15-88 or 90.2. Applied further seeks preliminary and permanent injunctive relief prohibiting DOBI from taking any enforcement action alleging that the Program violated applicable New Jersey insurance law.

PARTIES

11. Petitioner AUI is a Nebraska corporation with its principal place of business located in Omaha, Douglas County, Nebraska.

12. Petitioner CNI is a property and casualty insurance company domiciled in Iowa with its principal place of business in Omaha, Douglas County, Nebraska. It is authorized to issue workers' compensation insurance policies in New Jersey.

13. Petitioner AUCRA is an Iowa property and casualty insurance company with its principal place of business in Omaha, Douglas County, Nebraska.

14. DOBI is a New Jersey governmental agency charged with regulation of banking and insurance businesses in this state.

JURISDICTION

15. DOBI possesses subject matter jurisdiction because this matter relates to the business of insurance. See N.J.S.A. § 17:1-1; N.J.A.C. § 1:1-3.1(a).

16. This matter constitutes a "contested case" as defined in N.J.A.C. § 1:1-2.1 because Applied's rights, duties, obligations, privileges, or other legal relations vis-à-vis the Program must be decided by DOBI after notice and a public hearing pursuant to N.J.S.A. §§ 17:29B-6 & 34:15-88.

17. In accordance with N.J.A.C. § 1:1-4.1, Applied requests that DOBI "make such a determination within 30 days from receipt of" this petition and transmit this case to the Office of Administrative Law.

FACTUAL ALLEGATIONS

Workers' Compensation

18. For most New Jersey employers, workers' compensation insurance—which this state requires all employers to maintain, see N.J.S.A. § 34:15-71—is a significant expense.

19. There are several workers' compensation insurance options available to New Jersey employers, two of which are relevant here. First, guaranteed cost workers' compensation insurance ("GC") provides coverage based on a fixed premium that is determined by the employer's payroll and the job classifications of the employer's employees as set forth in the Workers Compensation and Employers Liability Insurance Manual, which is published annually by the New Jersey Compensation Rating and Inspection Bureau ("CRIB"). Under a GC Policy, the employer's premium costs may vary only based on the employer's payroll figures and job classification; losses experienced due to workers' compensation claims submitted during the policy year do not impact the employer's premium.

20. Second, employers may opt for a "loss-sensitive" workers' compensation insurance program, under which the ultimate cost to the employer may vary depending on the employer's claims experience. Loss-sensitive plans have been available to employers for many years and are well-established in the workers' compensation insurance industry. Such plans come in a number of different forms, such as a retrospective rating plan, a dividend plan, a large-deductible plan, or captive insurance using segregated cells.

The Program

21. The Program is a loss-sensitive workers' compensation program developed by AUI. The Program involves the use of both reinsurance agreements and captive insurance in order to deliver substantial savings on workers' compensation insurance to employers who maintain a strong culture of workplace safety and thereby minimize workers' compensation losses. In other words, the Program effectively allows employers the opportunity to share in the profits of underwriting their individual workers' compensation policies.

22. The Program consists of two distinct components. The first component is a GC Policy issued by CNI with rates and forms approved by CRIB. This policy satisfies the employer's obligation to maintain workers' compensation insurance for their employees.

23. The second component supplies the loss-sensitive aspect of the Program and is effected by way of a series of reinsurance transactions.

24. First, the premiums paid to CNI under the GC Policy are transferred (or ceded, in reinsurance parlance) to California Insurance Company ("CIC"), an affiliate of CNI, pursuant to a reinsurance pooling agreement between CNI, CIC, and other affiliated entities.

25. Second, CIC cedes a portion of that premium to AUCRA, a CNI affiliate that acts as a captive reinsurer under a reinsurance agreement between AUCRA and CIC approved by the relevant regulatory authorities. Sometimes referred to as "rent-a-captives," captives such as AUCRA have been in existence for many years and are also used outside the workers' compensation context.

26. Finally, AUCRA cedes a portion of the premium to a "segregated cell" set up specifically for the employer via a reinsurance participation agreement ("RPA"). The segregated cell functions simply to wall off the employer's workers' compensation premium and losses from those of other employers, so as to ensure that the employer has no responsibility or liability for any other cell. In addition to the premiums ceded to the segregated cell, the employer also pays a deposit that functions as capital and surplus for the segregated cell.

