



CLIENT ALERT

Virginia Surety Company v. California Insurance Guarantee Association
Administrative Proceeding Before
the Insurance Commissioner of the State of California
File No. CIGA-07-1

As a member of the California Insurance Guarantee Association (“CIGA”), Virginia Surety Company had paid all CIGA premium assessments billed until 2007. In July 2006, Virginia Surety had notified the California Insurance Commissioner that it was not renewing any non-warranty coverages in California, including workers’ compensation. As a result of Virginia Surety’s ceasing its workers compensation placements and renewals, adjustment of prior assessments by CIGA demonstrated overpayments in those prior payments and resulted in a credit due to Virginia Surety’s account. Virginia Surety sought a refund of that credit from CIGA. On November 15, 2007, CIGA adopted rules regarding assessment credits and rejected Virginia Surety’s request for a refund. Virginia Surety appealed to the Commissioner.

Barger & Wolen partners [Kent R. Keller](#) and [Stephen C. Klein](#) represented Virginia Surety Company on the appeal.

In an order issued January 9, 2009 (effective February 12, 2009), California’s Insurance Commissioner Steve Poizner adopted the decision of Administrative Law Judge David R. Harrison declaring “The Credit Refund Rules CIGA Adopted at its November 15, 2007 Board Meeting Were Invalid.” Among the findings of this decision are that the rules adopted by CIGA were “after the fact, without prior notice or hearing, specifically in response to [Virginia] Surety’s refund request.” Also, that CIGA “never presented these rules to the Insurance Commissioner for approval” and that CIGA could not lawfully adopt or implement these rules without prior approval of the Insurance Commissioner. So important was this aspect of the decision that the Commissioner has declared it as “**precedential**.”

CIGA’s contention that it denied the request of

Virginia Surety for a refund under [California Insurance Code section 1063.5](#), in accordance with the 2007 Amendments to that section, was rejected as not having been a reasonable exercise of the discretion granted to CIGA. The decision found that CIGA’s interpretation of the amendments resulted in an unfair, “*de facto* forfeiture of assessments credits a member had earned by timely paying its assessments as CIGA called for them.” In sum, the administrative law judge found that “CIGA has failed to establish a reasonable basis for its actions consistent with the purposes of the 2007 Amendment.”

Virginia Surety had sought a refund of credits accumulated as a result of overpayment adjustments to its CIGA assessments for workers’ compensation insurance. Virginia Surety contended that California Insurance Code section 1063.5 permitted CIGA, both before and after the 2007 Amendments, to refund credits, and in particular after the amendments which explicitly granted to CIGA discretion to pay such refunds where, as here, it had agreed with the California Insurance Commissioner to cease writing in the category of insurance that generated the credits. In rejecting Virginia Surety’s application for refund, on November 15, 2007, CIGA adopted criteria for such refunds which included not only the requirement as set forth in the 2007 Amendment of an agreement with the Commissioner, but the additional requirements that the member insurer be in run-off under the supervision, oversight or control of the regulator of the member’s state of domicile and that the member demonstrate that the failure of the member to receive the refund could jeopardize the run-off plan. CIGA’s claimed justification for imposition of the criteria was its concerns for cash flow due to reduction in California gross workers’ compensation premiums, its bonded indebtedness of \$750 million, the possibility that it would have to return to the bond market

and the deficit in the workers' compensation account.

At the hearing on the matter, evidence was presented (1) that in February 2007 CIGA had paid a refund to another member of approximately \$16 million, (2) that such payment was made on the basis of doing so "would not have any adverse effect on the Association's cash flow needs, or its ability to pay covered claim," (3) that CIGA's financial condition in November 2007 was at least as good as it was in February 2007 when it made the \$16million refund and (4) that CIGA's chief financial officer testified that paying the refund sought by Virginia Surety would have "no significant adverse effect on CIGA's financial condition." CIGA was the principal proponent of the 2007 Amendment to section 1063.5 and it was found that CIGA's financial condition was significantly better than when it sought and obtained the 2007 Amendment.

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The Administrative Law Judge found that the 2007 Amendment to section 1063.5 dictated "a course of action and an exercise of discretion designed to carry out the Amendment's pur-

pose *in conformity with the spirit of the law and in a manner to subserve and not to impede or defeat the ends of substantial justice.*" (Emphasis in original.) He determined that the burden of justifying a denial of a refund should properly be borne by CIGA and that CIGA had failed here to establish a reasonable basis for its actions consistent with the purposes of the 2007 Amendment. The Administrative Law Judge, and by adoption of the decision, the California Insurance Commissioner, concluded that in refusing Virginia Surety's request for refund, CIGA did not reasonably exercise its statutory discretion under the 2007 Amendment

The end result is that unless CIGA challenges the Commissioner's decision in court, Virginia Surety will receive a refund of its overpayments. Further, CIGA cannot adopt "factors" limiting its discretion to pay refunds with the Commissioner's prior approval.

Kent R. Keller is a partner in the firm's Los Angeles office. He is well known for his handling of insurance regulatory matters, bad faith and in recent years, class action cases as well as litigation involving a wide variety of contract disputes and unfair business practices, including Business and Professions Code section 17200 lawsuits.

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