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STATE FALSE CLAIMS ACTS: CONSIDERATIONS FOR INSURERS

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With the 1986 overhaul of the federal False Claims Act,[1] civil actions brought by government and individuals founded on allegations of false claims submitted to the government have become commonplace. Historically, such suits have been aimed mostly at government contractors, grantees, and those who provide Medicare and Medicaid services, but that is changing. A widening circle of industries, including the insurance industry, is more frequently being targeted by FCA lawsuits.

One reason is the proliferation of state false claims acts ("FCAs"). California, Delaware, the District of Columbia, Florida, Hawaii, Illinois, Indiana, Massachusetts, Montana, Nevada, Tennessee, and Virginia have adopted FCAs of broad application, and similar acts are under consideration elsewhere.[2] Many state FCAs create comparatively broader liability than the federal act. Moreover, several state FCAs make false claims or false statements submitted to units of local governments and public corporations and instrumentalities created by state law actionable, in addition to false statements submitted to state government.[3] The monetary exposure is high: significant fines (ranging from $5,000 - $25,000 or more per occurrence), double or treble damages, costs, and attorneys fees are typically imposed by these state laws.

State FCA claims are exceptionally attractive to entrepreneurial plaintiffs. Besides authorizing suit by the government itself, nearly all state FCAs encourage private "relators" (*qui tam* plaintiffs) to sue on the government's behalf, as the federal FCA does, and handsomely reward a relator who succeeds with a substantial share of the recovery or settlement. Proof of specific intent to defraud is not required to establish FCA liability. Instead, liability attaches for "knowingly" presenting a false statement to obtain money from the government, or to avoid an obligation owed to the government.[4] "Knowingly" is usually defined as acting merely with "deliberate ignorance" of the truth or falsity of information or with "reckless disregard" of the truth or falsity of information.[5] Knowledge of falsity by relatively low-level employees or agents may be sufficient to impose FCA liability on an organization.[6] Statutes of limitations for FCA claims are typically long - seven to ten years.[7] Moreover, because FCAs typically require the relator to provide detailed information about the alleged violation to the attorney general of the state, or similar law enforcement agencies, *qui tam* FCA suits often spawn government investigations, which may proceed without the FCA defendant being aware of the existence of the FCA suit, since these laws usually require suit to be filed under seal and to remain sealed while the government investigates.[8]

Insurers who provide state-paid health coverage, or coverage coordinated with governmentally administered healthcare face potential liability from those operations under both the federal FCA and state FCAs. *See generally, Cooper v. Blue Cross & Blue Shield of Fla.*, 19 F.3d 562 (11th Cir. 1994). However, the greater source of potential insurer liability may lie in the "reverse false claim" clauses inserted in virtually all state FCAs.

Such "reverse false claim clauses" deserve special attention. They create liability for knowingly making or using a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money to a government or governmental instrumentality.[9] These clauses would most obviously apply to the under-reporting of taxes and similar obligations, or to making erroneous records and reports from which taxes or similar obligations are assessed. Insurers pay taxes, license fees, and residual market assessments to state governments, local governments, and government instrumentalities. Errors in recordkeeping or reporting relating to such impositions or the unique features of some multi-state insurance products may give rise

inadvertently to potential "reverse false claim" FCA liability.[10] Similarly, insurer operations, or subsidiary operations, that involve the frequent purchase and sale of real property often require self-reporting and payment of documentary taxes or similar fees associated with such transactions, which if under-reported may also be a source of potential reverse false claim liability.

Unlike the federal FCA, which excludes erroneous tax reporting from its scope, several state FCAs do not.[11] While some states exclude statements or records made in connection with certain state tax laws from their FCAs, premium tax laws and laws imposing insurance-related assessments may lie outside the excluded tax provisions, and thus may remain a potential source of liability in such states.[12] Since the adoption of the Florida FCA in 1994, at least three insurers have been targets of *qui tam* FCA suits, based on alleged improper reporting of premiums used to compute taxes or residual market assessments, alleged improper concealment of market conduct issues to avoid asserted obligations payable to the government, and alleged under-reporting of real estate transaction fees.

Some state FCAs go even further. Massachusetts, for instance, imposes liability on a person who "enters into an agreement, contract, or understanding with one or more officials . . . . knowing the information contained therein is false."[13] Tennessee does so as to any person who "knowing makes, uses, or causes to be made or used any false or fraudulent conduct, representation, or practice in order to procure anything of value directly or indirectly from the state."[14] Either of those provisions potentially could create FCA liability for "knowingly" presenting incorrect information to the state's insurance regulator in connection with an application for a certificate of authority, change of ownership approval, rate and form applications, and consent orders approving them.

Given the significant breadth of exposure under these laws, organizations would be wise to consider taking steps that will lower the risk. Since FCA liability arises from submitting false information "knowingly," it may be advisable to put procedures in place to regularly test for errors in invoices and tax-related reports to state government. Organizations that frequently or regularly submit invoices to state or local government agencies, or to organizations funded in whole or in part by state funds, may wish to consider regularly auditing a sample of the accounts to evaluate the extent of the organization's error ratio and to correct any problems identified by a significant error rate. Similarly, organizations should consider regular audits of a random sample of state tax records and tax-related reports. Since many false claims act cases are instituted by disgruntled employees or former employees, consideration should be given to ways of regularly seeking comment from those who deal with government billing, collection, and tax-related reporting about problems they perceive or suggestions they have for improving accuracy and reducing errors. If the organization conducts exit interviews of departing employees, it may be wise to include interview questions designed to elicit the exiting employee's knowledge or views about the accuracy of the company's government and tax-related billings and reports. Such initiatives may have benefits on more than one level. They may help identify potential problems, and they will help establish that the company was acting neither with "deliberate ignorance" nor "reckless disregard," should an FCA suit arise in connection with such operations.

Additionally, when discussing data errors in premium reports with state insurance regulators or statistical reporting bureaus, or when negotiating a resolution of such problems with state regulators, organizations should be sensitive to potential FCA issues. For instance, an unqualified recitation of fact in a consent order negotiated with the state insurance regulator, or in correspondence or discussions with the regulator, has the potential to become a party admission in a *qui tam* FCA suit that the organization may not know of, if the suit remains under seal while such regulatory negotiations are taking place.

If served with a *qui tam* FCA complaint, organizations should immediately investigate whether there are grounds to conclusively dismiss the *qui tam* suit at an early stage without reaching the merits and without merits discovery. Like the federal act, nearly all state FCAs contain jurisdictional bars which preclude subject matter jurisdiction over a *qui tam* FCA suit where its allegations are substantially related to information that

has been publicly disclosed by various means, unless the relator can establish that he is the "original source" of the information underlying the allegations in the *qui tam* action.[15] Similarly, many state FCAs impose certain procedural requirements on *qui tam* plaintiffs, violations of which, if substantial, may result in with-prejudice dismissal of the *qui tam* action without the necessity of addressing the merits.[16] The state FCA should be carefully examined for other more unique procedural defenses. The Florida FCA, for instance, contains an exclusive venue provision requiring *qui tam* actions to be brought only in the trial court district that encompasses the state Capitol.[17]

Thoroughly cataloging merits defenses is beyond the scope of this discussion. However, counsel for an insurer subject to an FCA suit should consider whether the particular state FCA should be regarded as a remedial law to be liberally construed, or instead as penal, and therefore strictly construed;[18] whether ambiguity in the substantive law or contract language on which the false claim allegations are based affords a defense that the allegedly false claim is not objectively false;[19] whether the insurer's training and internal quality control systems afford a defense that the alleged falsity does not arise from deliberate ignorance or reckless disregard; and whether the due process and excessive fine clauses of the federal or applicable state constitutions may prevent, or at least reduce, the monetary exposure of the target defendant.[20]

Endnotes

1. 31 U.S.C. §§ 3729-3733

2. Bills proposing such statutes have been introduced in recent years in Alabama, Arkansas, Colorado, Connecticut, Kansas, Maryland, Minnesota, Mississippi, Missouri, New Jersey, New York, Oklahoma, Pennsylvania, South Carolina, Texas, and Washington.

3. California, the District of Columbia, Delaware, Florida, Hawaii, Illinois, Indiana, Massachusetts, Montana, Nevada, Tennessee, and Virginia have enacted False Claims Acts with substantially broader scope than the federal act after which they are patterned. *E.g.,* § 68.082, Fla. Stat.; Cal. Gov't Code § 12650(b)(1); Del. Code. Ann. tit. 6, §1202(3); Mass. Gen. Laws Ann. ch. 12, § 5A; Tenn. Code. Ann. §§ 4-18-101 - 4-18-108 (2002).

4. *E.g.,* § 68.082, Fla. Stat.

5. *Id.*

6. *Grand Union Co. v. United States.*, 696 F.2d 888 (11th Cir. 1983) (evidence which permitted the inference that check-out cashiers knowingly permitted Food and Nutrition Service agents to purchase ineligible nonfood items with food stamps presented substantial fact issue as to whether the grocery store chain violated the False Claims Act, precluding summary judgment for defendant).

7. *E.g.*, § 68.089, Fla. Stat.

8. *E.g.,* § 68.083, Fla. Stat.

9. *E.g.,* § 68.082, Fla. Stat.

10. Consider, for example, an insurer providing a multi-state large-risk workers' compensation program with a negotiated nationwide premium computation formula. If the manual premium in a given state would normally be "x," but the insurer reallocates some premium to accommodate the nationwide premium

algorithm, that act could be viewed as making a false record to reduce premium tax obligations to that state.

11. *E.g.,* Del. Code. Ann. tit. 6, §§ 1201-1209; Nev. Rev. Stat. Ann. §§ 357.010, *et seq.*; Haw. Rev. Stat. Ann. §§ 46-171 - 46-179.

12. *Compare* Tenn. Code. Ann. § 4-18-103(f) *with* Tenn. Code. Ann. § 56-4-205 (premium tax outside Tennessee Internal Revenue Code, which contains the taxes excluded from Tennessee's FCA). *See also,* §§ 213.05, 213.30, Fla. Stat. (removing certain taxes from qui tam provisions of the Florida FCA, but not affecting the right of the state itself to sue under the FCA for false tax reporting, and not excluding residual market assessments and agent licensing fees from the FCA).

13. Mass. Gen. Laws Ann. ch. 12, § 5B(7)(West 2002)

14. Tenn. Code. Ann. § 4-18-103(a)(9)

15. *E.g.,* § 68.087(3), Fla. Stat.