27. Notwithstanding the cession of premiums and losses from CNI, CNI remains exclusively responsible for all workers' compensation claims under the issued GC Policies. Should AUCRA or the employer breach the RPA, CNI is not excused from paying workers' compensation claims based on the issued GC Policy.

28. The end result of these transactions is effectively to establish the employer's own captive insurance company, without any of the accompanying, and oftentimes considerable, expenses associated with doing so.

29. Each month, premiums generated from the employer's GC Policy are ceded to the segregated cell, along with losses for that specific employer. In addition, the employer is provided with a detailed monthly accounting explaining the amounts paid and losses incurred to date.

30. At the inception of the Program, a minimum cost and maximum cost is established based on the employer's estimated payroll. Throughout the Program, once actual payroll is established, the minimum and maximum are adjusted. Under the Program, the employer will not pay less than the minimum nor more than the maximum regardless of how many claims the employer has under the GC Policies. At all times, however, the employer is aware that its ultimate cost is subject to variation based on the individual employer's claims experience.

31. As noted above, captive arrangements such as this are commonplace throughout the United States and actively encouraged in New Jersey.

Applied's Communications With CRIB

32. CRIB is a statutorily-created organization exclusively responsible for all workers' compensation rate and form filings in New Jersey, in addition to serving as the statistical repository for New Jersey workers' compensation insurance claims. See N.J.S.A. § 34:15-88.

33. Accordingly, CNI files all of its workers' compensation forms (including the form of its GC Policy) and its rates with CRIB, which forms and rates have been duly approved by CRIB.

34. In 2012, CRIB made an inquiry to Applied regarding the operational methodology of the Program, including the reinsurance agreement's operation generally and the RPA's operation specifically. Following a meeting between CRIB and Applied during 2012, CRIB concluded that the RPA was a separate financial arrangement between AUCRA and the employer that had no bearing on CNI's compliance with CRIB's form and rate requirements.

35. CRIB's position concerning the RPA has been consistent since that time, as evidenced most recently in a letter from CRIB dated November 5, 2018, and attached hereto as **Exhibit 2**.

36. In justifiable reliance on CRIB's consistently stated position, Applied continued to market and administer the Program to New Jersey-based employers until it voluntarily ceased to do so.

Applied's Communications With DOBI

37. Separate and apart from CRIB's inquiries concerning the Program, DOBI also requested an explanation of the Program's operation. Following an initial meeting, DOBI requested voluminous documents associated with the Program, all of which were produced in a timely fashion.

38. Subsequent to the production of the requested documents another meeting occurred between representatives of Applied and DOBI to review the documents produced.

39. DOBI indicated that while they understood how captives operated, it was their opinion that, due to the loss-sensitive nature of the Program effected through a rent-a-captive, CNI was not charging New Jersey-based Program participants the rates for the GC Policies that were filed and approved with CRIB.

40. Applied again met with DOBI officials on August 1, 2017, and thereafter responded to further requests for information and participated in telephone conferences.

41. By letter dated May 18, 2018, DOBI notified Applied that it had completed its investigation and had concluded “that Applied’s programs fundamentally altered [CNI’s] workers compensation policies so that they were not in accordance with CRIB’s rating system,” allegedly in violation of N.J.S.A. §§ 34:15-88 & 90.2.

42. As a result, DOBI “concluded that all New Jersey businesses harmed by the programs be made whole and that all current contracts should be unwound.” DOBI further demanded that Applied not seek to collect additional premium from any employers who paid less under the Program than they otherwise would have based solely on the rates set forth in the GC Policies. Notably, there is a significant number of Program participants who ultimately paid less than they otherwise would have under the GC Policies.

43. DOBI threatened to institute “formal enforcement actions seeking revocation or suspension of CNI’s licenses, imposition of fines and payment of restitution” if Applied failed to accede to DOBI’s demands immediately.

44. DOBI’s position is inconsistent with New Jersey law and directly at odds with the position taken by CRIB. The RPA is a separate, reinsurance-related agreement entered into between AUCRA and the individual employer that does not change and/or modify the approved rates set forth in the GC Policies. CNI is and at all times has been in compliance with N.J.S.A. §§ 34:15-88 & 90.2. Because the RPA is a reinsurance transaction, New Jersey’s licensing laws are inapplicable to it. See N.J.S.A. § 17:32-21(d).

45. Furthermore, DOBI’s demands represent an attempt to rewrite and invalidate the RPAs, in violation of section 531 of the Dodd-Frank Act. See 15 U.S.C. § 8221(b)(2)-(4).

Under that statute, DOBI is prohibited from “enforc[ing] a reinsurance contract on terms different than those set forth in the reinsurance contract” where, as here, the ceding insurer is not a New Jersey domiciliary. That is precisely what DOBI seeks to do here.

COUNT I

(For Injunctive and Declaratory Relief)

46. Applied incorporates paragraphs 1 through 45 as if fully set forth herein.

47. As alleged above, the Program complies with New Jersey workers’ compensation law in all respects, including the rate filing and approval requirements set forth at N.J.S.A. §§ 34:15-88 & 90.2. Indeed, since 2012, CRIB has consistently represented to Applied that CNI’s GC Policies complied in all material respects with those requirements. Applied justifiably relied on those representations in continuing to market and administer the Program in New Jersey.

48. DOBI’s determination that the RPAs altered the rates set forth in the GC Policies, and its threats to take draconian enforcement actions against Applied, contravene both the relevant statutes and CRIB’s stated position regarding CNI’s compliance with New Jersey’s workers’ compensation laws.

49. DOBI’s demand for rescission of RPAs executed by and between AUCRA and certain New Jersey-based Program participants also violates section 531 of the Dodd-Frank Act insofar as it constitutes an attempt to “enforce a reinsurance contract on terms different than those set forth in the reinsurance contract” 15 U.S.C. § 8221(b)(3). As set forth above, the RPAs are reinsurance-based transaction that are not subject to regulation under New Jersey’s licensing laws, N.J.S.A. § 17:32-21(d), and DOBI’s attempt to enforce the RPAs in a manner inconsistent with the terms of those agreements is preempted by federal law.

50. Applied accordingly requests a determination that the Program is a valid

captive/reinsurance arrangement in New Jersey and that CNI, as a licensed New Jersey insurer issuing GC Policies pursuant to CRIB-approved forms and rates, has not violated N.J.S.A. §§ 34:15-88 & 90.2. Applied further requests that DOBI be estopped from asserting that the Program violates New Jersey law and preliminarily and permanently enjoined from taking any enforcement action against Applied based on any such assertion.

PRAYER FOR RELIEF

WHEREFORE, Applied respectfully requests:

1. A determination that this dispute is a "contested case" within the meaning of N.J.A.C. § 1:1-2.1;
2. Transmission of this contested case to the Office of Administrative Law no more than 30 days from the date of DOBI's receipt of this petition, in accordance with N.J.A.C. § 1:1-4.1;
3. An order declaring that the Program is lawful and does not violate N.J.S.A. §§ 34:15-88 or 90.2;
4. An order preliminarily and permanently enjoining DOBI from taking any enforcement action against Applied based on a claim that the Program violates applicable New Jersey insurance law;
5. Reasonable attorneys' fees and costs incurred by Applied in connection with this matter;
6. Such other and further relief as this tribunal may deem just and appropriate under the circumstances.

Dated: New York, New York
March 5, 2019

Respectfully submitted,

DLA PIPER LLP (US)

By: /s/ Shand S. Stephens
Shand S. Stephens (*pro hac vice forthcoming*)
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Attorneys for Petitioners
Applied Underwriters, Inc.
Applied Underwriters Captive Risk
Assurance Company, Inc., and
Continental Indemnity Company

Exhibit 1



State of New Jersey

DEPARTMENT OF BANKING AND INSURANCE

DIVISION OF INSURANCE

CONSUMER PROTECTION SERVICES

ENFORCEMENT UNIT

PO Box 329

TRENTON, NJ 08625-0329

TEL (609) 292-5316

FAX (609) 292-5337

PHIL MURPHY
Governor

SHRILA OLIVER
Lt. Governor

MARLENE CARIDE
Acting Commissioner

PETER L. HARTT
Director

May 18, 2018

Jeffrey A. Silver
Executive Vice-President, Secretary & General Counsel
Applied Underwriters
10805 Old Mill Road
Omaha, Nebraska 68154

Re: EquityComp / SolutionOne / PremierExclusive Programs

Dear Mr. Silver:

Thank you for meeting with the Department of Banking and Insurance (Department) on August 1, 2017, responding to the Department's requests for information and participating in follow up telephone calls. The Department has completed its investigation and is writing to advise you of its position.