16. See, e.g., § 68.083, Fla. Stat. *See United States ex rel. Pilon v. Martin Marrietta Corp.*, 60 F.3d 995 (2nd Cir., 1995); *Erickson v. American Inst. of Biological Sciences*, 716 F. Supp. 908 (E.D.Va. 1989). *See also, Bailey v. Davis*, 273 So.2d 422, 423 (Fla. App. 1973); *Kinzel v. City of North Miami*, 212 So.2d 327, 328 (Fla. App. 1968); *Ferry Morse Seed Co. v. Hitchcock*, 426 So.2d 958, 961 (Fla. 1983).

17. § 68.083(3), Fla. Stat.

18. *Compare, e.g.,* § 68.091(1), Fla. Stat. ("This act shall be liberally construed to effectuate its remedial and deterrent purposes.") *with In Re: One 1993 Dodge Intrepid*, 645 So.2d 551 (Fla. App. 1994) (recognizing that the Excessive Fines Clause applies even though a forfeiture statute is legislatively characterized as remedial).

19. *See United States ex rel. Luckey v. Baxter Healthcare Corp.*, 183 F.3d 730 (7th Cir. 1999). *See generally, General Electric Company v. U.S. Environmental Protection Agency*, 53 F.3d 1324 (D.C. Cir. 1995).

20. *See, e.g., In re Forfeiture of: 1990 Chevrolet Blazer;* 684 So.2d 197 (Fla. App. 1996); *Electric Company v. U.S. Environmental Protection Agency, supra.*

FLORIDA BECOMES FIRST STATE TO ENACT STATUTE AUTHORIZING WAIVER OR REDUCTION OF COLLATERAL REQUIREMENTS FOR NON-U.S. REINSURERS

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Florida is the first state to enact a statute authorizing waiver or reduction of collateral requirements for non-U.S. reinsurers. However, implementation of Florida's new collateral requirements law may prove to be challenging for both the regulator and the insurance industry.

I. Development of Florida's New Statute - Influencing Factors

Florida's move to waive or reduce collateral requirements for non-U.S. reinsurers was heavily influenced by Florida's property insurance market following the 2004 and 2005 hurricane seasons and the on-going debate at the NAIC regarding reinsurance regulation and collateral requirements. In 2005, the Florida Legislature created the Task Force on Long-Term Solutions for Florida's Hurricane Insurance (hereinafter referred to as the "Florida Task Force").[1] The Florida Task Force was directed to make recommendations to Florida's legislative and executive branches regarding Florida's property insurance market to ensure that sufficient capacity remained in both the private and public sectors for the availability of insurance coverage for hurricane losses in the State.[2] The Florida Task Force was provided an overview of the global reinsurance market and the importance of reinsurance in the Florida property market, with particular emphasis on developing issues in the marketplace and the price sensitive nature of the market.[3] Furthermore, the Florida Task Force was informed concerning then prevailing statutory accounting rules requiring non-U.S. reinsurers to fully collateralize risks they reinsure through trust or letters of credit within the U.S. and the NAIC's examination of the collateralization issue through its Reinsurance Task Force of the Financial Condition (E) Committee.[4] At the conclusion of the Florida Task Force's deliberations, it issued a report recommending, among other things, that the Florida Office of Insurance Regulation, through its leadership position within the NAIC, seek to remove any arbitrary, artificial barriers to competition in the reinsurance market without jeopardizing solvency.[5]

Contemporaneously with the Florida Task Force's activities, the NAIC issued its U.S. Reinsurance Collateral White Paper (hereinafter referred to as the "White Paper") summarizing the historical arguments for and against amending U.S. reinsurance collateral requirements. The White Paper provided the Reinsurance Task Force with a basis for public policy recommendations intended to address future developments concerning collateral requirements.[6] At the Spring 2006 NAIC national meeting, the Reinsurance Task Force was charged to: 1) develop alternatives to the current reinsurance regulatory framework, including the use of collateral within the U.S and abroad; 2) consider approaches that account for a reinsurer's financial strength regardless of domicile; 3) consider and identify variations of state regulation relative to reinsurance contracts and financial reporting; 4) consult with international regulators in addition to all interested parties; and, 5) present a proposal to the NAIC at its December 2006 national meeting.[7]

At the NAIC December 2006 National Meeting, the Reinsurance Task Force presented the Reinsurance Evaluation Office Proposal Procedure to Grant Credit for Ceded Reinsurance (hereinafter referred to as the "NAIC REO Proposal"). The NAIC REO Proposal seeks to establish a regulatory system that distinguishes financially strong reinsurers from weak reinsurers, without relying exclusively on their state or country of domicile, with collateral to be determined as appropriate.[8] The NAIC REO Proposal would create an organization called the Reinsurance Evaluation Office (REO) to rate the financial strength of reinsurers doing business in the U.S., irrespective of the reinsurer's country of domicile.[9] State insurance regulators, through the REO, would establish procedures for evaluating the financial strength and operating integrity of reinsurers and, based on the outcome of the evaluation, assign a rating (REO-1 through REO-5) to each reinsurer.[10] These ratings would be affirmed or modified through periodic reviews by the REO.[11] The analysis would incorporate insurance financial strength ratings assigned by nationally recognized statistical rating organizations ("NRSRO's") and the expertise of the NAIC for evaluating other key factors delineated in the proposal.[12] The analysis would also include a review of the financial strength and operating integrity, business operations, claims paying history, management expertise and overall performance of reinsurers in assigning ratings ("credit criteria").[13] The amount of collateral posted by each reinsurer would depend on the rating it receives from the REO.[14]

II. Florida's Regulation of Credit for Reinsurance and Collateral Requirements

Before Florida's 2007 statutory amendment, Florida regulated credit for reinsurance and the reinsurance activities of reinsurers by allowing domestic ceding insurers to take statutory credit to reduce liabilities by the amount ceded to reinsurers, or paid loss claim amounts recoverable from reinsurers as an asset on its balance sheet.[15] Specifically, credit for reinsurance was allowed when the reinsurer was licensed in the same state of domicile as the ceding company for a like kind of business or if the reinsurer was accredited by the State of Florida.[16] Credit for reinsurance was also allowed if the reinsurer maintained a trust fund in a qualified U.S. financial institution for the payment of valid claims of its U.S. ceding insurers and their assigns and successors in interest.[17] Finally, credit for reinsurance was allowed when reinsurance was ceded to an assuming insurer not meeting the above-referenced requirements, but only as to the insurance of risks located in jurisdictions in which the reinsurance is required to be purchased by a particular entity by applicable law or regulation of that jurisdiction.[18]

Effective January 25, 2007, section 624.610(3)(e), Florida Statutes, was created to authorize the Florida Office of Insurance Regulation to waive or reduce collateral requirements for non-U.S. reinsurers.[19] To qualify for waiver or reduction of collateral, a non-U.S. reinsurer must meet certain minimum financial requirements. The reinsurer must have surplus in excess of $100 million and have a secure financial strength rating from at least two nationally recognized statistical rating organizations deemed acceptable to Florida.[20]

Subsection (3) (e) further requires the Florida Office of Insurance Regulation to consider certain domiciliary jurisdiction regulatory requirements of the assuming non-U.S. reinsurer.[21] The required considerations include: 1) the reinsurer's domiciliary regulatory jurisdiction;[22] 2) the structure and authority of the reinsurer's domiciliary regulator with regard to solvency regulation requirements and the financial surveillance of the reinsurer;[23] 3) the substance of financial and operating standards for reinsurers in the domiciliary jurisdiction;[24] 4) the form and substance of financial reports reinsurers are required to file in the reinsurer's domiciliary jurisdiction or other public financial statements filed in accordance with generally accepted accounting principles;[25] 5) the domiciliary regulator's willingness to cooperate with U.S. regulators in general and the Florida regulator in particular;[26] 6) the history of reinsurer performance in the domiciliary jurisdiction;[27] 7) documented evidence of substantial problems with enforcement of valid U.S. judgments in the domiciliary jurisdiction;[28] and, 8) any other matters deemed relevant by the Florida Office of Insurance Regulation.[29] Finally, subsection (3) (e) requires the Florida Office of Insurance Regulation to give appropriate consideration to insurer group ratings that may have been issued and in lieu of granting full credit for reinsurance, the FOIR may reduce the amount required to be held in trust under subsection (3)(c).[30]

Subsection (3)(e) of the new Florida law and the NAIC REO Proposal share some common elements. These common elements include: 1) analysis by nationally recognized statistical rating organizations to rate non-U.S. reinsurers;[31] 2) sharing of information with the non-U.S. reinsurer's domiciliary regulator;[32] 3) evaluation of the domiciliary jurisdiction regulatory structure;[33] and, 4) consideration of any other information that may be required in the state regulator's judgment.[34]

III. Regulatory Challenges in Implementing Florida's New Reinsurance Collateral Requirements

Notwithstanding these similarities, Florida's adoption and implementation of subsection (3)(e) may be problematic for several reasons. First, subsection (3)(e) has vague and undefined statutory standards. The terms "secure financial rating" and "recognized statistical rating organizations" are undefined. There are no statutory standards defining what constitutes willingness to cooperate with U.S. and Florida regulators or an acceptable history of performance by non-U.S. reinsurers in their domiciliary jurisdictions. Furthermore, subsection (3)(e) does not limit the matters the Florida regulator may deem relevant in its evaluation, has no standards concerning the Florida regulator's appropriate consideration in evaluating insurer group ratings that have been issued, and does not specify standards by which the Florida regulator may reduce trust funds under subsection (3)(c) in lieu of granting credit for reinsurance.

Understandably, administrative agencies are often tasked to administer laws that at times are less precise, interact in complex ways, and must be applied to various facts and circumstances. Florida's policy regarding the use and application of subsection (3)(e) is in its formative stages due to subsection (3)(e)'s recent enactment, no known requests to the Florida Office of Insurance Regulation requesting waiver or reduction of collateral requirements,[35] and the status of the NAIC REO proposal.[36] However, because Florida's policy decisions to implement subsection (3)(e) will likely have industry-wide impact, ceding carriers, their trade associations, or reinsurers may consider filing a petition to initiate rulemaking for the purpose of establishing standards and agency policy for subsection (3)(e). The adoption of administrative agency rules to implement the provisions of section 624.610 is authorized.[37] Furthermore, any person regulated by an agency or having substantial interest in an agency rule may petition an agency to adopt a rule.[38] Therefore, petitioning for rulemaking may be a viable alternative for ceding carriers, reinsurers, and their respective trade associations to seek clear and consistent agency guidance regarding subsection (3)(e).

Finally, Florida's creation of subsection (3)(e) could impact its current accreditation status with the NAIC. Accredited states, like Florida, are required to annually submit to the NAIC an updated Financial Standards Self-Evaluation Guide that is evaluated by NAIC staff and the NAIC's Financial Regulation Standards and Accreditation Committee.[39] A state maintains accreditation status if it remains in compliance with the NAIC accreditation standards.[40] The NAIC's Part A accreditation standards are viewed as fundamental building blocks for sound insurance regulation.[41] Part A requires state laws regarding reinsurance ceded to contain the NAIC Model Law on Credit for Reinsurance, the NAIC's Credit for Reinsurance Model Regulation and the 1992 NAIC Life and Health Reinsurance Agreements Model Regulation or substantially similar laws.[42] Thus, implementation of subsection (3)(e) may also depend on the NAIC's determination that the addition of subsection (3)(e), alone or in conjunction with other provisions of Florida's credit for reinsurance law, satisfies Part A's requirement that state laws for reinsurance ceded be substantially similar to the above-referenced NAIC Model Laws regarding reinsurance.

Endnotes

1. Report of Task Force on Long Term Solutions for Florida's Hurricane Insurance Market at 10.

2. Id.

3. Report of Task Force on Long Term Solutions for Florida's Hurricane Insurance Market at 35.

4. Id.

5. Report of Task Force on Long Term Solutions for Florida's Hurricane Insurance Market at 36, 55.

6. NAIC U.S. Reinsurance Collateral White Paper, December 6, 2005, at 2.

7. NAIC Joint Meeting of Executive Committee/Plenary, March 5, 2006.

8. NAIC Reinsurance Evaluation Office, Proposal to Grant Credit for Ceded Reinsurance at 3.

9. Id.

10. Id.

11. Id.

12. Id.

13. Id.

14. Id.

15. § 624.610(2), Fla. Stat. (2006).

16. § 624.610(3)(a) and (b), Fla. Stat. (2006).

17. § 624.610(3)(c), Fla. Stat. (2006).

18. § 624.610(3)(d), Fla. Stat. (2006).

19. CS/HB 1-A (2007).

20. § 624.610(3)(e), Fla. Stat. (2007).

21. Id.

22. § 624.610(3)(e)1, Fla. Stat. (2007).

23. § 624.610(3)(e)2, Fla. Stat. (2007).

24. § 624.610(3)(e)3, Fla. Stat. (2007).

25. § 624.610(3)(e)4, Fla. Stat. (2007).

26. § 624.610(3)(e)5, Fla. Stat. (2007).

27. § 624.610(3)(e)6, Fla. Stat. (2007).

28. § 624.610(3)(e)7, Fla. Stat. (2007).

29. § 624.610(3)(e)8, Fla. Stat. (2007).

30. Id.

31. NAIC Reinsurance Evaluation Office, Proposal to Grant Credit for Ceded Reinsurance at 3.

32. NAIC Reinsurance Evaluation Office, Proposal to Grant Credit for Ceded Reinsurance at 5.

33. NAIC Reinsurance Evaluation Office, Proposal to Grant Credit for Ceded Reinsurance at 7-9.

34. NAIC Reinsurance Evaluation Office, Proposal to Grant Credit for Ceded Reinsurance at 8.

35. Panel Discussion, American Conference Institute Forum on Reinsurance Collateral, April 11-12, 2007.

36. The Reinsurance Task Force continues working on the technical details of the NAIC REO Proposal. The Reinsurance Task Force will report back to the Financial Condition (E) Committee at the NAIC's 2007 Summer National Meeting in June, followed by an overall feasibility update to the Financial Condition (E)

Committee at the NAIC Fall 2007 National Meeting. No date has been set as to when the new evaluation process would be fully functional.

37. § 624.610(14), Fla. Stat. (2007).

38. § 120.54(7)(a), Fla. Stat. (2007).

39. NAIC Financial Regulation Standards and Accreditation Program, March 2007, at 7.

40. Id.

41. NAIC Financial Regulation Standards and Accreditation Program, March 2007, at 8.

42. Id. at 10.

THE 2006 D.C. CAPTIVE ACT AMENDMENTS

Crossing the Next Frontier

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On March 14, 2007, in an effort to keep pace in an ever-changing field, the District of Columbia (the "District") amended its captive insurance laws by enacting the Captive Insurance Company Amendment Act of 2006 (the "2006 Amendments"). The 2006 Amendments, which updated segregated cell provisions included in the previous Captive Insurance Company Acts of 2000 and 2004, help reaffirm the District as one of the most innovative captive domiciles in the nation by providing increased flexibility with respect to the formation and structure of protected cell companies while simultaneously enabling cell companies to benefit from the many progressive captive provisions already in place under District law.

A captive is generally defined as an insurance company created by its owners for the primary purpose of insuring the risks of its parent, affiliates or members of an association.[1] Captives, which first appeared in the 1960s[2], continue to remain significant and ongoing business opportunities because of their lower insurance costs, customization, better risk control and possible tax advantages.[3] In 2004, the District expanded its captive insurance laws to allow for greater flexibility with respect to the formation of segregated or protected cell captives, [4][5] which are single legal entities that provide insurance through separate financial divisions, or cells, for each insured client or activity.[6] Under this framework, the captive itself has a core capital, but each division also has its own additional capital provided by the client using that cell.[7] The segregated cell structure is attractive both to small organizations seeking to take advantage of the captive insurance market and to larger companies with high premiums and difficult exposures[8] because the assets of each individual cell are secure and are statutorily protected from the creditors of another cell.[9] Similarly, a segregated cell's assets are protected against incursion by adverse selection, losses and underwriting, which creates a regulatory and accounting wall around each captive division.[10]

The 2006 Amendments represent the next generation of protected cell legislation. Following the lead of Jersey and other alien domiciles, the 2006 Amendments authorize the formation of separately incorporated cells and

provide greater detail to the scope of authorized transactions involving protected cells. The enhanced specificity included in the 2006 Amendments is extremely appealing because it provides greater certainty to captive owners, managers and regulators regarding the status and actions of protected cell companies. No other U.S. jurisdiction has similar protected cell legislation. According to Commissioner Thomas E. Hampton of the District's Department of Insurance, Securities and Banking (the "DISB"), the amendments to the protected cell statute "will put the District ahead of other jurisdictions in our captive insurance regulation and attract more captive insurance companies to the District."[11] In addition, Larry Smith, Chairman of the Captive Insurance Council of the District of Columbia, an organization that was instrumental in ensuring the passage of the 2006 Amendments, has stated that the amendments to the District's segregated cell laws "should make the District an even more attractive location for the formation of new captive insurance companies" and establish the District's captive laws as "the most advanced in the United States in terms of . . . forming protected cell insurance companies."[12]

Protected Cells and Incorporated Cells

The 2006 Amendments authorize the creation of two types of protected cells: traditional protected cells and incorporated protected cells.[13] A traditional protected cell, as generally described above, is a separate account established and maintained by a segregated cell captive insurer that has no legal identity separate from that of the protected cell captive insurer of which it is a part.[14] Conversely, an incorporated protected cell is a protected cell that is formed as a corporation or other legal entity and has a legal identity independent from that of its parent protected cell captive insurer.[15] As such, an incorporated cell may hold assets, sue and be sued in its own name, and do anything else that an ordinary corporation can do under District law. This structure is intended to eliminate any doubt as to the strength of the firewall between cells, as assets and liabilities are segregated as effectively as they would be among subsidiaries in a corporate group structure, although the incorporated cells are not subsidiaries of the protected cell captive insurer. It is anticipated that an incorporated cell would have its own federal employment identification number ("FEIN") and file its own tax return. A protected cell captive would be part of the protected cell captive insurance company's tax return. Moreover, unless otherwise provided for in the articles of incorporation or other organizational documents of a protected cell captive insurer, each incorporated protected cell of a protected call captive insurer will have the same directors, secretary and registered office as the protected cell captive insurer,[16] which translates into significant administrative benefits and cost savings for captive owners and managers.

Relationship Between Cells and Cell Companies

Pursuant to District law, each protected cell shall be accounted for separately on the books and records of a protected cell captive insurer to reflect the financial condition and results of operations of each individual cell, including net income or loss, dividends or other distributions to participants, and such other factors as may be provided by the Commissioner of the DISB (the "Commissioner") or any applicable participant contract between the entities.[17] Consequently, if a protected cell captive insurer enters into a transaction with respect to a particular protected cell or incurs a liability arising from an activity or asset of a particular protected cell, a claim by any person in connection with the transaction or liability shall extend only to the general assets of that individual cell.[18] Likewise, if a protected cell captive insurer enters into any transaction or incurs any liability in its own right and not in respect of any of its protected cells, any claim in connection with the transaction or liability shall extend only to the general assets of the protected cell captive insurer.[19] A protected cell captive insurer may also create and issue shares in one or more classes or series for one or more protected cells, and the proceeds for the issuance of such shares will be included in the assets of the protected cell that issued the shares.[20] Similarly, a protected cell captive insurer can pay a dividend on protected cell shares of any class or series whether or not a dividend is declared on any other class or series of protected cell shares or any other shares.[21]

The 2006 Amendments provide even greater flexibility with respect to the relationship between cells and cell companies by permitting a protected cell to enter into an agreement with its protected cell captive insurer or with another protected cell of the protected cell insurer that is enforceable as if each protected cell were a separate legal entity, even if the protected cell is not organized as an incorporated protected cell.[22] This enhanced contracting capacity will help eliminate the uncertainty that has previously hindered the use of the protected cells and should facilitate the creation of reinsurance or risk pooling cells within a protected cell structure.