As you may recall, the Department received multiple complaints from New Jersey businesses covered by the EquityComp and SolutionOne programs (collectively the programs). The programs combine issuance of a guaranteed cost workers compensation policy sold by Continental Indemnity Company (Continental) and a reinsurance participation agreement (RPA) with Applied Underwriters Captive Risk Assurance Company, Inc., a subsidiary of Applied Underwriters, Inc. (Applied). The complaints primarily concerned amounts due under the RPA.

N.J.S.A. 34:15-88 provides that all workers compensation policies must be issued "in accordance with the classifications, rules, basis rates, and system of merit or schedule rating approved by the commissioner of banking and insurance as aforesaid and applied by the rating and inspection bureau." N.J.S.A. 34:15-90.2 establishes that only the Compensation Rating and Inspection Bureau (CRIB) may prepare and file for the Commissioner's approval "any amendments to its policy forms and its system of classification of risks and premiums thereto, together with the basis rates and system of merit or schedule rating applicable to such insurance."

The Department has determined that Applied's programs fundamentally altered Continental's workers compensation policies so that they were not in accordance with CRIB's rating system; thus, the programs are not permissible. Moreover, your June 4, 2012 conversation with representatives of the CRIB does not constitute approval by the Commissioner.

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The Department has also concluded that all New Jersey businesses harmed by the programs should be made whole and that all current contracts should be unwound. Both steps should be taken as soon as possible. The Department will consider an insured business to be made whole if all insurance premiums in excess of the premiums that should have been charged by Continental in accordance with the approved CRIB rating system are refunded, after any applicable payroll audits. In addition, Applied shall not seek to collect additional premiums from insured businesses that may have paid less than they would have under their Continental policy. Please note also that any specified fees for non-insurance services under the RPA, such as those for payroll processing, etc. do not have to be returned to insured businesses.

Going forward, all workers compensation policies must be issued by licensed insurers in accordance with the CRIB manual. The CRIB manual includes rules for retrospective rating for qualified businesses, and the applicable rating endorsement must be attached to the policy. Applied must agree not to enter into any contracts with insureds that alter the premiums collected in any way.

Failure to pursue the steps set forth above will result in formal enforcement actions seeking revocation or suspension of licenses, imposition of fines and payment of restitution.

Please contact me to discuss implementation the Department's directions.

Very truly yours,



Gale P. Simon
Assistant Commissioner

C: Bruce Byrnes, Vice President & Senior Counsel
Berkshire Hathaway Group Reinsurance Division
Peter Hartt, Director of Insurance
Kristine Maurer, Assistant Director of Insurance
Carl Sornson, Assistant Commissioner
Adam Masef, Deputy Attorney General

Exhibit 2



COMPENSATION RATING AND INSPECTION BUREAU

60 PARK PLACE
NEWARK, NEW JERSEY 07102
(973) 622-6014

PAUL G. WITKO
Executive Director

Coverage ID: 0666577

November 5, 2018

[REDACTED]

Re:

[REDACTED]

Dear Mr. Kirkwood:

Thank you for your September 28, 2018 letter in which you address specific elements of cancellation provisions in the provided "Re-insurance Participation Agreement" between the captioned entity and Applied Underwriters Captive Risk Assurance Company Inc.

The content of your letter is accurate in that a guaranteed cost policy with Continental Indemnity Company is on file with the Compensation Rating and Inspection Bureau. However, the provided Reinsurance Participation Agreement is not a workers compensation policy and therefore a cancellation of this agreement and the provisions of the agreement fall outside the authority of the Rating Bureau.

The captioned guaranteed cost workers compensation policy maintains statutory provisions with respect to cancellation and entitles the employer, through Part Six, Paragraph D, to cancel the policy at any time, and the Manual through Rule 3:3-80 entitles the insurance company to assess a short rate penalty in most instances where an insured is requesting cancellation during a policy term.

Applied Underwriters Captive Risk Assurance Company Inc is not a member of the Rating Bureau and the Reinsurance Participation Agreement entered into between the captioned employer and said company, while appearing to be predicated on the loss development of the captioned policy, is not a workers compensation policy, and therefore the cancellation of the agreement, or the various provisions in the agreement, are outside the authority of the Rating Bureau, and I would be remiss to opine on the agreement accordingly.

Sincerely,
James O'Hare
Director of Underwriting, Ext. #214

JOH/pab

Correspondence ID: 462014