Conversion To or From a Protected Cell Captive Insurance Company

One of the strengths of the 2006 Amendments is the flexibility they give to the protected cell captive structure. Under the 2006 Amendments, a captive insurer already licensed in the District may amend its organizational documents to become a protected cell captive insurer upon receiving the approval of (i) two-thirds of the captive's shareholders and (ii) all of the creditors of the captive insurer.[23] Alternatively, the 2006 Amendments permit a protected cell captive insurer licensed under District law to cease to be a protected cell captive insurer and to become a traditional captive upon receiving the approval of (i) two-thirds of the captive's shareholders; (ii) all of the creditors of the captive insurer; (iii) two-thirds of the participants of each protected cell; and (iv) the Commissioner.[24] The 2006 Amendments also allow for a protected cell, including an incorporated cell, to transfer from one protected cell captive to another upon receiving similar shareholder, creditor and regulatory approval.[25] Furthermore, under certain circumstances, the revised legislation gives existing captive insurers the flexibility to become a protected cell of a protected cell captive and permits a protected cell to separate from its protected cell captive and become an independent captive insurer.[26]

Best Practices and Captive Investments

In addition to expanding the law with respect to protected cell captive insurers, the 2006 Amendments continue to allow segregated cell captives to benefit from many of the progressive captive provisions already in place in the District. Perhaps the most innovative of these provisions is the "best practices" statute adopted in 2004 that enables the Commissioner to effectively keep up with advances in other captive domiciles. Under this provision, the Commissioner is empowered to authorize a captive insurer otherwise qualified to conduct business in the District to engage in any activity in any form permitted to a captive insurer in any other jurisdiction.[27] This broad authority allows the District to immediately capitalize on improvements in other jurisdictions' captive laws and avoid the lengthy process of amending its legislation every time a new innovation arises in the field. Moreover, the "best practices" statute enhances the Commissioner's ability to better meet the particular needs of individual captive insurers by enabling him to apply general provisions enacted in other jurisdictions to specific situations within the District. Current District law also provides investment flexibility in that any captive insurer may file a schedule of its proposed investments, and all material changes thereto, with the Commissioner, who shall approve the investments if he determines that they do not threaten the captive's solvency or liquidity.[28]

Forming a Captive in the District

District law provides that in order to incorporate and obtain a license from the DISB, a captive insurer must apply for a certificate of authority with the Commissioner.[29] All applications must include a proposed copy of the captive insurer's organizational documents, a pro forma financial statement, a feasibility study and a strategic business plan.[30] Additionally, the DISB requires captive applicants to submit evidence of the following: the amount and liquidity of its assets relative to the risks it intends to assume; the expertise and experience of its managers; the overall soundness of its operational plan; the adequacy of the loss prevention programs implemented by its parent or member organizations; and satisfactory minimum capital and surplus requirements.[31] Significantly, because it permits the Commissioner to issue both a simultaneous certificate of

authority and a certificate of incorporation or organization for all business entities, District law creates a more streamlined and convenient filing process for applicants. Moreover, the District's captive laws also ease administrative burdens by providing that prior to final formation, the Commissioner may issue a provisional certificate of authority that enables a captive to engage in limited insurance and reinsurance activities while its application is pending with the DISB.[32]

An application by a captive insurer or segregated account for a certificate of authority shall include a non-refundable application fee determined by the Commissioner, and in some cases the Commissioner may require an applicant to retain independent legal, financial, and examination services from outside the DISB to review and make recommendations regarding its qualifications.[33] If the DISB determines that the materials filed by the captive insurer or segregated account are complete and satisfactory, the Commissioner will issue an applicant both a final certificate of authority and a certificate of incorporation or organization within thirty days.[34] All licensed captive insurers or segregated accounts must renew their certificate of authority on an annual basis.[35] Further information regarding captive formation in the District is available at http://www.disb.dc.gov/.

Captive Powers

Pursuant to existing law, a captive may be structured in any business form permitted in the District and can offer all types of insurance except for direct personal motor vehicle or homeowners' coverage.[36] A captive may also provide workers' compensation to its parent and affiliates unless prohibited by the laws of the state in which the insurance is transacted.[37] Similarly, a captive insurer or segregated account may take credit for the reinsurance of risks or portions of risks ceded to reinsurers in compliance with the District's Law of Credit Reinsurance Act of 1993,[38] which has the effect of lowering capital requirements.[39] To provide increased flexibility, however, District law also grants the Commissioner discretion to allow a captive to take credit for the reinsurance of risks that do not comply with the NAIC Credit for Reinsurance Act.[40] In addition, a captive insurer or segregated account may take credit for the reinsurance of risks or portions of risks ceded to a pool, exchange or association acting as a reinsurer which has been authorized by the Commissioner.[41] The Act likewise enables a captive operating in the District to write insurance or reinsurance for parent or affiliate employee benefit plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA").[42] A captive may also pay dividends under an ongoing plan approved by the Commissioner if, at the time of payment, its retained capital exceeds the minimum statutory requirements.[43]

Minimum Capital and Surplus Requirements

Once licensed, a captive insurer, including each segregated account of a protected cell captive insurer, operating in the District must at all times maintain minimum capital and surplus amounts. Although all captives must maintain a minimum unimpaired capital of $100,000, the Commissioner may require additional unimpaired paid-in capital or surplus based on the type, volume, and nature of a captive's insurance business.[44] Both the capital and surplus minimums must be in the form of either cash or an irrevocable letter of credit.[45] A letter of credit used by a captive insurer or segregated account as evidence of capital or surplus shall be on a form approved by the Commissioner, automatically renewable annually, and issued by a bank that is chartered in the District or by a branch located in the District of a bank which is a member of the Federal Reserve, or insured by the Federal Deposit Insurance Corporation.[46]

Requirements for Transacting Business

The District's captive law requires that a captive must merely maintain an office, as opposed to a principal place of business, in the District, appoint a registered agent in the District to receive service of process, and require its board of directors to meet in the District at least once a year.[47] Additionally, a captive must make adequate arrangements with a District bank, retain a pre-approved individual or business organization to

manage its affairs, employ a qualified certified public accountant, contract with an attorney knowledgeable in captives who is licensed to practice law in the District, and obtain experienced actuaries to perform reviews and operation evaluations.[48] A segregated account maintained by a captive insurer must comply with these requirements for transacting business if it is organized as a separate legal entity.[49]

In order to transact business in the District, a captive insurer must also pay annual premium taxes not later than March 2 of each year.[50] The minimum tax is $7,500 on District captives and $10,000 on risk retention groups, and the total tax paid by a captive insurer in any given year shall not exceed $100,000.[51]

Except as provided under applicable law, District captives are not subject to any other insurance laws.[52] In addition, unlike other insurance companies, captives are not required to either join or make financial contributions to guaranty funds or rating organizations.[53] Finally, captive insurers are exempt from the regulatory assessments imposed on insurers and health maintenance organizations under the District's Insurance Regulatory Trust Fund Act of 1993.[54]

Annual Reports and Periodic Financial Examinations

District law requires that each captive insurer operating in the District submit an annual financial report by March 2 of each year.[55] This filing must be prepared by a certified public accountant and in accordance with generally accepted accounting principles ("GAAP"), and a captive insurer must file a consolidated report on behalf of each of its segregated accounts.[56] Additionally, the Commissioner also retains the right to visit each captive insurer at any time he deems necessary to inspect the financial affairs of the captive insurer or any of its segregated accounts.[57] In conjunction with such an examination, the Commissioner may require a captive to employ qualified independent legal, financial and examination services from outside DISB to conduct inspections and make recommendations.[58]

Conclusion

It is widely noted that the administrative benefits of a protected cell company structure can be significant. Once such a protected cell company is established, repeat transactions can be executed rapidly, as a new cell can be added at a fraction of the cost and time that would be needed if the structure were to be established from scratch. The District of Columbia's new protected cell legislation offers clear advantages over other domestic domiciles with respect to protected cell flexibility, including the choice of incorporated or unincorporated cells, the right of cells to transact with each other, and enhanced freedom in connection with the ownership, uses and operations of cells. Coupled with the innovative and progressive body of captive insurance law already in place in the District, the 2006 Amendments undoubtedly mark a cross into the next frontier of captive regulation and effectively establish the District as one of the most flexible and cutting-edge captive jurisdictions in the world.

Endnotes

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3. Jon Harkavy & Arthur Perschetz, *Buyers and Brokers Look to Advantages of Captive Insurers*, 4 Ins. Advisor Monthly, Issue 11, Jan. 2002, at 22.

4. See, e.g.,

5. Arthur D. Perschetz, *The New D.C. Captive Act: A Creative Response to an Evolving Market*, FORC Quarterly Journal of Ins. Law and Regulation, Vol. XV, Ed. Vii, December 1, 2004.

6. *Lori* Widmer, *Protected Cells: The Next Generation Captive,* Risk & Ins., Oct. 1, 2000.

7. *Id.*

8. *Id.*

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10. *Id.*

11. *Press* Release, Government of the District of Columbia, Department of Insurance, Securities and Banking, *District Adopts New Captive Insurance Laws: Changes Will Give the District Competitive Advantage as a Captive Domicile* (Mar. 28, 2007)

12. *Id.*

13. D.C. Code § 31-3931.04(a)

14. *Id.* § 31-3931.04(b)(14)

15. *Id.* § 31-3931.04(a)(1)

16. *Id.* § 31-3931.04(a)(6)

17. *Id.* § 31-3931.04(a)(18)

18. *Id.* § 31-3931.04(a)(33)

19. *Id.* § 31-3931.04(a)(34)

20. *Id.* § 31-3931.04(a)(21)

21. *Id.* § 31-3931.04(a)(23)

22. *Id.* § 31-3931.04(a)(15)

23. *Id.* § 31-3931.04(a)(49)-(50)

24. *Id.* § 31-3931.04(a)(51)-(52)

25. *Id.* § 31-3931.04(a)(55)-(57)

26. *Id.* § 31-3931.04(a)(66)-(67)

27. *Id.* § 31-3931.02(c)

28. *Id.* § 31-3931.07

29. *Id.* §§ 31-3931.09(a); 31-3931.11

30. *Id.* § 31-3931.09(a)

31. *Id.* § 31-3931.09(b)

32. *Id.* § 31-3931.11(f)

33. *Id.* § 31-3931.09(c)

34. *Id.* § 31-3931.09(d)

35. *Id.*

36. *Id.* § 31-3931.02(b)

37. *Id.*

38. *Id.* § 31-501 *et seq.*

39. *Id.* § 31-3931.08

40. *Id.*

41. *Id.*

42. *Id.* § 31-3931.02(9)

43. *Id.* § 31-3931.06(k)

44. *Id.* § 31-3931.06(a), (c)

45. *Id.* § 31-3931.06(b)

46. *Id.* § 31-3931.06(d)

47. *Id.* § 31-3931.11(c)-(d)

48. *Id.* § 31-3931.11(c)

49. *Id.* § 31-3931.11(e)

50. *Id.* § 31-3931.12

Annual District Tax Rules	Direct Business, Paid to the District	Assumed Reinsurance, Paid to the Mayor

First $25 million	0.250%	0.225%
Next $25 million	0.150%	0.150%
Over $50 million	0.050%	0.025%

51. *Id.*

52. *Id.* § 31-3931.22

53. *Id.* §§ 31-3931.16; 31-3931.17

54. *Id.*

55. *Id.* § 31-3931.13(a)

56. *Id.*

57. *Id.*

58. *Id.* § 31-3931.14(a)

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MARKETING AND SALE OF TRAVEL INSURANCE GETS TOUGHER IN NEW YORK

According to Bureau of Transportation statistics at the U.S. Department of Transportation, John F. Kennedy International Airport ("JFK") continued to rank first among United States airports in international passenger traffic as of 2005, with an average of over 51,000 international passengers each day, traveling on over 80 U.S. and foreign airlines from more than 50 countries. Four of the top 20 U.S.-international airport pair gateways involve JFK. In 2000, JFK-London Heathrow was the leading U.S. international airport pair with over 2.9 million passengers. JFK-Paris, JFK-Frankfurt and JFK-Tokyo were the others.

Yet, despite the availability of a travel agent's limited license without the requirement of an exam, the license available under § 2103(g)(1)[1] of the New York Insurance Law restricts the scope of a producer's authority much more than most similar licenses available in other states with major international airport traffic volume, including California, Florida, Illinois, Georgia, Texas, Hawaii and Washington, and more so than in states with major international cruise traffic, including California, Florida, Hawaii and Washington. A limited license under § 2103(g) (1) of the New York Insurance Law is limited to the sale of coverage for baggage loss or accident insurance primarily for the purposes of covering risks of travel. Trip cancellation, delay and interruption are not within the scope of coverages a travel agent may sell under cover of a limited license

under § 2103(g) (l).

New York Insurance Department Circular Letters

Circular Letter 1991-12[2] set the tone, advising the insurance and travel industries that group or blanket accident and health insurance covering New York customers of a travel agent is prohibited (Sections 4235 and 4237[3]). Certificates of travel coverage are subject to the filing and approval requirements of Section 3201(6)(1)[4] and New York Insurance Department Regulation 123 (11 NYCRR § 59.4[5]). Further, Circular Letter 1991-12 set forth the Department's position that when an authorized insurer provides a travel agent with travel insurance, which the travel agent then provides to customers making travel arrangements, both the insurer and the travel agent are in violation of the anti-tie-in provisions under § 4224(d)(l)[6] unless the coverage is provided on an optional basis for a separate charge.

Then, in December 2006, the Department issued supplemental Circular Letter 2006-24,[7] targeting, in addition to travel agents, tour operators and other travel suppliers such as airlines, cruise ships and others who have been soliciting and selling trip cancellation waivers, which generally provide for either a total or partial refund by such travel agents of any cancellation penalties or other costs that would not otherwise be refundable, such as the ticket price of a nonrefundable ticket. Certain of these waivers are only sold as part of a travel protection plan including an underlying insurance policy. The Department also views this practice as an illegal tie-in.

It is interesting to compare the restrictions under New York law on the sale of travel insurance through various tour or cruise operators and other travel agents and the laws of most other states, including states which are at the heart of a growing international travel industry, most notably California, Connecticut, Florida, Georgia, Hawaii, Louisiana, Maryland, New Jersey and Washington.

California

California issues limited licenses as travel insurance agents to employees of railroad, steamship, airline and other organizations engaged in transporting persons as common carriers and to individuals or employees of persons engaged in selling transportation on common carriers.[8] Travel insurance agents may sell insurance to travelers covering loss of baggage and personal effects while in transit or in any hotel or other building en route.

Connecticut

Connecticut's law (Bulletin L 13, dated 7/24/02[9]) offers the possibility of a "travel limited line" license, including travel, accident, baggage and trip interruption or cancellation coverage.

Licensed travel agents may share commissions earned with any person providing a referral for such business, provided the unlicensed person who receives referral fees does not act as a producer by soliciting, negotiating or selling insurance and does not in any other way imply or represent that he is a licensed producer. This, in turn, permits cruise ship lines, tour operators and others to receive compensation for referring customers.

Florida

Florida issues a limited license to travel agents selling baggage loss insurance, in-transit and storage personal property insurance or communication equipment inland marine insurance.[10]

A limited license may be issued - covering the full risks of travel including personal accident insurance - to a full-time salaried employee of a common carrier or a full-time salaried employee or owner of a transportation

ticket agency or to the full-time salaried employees of such an agency.

Still another limited license may be issued to a motor vehicle rental agent or to an entity which offers motor vehicles for rent or lease. The authorized coverage may include accidental personal injury or death of the lessee or any passenger riding or driving with the covered lessee in the rented motor vehicle, provided the coverage is for no more than 30 consecutive days per lease period.

Florida also issues a limited license for baggage and motor vehicle excess liability. This license is available to a full-time salaried employee of a common carrier or a full-time salaried employee or owner of a transportation ticket agency, where the person is engaged in the sale or handling of transportation of baggage and personal effects of travelers. However, such insurance may only be sold in connection with such transportation.

A business entity that offers motor vehicles for rent or lease may, as an agent of an insurer, transact insurance that provides coverage for the liability of the lessee to the lessor for damage to the leased or rented motor vehicle, provided: (1) the lessee is not provided coverage for more than 30 consecutive days per lease period; (2) the lessee is provided written notice that his personal insurance policy that provides coverage on an owned motor vehicle may provide coverage with or without a deductible; and (3) the purchase of the insurance is not required in connection with the lease or rental of a motor vehicle.[11]

Georgia

Georgia law makes available a limited travel agent license authorizing a rental company to offer or sell insurance through a licensed insurer in connection with the rental of vehicles.[12] The rental company licensed under this subsection may offer or sell insurance through licensed insurers only in connection with, and incidental to, the rental of vehicles in any of the following general categories:

- personal accident insurance covering the risks of travel
- liability insurance
- personal effects insurance for loss of personal effects that occur during the rental period
- roadside assistance and emergency sickness protection programs
- any other travel or vehicle-related coverage that a rental company offers in connection with and incidental to the rental of vehicles.

See, *also* Georgia Insurance Department Regulation 120-2-3-.32.[13]

Hawaii

Hawaii issues a limited license to persons selling travel tickets of a common carrier. The license covers the sale of accident and health or sickness insurance and baggage insurance on personal effects.[14]

Further, under the Hawaiian law,[15] a limited lines motor vehicle rental company producer license may be issued to a motor vehicle rental company, authorizing the employees of the company to solicit and sell the authorized insurance coverages. Those authorized coverages include personal accident, health and sickness and accidental death and dismemberment, personal effects insurance covering the renter, roadside assistance and emergency sickness protection. The limited lines motor vehicle rental company producer may distribute brochures describing the material terms of coverage solicited or sold and the identity of the insurer.

Louisiana

Louisiana insurance law[16] authorizes the sale of vehicle mechanical breakdown insurance covering mechanical breakdown or failure of a motor vehicle, other customer assistance and convenience services, such as vehicle rental assistance, towing assistance, trip interruption and roadside assistance, vehicle service agreements or extended warranty agreements. *See also* §§ 22:2101 to 22:2105[17] and LAC 37:XIII.10301 to .10311.[18]

Maryland

Maryland offers a limited lines license to individuals who sell transportation tickets of a common carrier, authorizing the holder to act as an insurance producer only as to travel ticket policies of life insurance, accident insurance, or baggage insurance on personal effects.[19] See also § 10-604[20] and COMAR 31.03.11.02.[21]

New Jersey

New Jersey authorizes the sale of ticket insurance, meaning the insurance coverages sold concerning the risk of travel sold by a travel agent or by a ticket agent of any car rental company or common carrier. New Jersey also authorizes the sale of travel insurance, including insurance coverage for trip cancellation, trip interruption, baggage, life, sickness and accident, disability, and personal effects when limited to a specific trip and sold in connection with transportation provided by a common carrier.[22]

Washington

Washington issues limited licenses to persons selling transportation tickets of a common carrier who act as an agent only as to transportation ticket policies of liability insurance or baggage insurance or personal effects.[23] See also WAC 284-17-455.[24]

Other States

Other states that make available limited travel licenses to certain players in the travel industry include *Alabama* (restricted license for rental car companies, covering personal accident, liability, personal effects, roadside assistance and emergency sickness and any other travel or auto-related coverage incidental to the rental of vehicles);[25] *Alaska* (limited license available to sellers of tickets of common carriers, covering health insurance, baggage insurance on personal effects, and trip cancellation or trip interruption insurance;[26]) *Arkansas* (limited license for vehicle rental companies, covering personal accident insurance, liability insurance, personal effects insurance, roadside assistance and emergency sickness protection, and any other travel or auto-related coverage incidental to the rental of vehicles;[27]) *Colorado* (makes available a single license to sell travel tickets but also exempts from definition of "producer" employees of auto rental companies who offer coverage incidental to the rental of motor vehicles including personal injury or death, personal liability and property damage, collision, damage to or loss of personal effects, roadside assistance and emergency repairs associated with motor vehicle operation and travel;[28]) *Delaware* (limited license for rental car companies offering personal accident insurance, liability insurance, personal effects insurance and roadside assistance and emergency sickness protection plans;[29]) *Idaho* (exempts from licensing a person who, concurrent with the rental of a motor vehicle, provides as optional coverage attached to a car rental agreement auto- and travel-related coverages for a period of up to 90 days;[30]) *Illinois* (limited license for rental car companies, offering personal accident insurance, liability insurance, personal effects insurance, roadside assistance and emergency sickness protection and any other incidental auto-related or travel coverages;[31]) *Indiana* (license restricted to the ticket-selling producer of a common carrier who will sell only insurance on personal effects carried as baggage, in connection with the transportation provided by the common carrier;[32]) *Iowa* (license restricted to the sale by vehicle rental companies of personal accident, liability insurance, personal effects and roadside assistance and emergency sickness protection plans;[33] *Kansas* (makes available

license limited to the sale by vehicle rental companies of personal accident, liability, personal effects insurance and roadside assistance and emergency sickness protection;[34] *Kentucky* (authorizing the sale of trip cancellation, trip interruption, baggage, life, sickness and accident, disability and personal effects, if limited to a specific trip and sold in connection with transportation provided by a common carrier;[35] *Michigan* (exempts from licensing a person whose only sale of insurance is for travel or auto-related insurance sold in connection with and incidental to the rental of a motor vehicle for a period of up to 90 days;[36] *Missouri* (limited lines license available for sales of insurance covering the risks of travel;[37] *Minnesota* (limited license available authorizing sale of travel baggage insurance and mobile telephone insurance only;[38] *Mississippi* (license restricted to the sale by vehicle rental companies of personal accident, liability, personal effects and such other motor vehicle-related insurance as may be approved by the Commissioner;[39] *Montana* (license available for sale of rental vehicle insurance; nature unspecified;[40] *Nebraska* (rental car company limited license covering motor vehicle liability, accident and health covering accidental death and dismemberment and medical expenses resulting from an accident during the rental period and insurance for loss of or damage to personal property that occurs during the rental period;[41] *Nevada* (limited lines license available for travel and baggage;[42] *New Hampshire* (limited license available to ticket-selling agent or other representative of a common carrier appointed by a licensed insurer with regard to insurance on personal effects carried as baggage on a common carrier and to travel agents selling limited travel accident insurance in transportation terminals;[43] *New Mexico* (limited license available to transportation ticket sellers employed by public carriers, covering insurance incidental to transportation of persons or storage or transportation of baggage and rental car insurance covering personal accident including medical expenses arising from an accident occurring during the rental period, liability, personal effects and roadside assistance and emergency sickness;[44] *North Carolina* (limited license to sell travel accident and baggage coverage and rental car insurance covering excess liability, accident and health including medical expenses arising from an accident occurring during the rental period, and personal effects insurance;[45] *Ohio* (limited lines license available for sale of travel insurance coverage for trip cancellation, trip interruption, baggage, life, sickness and accident, disability, and personal effects when sold in connection with transportation provided by a common carrier;[46] *Oklahoma* (specific lines license available to sell travel accident and baggage insurance;[47] *Oregon* (makes available limited class insurance license to sell "trip travel insurance" covering trip cancellation, trip interruption, baggage, accidental death, sickness and accident, disability and personal effects and license to sell auto rental coverage including personal accident insurance, liability, personal effects and roadside assistance and emergency sickness;[48] *South Carolina* (limited license to sell auto rental coverage including personal accident, liability, personal effects and roadside assistance and emergency sickness protection;[49] *South Dakota* (limited license available to agents of motor service clubs to sell travel accident insurance and license available to transportation ticket-selling agents of common carriers, covering personal accident insurance under ticket policies and covering baggage insurance;[50] *Tennessee* (limited lines license available to sell insurance on personal effects carried as baggage or limited travel accident insurance sold in connection with transportation provided by a common carrier;[51] *Texas* (specialty license available to travel agency, a franchisee of a travel agency or a public carrier to sell accident and health insurance, trip cancellation and interruption, personal effects insurance and life insurance not exceeding $150,000 on any one life covering risks of travel during a planned trip;[52] *Utah* (limited line producer license available for insurance covering the risks of travel and car rental related risks;[53] *Vermont* (limited lines license available to sell rental car insurance covering personal accident for rental car occupants, accidental death and dismemberment and medical expenses arising from an accident that occurs during the rental period, liability insurance, personal effects insurance, roadside assistance and emergency sickness protection;[54] *Virginia* (limited lines property and casualty agent license available for sale of sickness and hospitalization insurance and travel baggage insurance;[55] *West Virginia* (limited license available to auto rental companies to sell personal accident, liability, personal effects and roadside assistance and emergency sickness protection;[56] Wisconsin (exempts from insurance marketing intermediary definition and licensing any representative of a common carrier who sells only over-the-counter, short-term travel accident ticket policies and baggage insurance;[57] and *Wyoming* (makes available license limited to the sale by vehicle rental companies of personal accident, liability, personal effects insurance and roadside assistance and emergency sickness protection.[58])

Thus, most states make available limited travel licenses with broader coverage than New York. With travel through New York's ports and airports increasing in 2006 at the highest rate since September 11, 2001, there would appear to be a public interest in making these coverages more readily available through increased numbers of distribution channels, particularly in New York and consistent with New York's role as the center of U.S. and world commerce and travel.

Endnotes

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3. N.Y. Ins. Law §§ 4235, 4237

4. Id. § 3201(6)(1)

5. N.Y. Comp. Codes R. & Regs. tit 11, § 59.4 (2007)

6. Id. § 4224(d)(1)

7. N.Y. Ins. Dept. Circular Ltr. 2006-24, Travel Insurance (Dec. 29, 2006)

8. Cal. Ins. Code § 1752 (West 2007)

9. Conn. Ins. Dept., Bulletin L-13, Changes to Insurance Producer Licensing Due to the New Producer Law Effective September 1, 2002 (Jul. 24, 2002)

10. Fla. Stat. § 626.221 (2007)

11. Id. § 626.321

12. Ga. Code Ann. § 33-23-12(c)(2) (2007)

13. Ga. Comp. R. & Regs. r. 120-2-3-.32 (2007)

14. Haw. Rev. Stat. § 431:9A-107.5 (2007)

15. Id. § 431:9A-142

16. La. Rev. Stat. Ann. § 22:1800 (West 2007)

17. Id. §§ 22:2101-22:2105

18. La. Admin. Code tit. 37:XIII, §§ 10301-10311 (2006)

19. Md. Code Ann., Ins. § 10-122 (2007)

20. Id. § 10-604

21. Md. Regs. Code tit. 31, § 03.11.02, Lexis COMAR 31.03.11.02 (2007)
22. N.J. Admin. Code tit 11 § 17-1.2, Lexis N.J.A.C. 11:17-1.2 (2007)
23. Wash. Rev. Code Ann. § 48.17.190 (West 2007)
24. Wash. Admin. Code § 284-17-455 (2007)
25. Ala. Code § 27-7-5.1 (2007)
26. Alaska Stat. § 21.27.150 (Michie 2007)
27. Ark. Code Ann. § 23-64-202 (Michie 2007); Ark. Ins. R. & Regs. 14 § 8 (2007)
28. Colo. Rev. Stat. Ann. §§ 10-2-105, 10-2-407 (West 2006)
29. Del. Code Ann. tit. 18, § 2003 (2007)
30. Mont. Code Ann. § 33-17-1504 (2005)
31. 215 Ill. Comp. Stat. 5/500-105 (West 2007)
32. Ind. Code § 27-1-15.6-18 (2007)
33. Iowa Code Ann. § 522A.1, et seq. (West 2006)
34. Kan. Stat. Ann. § 40-241 (2006)
35. Ky. Rev. Stat. Ann. §§ 304.9-020 & 230 (Michie 2006)
36. Mich. Comp. Laws Ann. § 500.1202(2)(h) (West 2007)
37. Mo. Rev. Stat. § 375.012.1(10) (2007)
38. Minn. Stat. § 60 K.36 (2006)
39. Weil's Code of Miss. R., Reg. 2002-02 § 5, Lexis CMSR 28-000-082 (2007)
40. Mont. Code Ann. § 33-17-1504 (2005)
41. Neb. Rev. Stat. § 44-4067 (2007)
42. Nev. Rev. Stat. § 683A.261.1(j) (2007)
43. N.H. Rev. Stat. Ann. § 402:16-a (2007)
44. N.M. Stat. Ann. §§ 59A-12-18 & 59A-32A-1 to 9 (Michie 2007)
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46. Ohio Admin. Code Ann. § 3901-5-09(E)(2)(e) (Anderson 2007)

47. Okla. Stat. tit. 36, § 1435.20.A.2 (2007)

48. Or. Rev. Stat. § 744.854 (2005); Or. Admin. R. 836-071-0108 (2007)

49. S.C. Code Ann. § 38-43-500 (Law. Co-op 2006)

50. S.D. Codified Laws §§ 58-30-52, 58-30-68 (2007)

51. Tenn. Code Ann. § 56-6-110 (2007)

52. Tex. Ins. Code Ann. §§ 4055.152 & 153 (West 2007)

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THE IMPACT OF THE CIVIL UNION ACT ON THE PROVISION OF INSURANCE BENEFITS IN NEW JERSEY

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Introduction

On December 21, 2006, New Jersey joined Vermont and Connecticut to become the third state in the country to permit civil unions between same-sex couples and to confer upon civil union partners the same rights and benefits conferred upon married persons under state law.[1] The Civil Union Act (CUA), effective February 19, 2007, was enacted as directed in *Lewis v. Harris,* where the New Jersey Supreme Court held that under the equal protection guarantees of the New Jersey Constitution, same-sex couples must be afforded the same legal rights and benefits as married couples under civil marriage statutes, whether by "civil union" or "marriage."[2]

The Legislature responded by adopting the CUA, which is intended to provide civil union couples with the "same benefits, protections and responsibilities under law, whether they derive from statute, administrative or court rule, public policy, common law or any other source of civil law, as are granted to spouses in a marriage."[3] This expressly includes all benefits, protections and responsibilities granted under the "laws relating to insurance, health and pension benefits."[4]

New Jersey also joined a handful of other states when, in conjunction with the adoption of the CUA, the Legislature amended the state's Law Against Discrimination to include in its protections civil union partners from discrimination based on civil union status.[5] 10:5-12.

Background

Effective July 10, 2004, New Jersey enacted a Domestic Partnership Act (DPA) to create a statewide domestic partnership registry in order to protect the rights of certain couples by extending to them a "subset" of the benefits of marriage.[6] Under the DPA, unmarried, same-sex couples ages 18 years and older and opposite-sex couples ages 62 years and older could register as domestic partners. The DPA explicitly stated that same-sex couples could not marry.

Upon the enactment of the CUA, a same-sex couple who entered into a registered domestic partnership prior to February 19, 2007, the effective date of the Act, may remain domestic partners and continue to obtain the more limited rights and benefits accorded domestic partners, or may enter into a civil union. Domestic partnership does not convert automatically into a civil union, although entry into a civil union automatically terminates a domestic partnership. And, with the enactment of the CUA, the opportunity to register as domestic partners in New Jersey now is available only to same-sex or opposite-sex couples, ages 62 years and older.[7]

Unlike the DPA, which provides that domestic partner benefits are optional, the CUA mandates that "civil union couples *shall* have all of the same benefits, protections and responsibilities under law, whether they derive from statute, administrative or court rule, public policy, common law or any other source of civil law, as are granted to spouses in a marriage."[8]

The Applicability of the CUA

The CUA recognizes civil unions entered in New Jersey, as well as civil unions, same-sex marriages and certain domestic partnerships entered in other jurisdictions.[9] Further, there are no residency requirements in order to enter into a civil union in New Jersey. If, however, an individual's state of residence is among the majority of states which has a so-called "defense of marriage" law, barring the marriage of same-sex couples, a New Jersey civil union of out-of-state residents is unlikely to be recognized in that state.

Moreover, the federal Defense of Marriage Act (DOMA) defines "marriage" as the union of one man and one woman and provides further that no state is required to give legal effect to a same-sex marriage permitted in another state---despite a state's obligation to recognize and give effect to marriages legally performed in other states under the Full Faith and Credit Clause of the United States Constitution.[10] As a result, there is some confusion as to the interplay of state and federal laws.

To add to the confusion, rights governed exclusively by federal law, such as the Employment Retirement Income Security Act of 1974, as amended (ERISA), are unaffected by the CUA, meaning that federal law continues to apply. Under federal law, employers may elect whether and to what extent to add insurance coverage for domestic partners. Under New Jersey law, however, insurance policies that provide coverage for a spouse *must* provide coverage for a civil union partner. Thus, while it is clear that civil union partners have the same rights to insurance benefits as spouses under state law, the extent of those rights is not readily apparent when governed by federal law.

The Regulatory Response

New Jersey's Department of Banking and Insurance has not yet adopted regulations implementing the CUA. The Commissioner has, however, issued Bulletin 07-04, to inform all interested parties that:

- Beginning February 19, 2007, all plans that include dependent coverage should be amended or administered to provide coverage to civil union couples. Coverage should not be deferred until the plan renewal date. Carriers should provide an opportunity to employees to make an election to cover a dependent acquired through a civil union on or after February 19, 2007, in the same manner as provided to cover a dependent acquired through a marriage.
- The Act does not alter federal law, which confers marriage rights and privileges to opposite-sex married couples only.
- A contract that covers spouses will, as of February 19, 2007, cover civil union partners. For example, a group life contract that allows a covered employee to elect to buy life insurance or coverage for his or her spouse must be read as allowing an employee with a civil union partner to purchase coverage for his or her partner.
- Unlike the DPA, the CUA *requires* employers to add coverage for civil union partners.

Additionally, in response to numerous inquiries received, the Executive Director of New Jersey's Small Employer Health (SEH) Benefits Program issued Advisory Bulletin 07-SEH-01, to clarify that:

- While benefit mandates generally apply to inforce plans on the first renewal on or after the effective date of the mandate, the rights set forth in the CUA are effective on February 19, 2007. Thus, coverage should not be deferred until the plan renewal date, and as of February 19, 2007, carriers should provide an opportunity to employees to make an election to cover a dependent acquired through a civil union on or after February 19, 2007 in the same manner as that provided to cover a new spouse.
- Since federal law confers marriage rights and privileges to opposite-sex couples only, a civil union partner is not a qualified beneficiary under the Consolidated Omnibus Budget Reconciliation Act (COBRA), and the dissolution of a civil union is not a qualifying event under COBRA.

  However, New Jersey's "mini-COBRA" law applies to every health insurance policy or contract issued to a small employer in New Jersey and requires continued health coverage to be offered to the spouses of employees of small employers, as defined therein.**11** In the event of the dissolution of a civil union, the former civil union partner is entitled to elect continuation in the same manner as a former spouse in the event of a divorce. Continuation under New Jersey law typically is extended to small employers with fewer than 20 employees, because continuation rights are provided under COBRA to employers with 20 or more employees. COBRA does not apply to same-sex couples. Therefore, benefits will be provided to civil union couples by employers with 2-50 employees, but not to employers with over 50 employees.

- Although the DPA affords employers an option to elect whether to add coverage for domestic partners to their plan, the CUA does not.
- The SEH Board will be proposing amendments to the standard health benefits plans to address the requirements of the CUA. Until the proposed amendments have been adopted, the Conformity with Law provision contained in each of the standard plans ensures that all carriers may administer all plans in compliance with the CUA.

Presumably, all insurance policies and contracts issued in New Jersey are amended by operation of law to provide the same benefits for married persons and civil union partners. Whether New Jersey will require insurers to adopt mandatory Civil Unions Endorsements, or to refile forms to comply with law, like Vermont has done, or simply indicate that existing forms will be construed pursuant to the intent of the law, as Connecticut has done, remains to be seen.

Insurance "Benefits, Protections and Responsibilities" Under New Jersey Law

To the extent that New Jersey insurance laws address the "benefits, protections and responsibilities" of spouses, as stated, the CUA requires that these provisions apply equally to civil union partners. The Commissioner, in Bulletin 07-04, has advised insurers that the CUA requires that insurance coverage be offered to civil union partners in the same manner as offered to spouses. Although the CUA requires equal coverage for all insurance policies issued in the state, it is unlikely to withstand a challenge on ERISA preemption grounds, and Bulletin 07-04 recognizes that the Act does not alter federal law.

ERISA generally does not preempt insurance laws requiring carriers to provide particular benefits in policies issued within the state.[12] However, self-insured plans, which are financed by employers (rather than purchased from a state-regulated insurer), and unions are federally regulated. In such cases, ERISA preempts the application of state laws relating to employee benefit plans. Therefore, state insurance laws do not apply, and the terms of the plan, rather than state law, govern. Nonetheless, an employer with a self-insured plan electing not to cover civil union partners may be subject to a potential discrimination claim under state law.[13]

Moreover, while the CUA requires equal coverage for civil union partners where coverage for spouses is provided, New Jersey law does not require private employers to offer insurance to any employee, let alone the dependents of their employees. Although the CUA provides that laws relating to insurance and health benefits shall apply to civil union couples, no law, including the CUA, requires that dependents be covered. It should be assumed that where benefits are offered voluntarily, state law will apply, so that if spouses are covered, civil union partners must be covered as well.

Whether the cost of coverage must be the same for spouses and for civil union partners is an open issue. One of the insurance "benefits" married persons receive, for example, is lower automobile insurance rates. Civil union opponents claim an asserted negative impact on the insurance rates of heterosexual couples because of the risk characteristics of homosexuals. Despite the sturm und drang, Blue Cross/Blue Shield of Vermont advised Vermont's Civil Union Review Commission that civil unions have had such an "imperceptible impact," that it does not even track this data. Vermont has adopted regulations which permit rate differences where supported by relevant actuarial data or actual cost experience, but marketing discounts must be equally available.

In any event, there is no question that for individuals who live and work in New Jersey and are covered by medical, dental, vision and other policies issued by insurers authorized to do business in New Jersey, such policies and contracts must comply with the CUA. New Jersey residents employed by companies headquartered in states other than New Jersey, or insured by companies based in states other than New Jersey, reportedly have experienced some difficulties in obtaining insurance benefits for civil union partners. This is a potential concern, especially where a group policy is issued for delivery in a state which has enacted a defense of marriage law prohibiting the recognition of same-sex unions.

In sum, the specific impacts of the CUA on the provision of insurance in New Jersey, while not exhaustive, include the following:

- *Liability:* Where the "named insured" includes a spouse, it also must include a civil union partner, and all benefits extended to spouses must be extended to civil union partners.
- *Health:* Health insurers issuing policies under the state's insurance laws must offer coverage to civil union partners if coverage is offered to spouses. Most self-funded health plans, however, are likely to receive ERISA preemption. Further, benefits under New Jersey's "mini-COBRA" law are required for civil union partners for *all* small employers, so that civil union partners of employers of up to 50 employees will receive COBRA benefits under New Jersey law.
- *Life:* Life insurance policies with survivor benefit clauses typically are governed by state law, so that civil unions must be treated the same as marriage. (Annuities governed by federal law are excepted.)

- *Workers' Compensation:* Civil union partners expressly are entitled to workers' compensation benefits, including payment of back wages and survivors' benefits under the CUA.[14]
- *Title:* Civil union partners may own real estate in the same manner as husband and wife, including as tenants by the entirety. This raises important issues under state law for title insurers issuing affidavits of title, who should request civil union status, and for lenders, whose security interests could be impaired.

Finally, under the CUA, civil union partners have standing to sue for all causes of action related to or dependent upon spousal status, including actions for wrongful death, emotional distress, loss of consortium, and any and all other torts or actions under contracts reciting, related to, or dependent upon spousal status. This impacts the risks assumed by insurers as well as claims and claims handling procedures, among other matters.[15]

Conclusion

While the CUA broadly requires all state insurance, health and pension benefits granted to spouses be granted to civil union partners, the impact of federal law on such benefits must be evaluated. If insurance benefits are denied to a civil union partner on the basis of federal law, an insurer operating prudently should notify the civil union partner of the specific reason for the declination and maintain a record of such declination in the event of a market conduct examination or potential lawsuit.

Endnotes

1. *N.J.S.A.* 37:1-28 *et seq.* An "Act Relating to Civil Unions" was adopted by Vermont effective January 1, 2000, s*ee Vt. Stat. Ann. tit.* 15, § 1204(a), and by Connecticut in 2005, s*ee Conn. Gen. Stat. Ann* § 46b-38nn. As of the drafting of this article, New Hampshire legislation to allow civil unions was pending. *See HB* 437 (2007).

2. 188 *N.J.* 415 (2006). Connecticut was the first state to voluntarily adopt such legislation; Vermont, like New Jersey, acted in response to court decision. *See Baker v. State,* 744 *A.2d* 864 (Vt. 1999).

3. *N.J.S.A.* 37:1-31.

4. *N.J.S.A.* 37:1-32.

5. *N.J.S.A.*

6. *N.J.S.A.* 26:8A-1 *et seq.*

7. *N.J.S.A.* 26:8A-4.1.

8. *N.J.S.A.* 37:1-31 (emphasis added).

9. *N.J.S.A.* 37:1-34. In accordance with the CUA, New Jersey recognizes civil unions in Connecticut and Vermont, as well as government-sanctioned, same-sex relationships in Great Britain, New Zealand, Iceland and Sweden; same-sex marriages in Massachusetts (the only state to recognize same-sex marriages), Belgium, Canada, The Netherlands, South Africa and Spain; and domestic partnerships formed in California. It is the nature of the rights conferred, not the name of the relationship selected, which controls the benefits afforded under New Jersey law. *NJ Atty. Gen. Op. No.* 3-2007 (Feb. 16, 2007). The Connecticut Attorney General

concluded that the state would recognize civil unions and domestic partnerships, but *not* same-sex marriages because Connecticut's public policy does not permit same-sex marriages. *Conn. Atty. Gen. Op. No.* 2005-004 (Sept. 20, 2005).

10. 28 *U.S.C.* §1738C. *See also* 1 *U.S.C.* § 7.

11. *N.J.S.A.* 17B:27A-27.

12. *Metropolitan Life Ins. Co. v. Massachusetts,* 471 *U.S.* 724 (1985) (Massachusetts statute requiring certain insurance policies, including group employee health care plans, to provide minimum mental health care benefits was not preempted by ERISA because law regulated insurers, not employers). *But see Egelhoff v. Egelhoff,* 532 *U.S.* 141 (2001) (suggesting that state laws regarding same-sex marriage would be preempted if they affect benefit plan administration).

13. In order to attempt to address this issue, some employers voluntarily have allowed employees to choose between a self-insured health plan, which is federally regulated, and a health maintenance organization, which covers civil union partners.

14. *See N.J.S.A.* 37:1-32i; *N.J.S.A.* 34:15-1 *et seq.*

15. *N.J.S.A.* 37:1-32b.

THE NEW MISSOURI MOTOR VEHICLE EXTENDED SERVICE CONTRACT LEGISLATION

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The new Missouri Motor Vehicle Extended Service Contract legislation became effective January 1, 2007.[1] The Missouri Department of Insurance, Financial Institutions and Professional Registration ("Missouri Department of Insurance") promulgated rules for the registration by service contract administrators and providers of motor vehicle extended service contracts for their service contracts issued in Missouri[2] and for faithful performance of a provider's obligations to its contract holders.[3]

Significant to insurers is a provision which requires service contract providers, as one of three options, to obtain a reimbursement insurance policy issued by an insurer authorized to transact insurance in Missouri.[4] Such mandatory language creates a larger market for reimbursement insurance coverage in the State of Missouri, an opportunity previously not established.

Should a provider of service contracts possess the necessary capital or assets under the statute, and elect to do so, that provider is permitted to maintain a funded reserve account and to place in trust with the director a financial security deposit.[5] An inability by a provider to adequately fund a reserve account and to make the required security deposit, or to maintain a net worth of at least one hundred (100) million dollars,[6] leaves a provider with no other alternative than to purchase a reimbursement insurance policy. The inconvenience of designating certain capital or assets for all business written in Missouri, exclusive of other business written in other states, could also motivate providers to seek coverage in the form of a reimbursement insurance policy.

Missouri reimbursement insurance policies issued for the purpose of providing coverage for service contracts issued, sold, or offered for sale in Missouri are required, under the new law, to conspicuously state that, upon failure of the provider to perform under the contract, such as failure to return the unearned provider fee, the insurer that issued the policy shall pay on behalf of the provider any sums the provider is legally obligated to perform according to the provider's contractual obligations under the service contracts issued or sold by the provider.[7]

The Missouri insurance department interprets this new legislation, for the purposes of calculating the amounts to be placed in the funded reserve account and the amounts to be placed as a financial security deposit, to include not only service contracts issued, sold, or offered for sale in Missouri on or after January 1, 2007, but also all service contracts which are issued and *in force*. This necessarily includes service contracts issued prior to January 1, 2007. The Department relies upon the language in the statute which specifically states that when the security deposit option is selected, the provider shall include all service contracts issued and in force; i.e., both before and after January 1, 2007.[8]

However, in application of other sections of the new extended service contract law, where there is no specific language requiring the inclusion of all in force business, the Missouri Department has not applied the law retroactively. For example, the provisions which set out the mandatory language to be included in service contracts are being applied only to new service contracts issued, sold, or offered for sale in Missouri on or after January 1, 2007. In effect, providers should not anticipate being asked to amend service contracts which were issued prior to January 1, 2007; and insurers should not anticipate being asked to issue endorsements on existing and in force Missouri reimbursement insurance policies issued prior to January 1, 2007. However, all new service contracts and new reimbursement insurance policies issued on Missouri Motor Vehicle Extended Service Contract business issued on or after January 1, 2007, fall subject to the requirements of the new law.

Reimbursement insurance policies issued on Missouri Motor Vehicle Extended Service Contracts are issued to a provider for the benefit of service contract holders, to discharge all of the obligations and liabilities of the provider under the terms of the service contracts in the event of nonperformance by the provider.[9] All obligations and liabilities are to include, but are not limited to, failure of the provider to perform under the service contract and the return of the unearned provider fee in the event of the provider's unwillingness or inability to reimburse the unearned provider fee in the event of termination of a service contract.[10]

Missouri recognizes a motor vehicle extended service contract or agreement for the repair, replacement, or maintenance of a motor vehicle or for indemnification for repair, replacement, or maintenance, for the operational or structural failure due to defect in materials, workmanship, or normal wear and tear, and can include payment for incidentals such as towing, rental, and emergency road service, but does not include mechanical breakdown insurance or maintenance agreements.[11] A mechanical breakdown insurance policy is distinguishable from a reimbursement insurance policy in that a mechanical breakdown insurance policy in Missouri is a policy, contract or agreement issued by an authorized insurer that provides for the repair, replacement, or maintenance of a motor vehicle or indemnification for repair, replacement, or service, for the operational or structural failure of a motor vehicle due to a defect in materials or workmanship or to normal wear and tear.[12]

A motor vehicle extended service contract is not considered a warranty in Missouri. A warranty is one which is made solely by the manufacturer, importer, or seller of property or services without charge, that is not negotiated or separated from the sale of the product and is incidental to the sale of the product, that guarantees indemnity for defective parts, mechanical or electrical breakdown, labor, or other remedial measures, such as repair or replacement of the property or repetition of services.[13]

On or after January 1, 2007, no provider of a motor vehicle extended service contract is authorized to issue, sell or offer for sale in Missouri a motor vehicle extended service contract, unless that provider has properly

registered with the Missouri Director of Insurance and complied with all provisions of this new legislation.[14] The definition of a provider of motor vehicle extended service contracts is broad and includes any person who administers, issues, makes, provides, sells, or offers to sell a motor vehicle extended service contract, or who is contractually obligated to provide service under a motor vehicle extended service contract such as sellers, administrators, and other intermediaries.[15]

Insurers authorized in Missouri which issue a reimbursement insurance policy to a provider of motor vehicle extended service contracts should be aware that under this new Missouri legislation the provider is considered the agent of the insurer.[16] When a provider is acting as the administrator and does business with other providers, that provider who is acting as administrator is required to notify the insurer of the existence and identities of the other providers.[17]

This new legislation specifically permits the insurer under a reimbursement insurance policy to seek indemnification or subrogation against a provider when an insurer pays or is obligated to pay the service contract holder.[18]

Financial controls are an important part of the Missouri Motor Vehicle Extended Service Contract law, and the Missouri Department of Insurance has established financial guidelines and oversight of providers by the department similar to the requirements established for an insurance company. These established requirements also can be seen and are parallel with the requirements for an accredited reinsurer in order for a domestic insurance company to take credit for insurance ceded to an otherwise unauthorized reinsurer. The financial strength required of a provider is reflected in the Missouri Motor Vehicle Extended Service Contract law which requires, in lieu of a reimbursement insurance policy, a net worth of one hundred million dollars, or a funded reserve account and a security deposit, as referenced above.[19]

The provider's security deposit requirement most closely resembles the accredited reinsurance model laws, adopted in Missouri. Each provider shall fund a security deposit, as follows:

1. A surety bond issued by an authorized surety;
2. Securities of the type eligible for deposit by authorized insurers in this state;
3. Cash;
4. A letter of credit issued by a qualified financial institution; or
5. Another form of security prescribed by regulations issued by the director.[20]

In order to determine whether or not the financial institution is qualified, the regulation specifically cites to the Missouri statute on credit for reinsurance[21] for the definition of a qualified financial institution acceptable to Missouri.

Provider fees, which are the consideration paid for a service contract in excess of the premium,[22] are not subject to premium taxes in Missouri. The premiums paid on the reimbursement insurance policies are subject to all applicable premium taxes as required for insurance policies issued on risks within the State of Missouri.[23]

The jurisdiction granted to the Missouri Department of Insurance for enforcement of the new Motor Vehicle Extended Service Contract law is broad. The Missouri Director of Insurance has the authority to take action necessary or appropriate to protect service contract holders in Missouri. The Director may issue cease and desist orders, orders prohibiting the selling or the offering of service contracts, and/or order a civil penalty. The Director may bring an action in the Circuit Court of Cole County, Jefferson City, Missouri, for an injunction or other appropriate relief to enjoin threatened or existing violations. Restitution may be sought. The civil penalty can be up to $1,000.00 per violation.[24]

The purpose of the new Missouri Motor Vehicle Extended Service Contract law is to regulate the business of motor vehicle extended service contracts for the protection of the residents of the State of Missouri. Other states have adopted similar legislation as well. Currently before the Missouri legislature is a bill which expands this same legislation into the area of home appliances. As the legislation expands further into additional areas of business in the various states, the opportunity for the issuance of additional policies of insurance also expands. When the water goes up in the pond, all the boats in the pond go up.

Endnotes

1. Section 407.1200 et seq. RSMo. (Supp. 2006)
2. 20 CSR 200-18.010
3. 20 CSR 200-18.020
4. Section 407.1203.3(1) RSMo. (Supp. 2006)
5. Section 407.1203.3(2)(a) and (b) RSMo. (Supp. 2006)
6. 20 CSR 200-020(1)(C)
7. Section 407.1206 RSMo. (Supp. 2006)
8. Section 407.1203.3(2)(b) RSMO. (Supp. 2006)
9. Section 407.1200(13) RSMo. (Supp. 2006)
10. Id.
11. Section 407.1200(7) RSMo. (Supp. 2006)
12. Section 407.1200(6) RSMo. (Supp. 2006)
13. Section 407.1203.1 RSMo. (Supp. 2006)
14. Section 407.1200(11) RSMo. (Supp. 2006)
15. Section 4 07.1200(15) RSMo. (Supp. 2006)
16. Section 404.1221.1 RSMo. (Supp. 2006)
17. Id.
18. Section 407.1221.2 RSMo. (Supp. 2006)
19. Section 407.1203.3 RSMo. (Supp. 2006)
20. Section 407.1203.3(2)(b)a, b, c, d, and e RSMo. (Supp. 2006)

21. 20 CSR 200-18.020

22. Section 407.1200(12) RSMo. (Supp. 2006)

23. Section 409.1203.4 RSMo. (Supp. 2006)

24. Section 407.1224 RSMo. (Supp. 2006)

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