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Staffing Company Appeal Focuses On Legality Of Side Agreements

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Are collateral and indemnity agreements used in a large deductible workers' comp policy legal even though the carrier neglected to file them before use? And if they are – do they apply even though there was no signed agreement until three months into a staffing company's policy?

Those are among the questions the California Department of Insurance's administrative hearing bureau will decide. At issue is whether the program's unfiled collateral and indemnity agreements qualify for one of the limited exceptions amended into Title 10 sections 2250 and 2268 of the California Code of regulations.

The dispute stems from the 2017 large-deductible policy that Protective Insurance Company wrote for Personnel Staffing Group (PSG). The policy was incepted on January 1, but the collateral and indemnity agreements were neither received nor signed by PSG until three months later.

Beyond the legality of the side agreements used in the policy, the parties are at odds over loss reserve amounts, claims handling practices, and the amount of collateral Protective demanded. When the policy was written, Protective was operating as Baldwin & Lyons and was looking to broaden its operations. PSG was the the carrier's first staffing company account.

Attorneys associated with the case say it will be the first interpretation of regulations governing the filing and use of ancillary agreements that were amended in 2016.

The amendments came amid several disputes between California employers and workers' comp carriers over the legality of unfiled side agreements to large deductible policies and workers' comp programs. The final regulations were developed over 15 months and required five public comment periods to form the final reg. The regulations took effect in early 2016.

Ancillary Agreements

Title 10 sections 2250 and 2268 spell out what documents qualify as an ancillary agreement and when they must be filed before use. Section 2250 states:

"Ancillary agreement" means an agreement that is a supplementary writing or contract relating to a policy or endorsement form that adds to, subtracts from, or revises the obligations of either the insured or the insurer regarding any terms of an insurance policy including, but not limited to, dispute resolution agreements, policy premium amounts or rates, expense or tax reimbursement or allocation, deductible amounts, policy duration, cancellation, or claims administration. "Ancillary agreements" do not include:

(1) Limiting and restricting endorsements as defined in Subdivision (e) of this regulation;

Agree To Disagree

At issue is whether the terms in the PSG collateral and indemnity agreements were ever negotiated and "mutually agreed upon by the parties" as required by section 2250 to be exempt from the filing requirement. If they were not, the agreements would be illegal under section 2268. It is undisputed that the collateral and indemnity agreements used in the program were never filed for CDI's approval before they were used (see sidebar for the pertinent text from sections 2250 and 2268).

PSG and Protective faced off last month for two days of evidentiary hearings in the case. During the hearing, attorney Michael P. O'Day of DLA Piper, who represents Protective Insurance Company, pressed the issue that there were negotiations between the parties over the terms of the collateral agreement.

But attorney Nick Roxborough of Roxborough Pomerance Nye & Adreani, who is representing PSG in the dispute, noted that it is undisputed that there was no agreement when the policy incepted. He says that PSG was presented with an ultimatum nearly three months into the $30 million program to sign the agreements or be terminated. "At the end of the day, there was no meeting of the minds," he maintains.

CDI administrative law judge Clarke de Maigret oversaw the evidentiary proceedings and ordered the parties to submit supplemental briefs after the first of the year. A formal proposed decision is expected later in 2021.

(2) Customized limiting and restricting endorsements as defined in Subdivision (g) of this regulation; or

(3) Agreements specifying only terms described in subdivisions (f)(3)(A) through (f)(3)(F) below, but only if, such terms are disclosed and negotiated contemporaneously with the inception or renewal of the underlying policy, and any revisions or additions to such terms subsequent to the inception or renewal of the policy are mutually agreed upon by the parties:

(A) the method for making payments,

(B) the method for funding deductible amounts or other policy-related charges due under a policy,

(C) the amounts of collateral or security the insured is required to maintain for claims that do not exceed the deductible,

(D) payment due dates,

(E) payment transmittal information, or

(F) the method of selecting a claims administrator, provided that such claims administrator may only administer claims that do not exceed the deductible.

Agreements that do not meet this definition would run afoul of section 2268 that focuses on the unlawful use of policy forms, endorsements and ancillary agreement which are sometimes known as side agreements.

The section specifies that:

(a) An insurer shall not use any policy *form, endorsement form, or ancillary agreement unless attached to and made a part of the policy. If an insurer attaches a policy or endorsement form that restricts or limits the coverage of the policy, it shall conform in all respects with these rules.*

(b) An insurer shall not use a policy form, endorsement form, or ancillary agreement except those filed and approved by the Commissioner in accordance with these regulations.

(c) An insurer shall not use a policy form, endorsement form, or ancillary agreement that does not conform to the regulations set forth in this Article or Insurance Code Sections 11657, 11658 or 11659. An insurer that fails to comply with this regulation is in violation of Insurance Code Sections 11657, 11658 or 11659 and therefore, is in violation of Section 700(c). Such an insurer shall be subject to proceedings pursuant to Sections 701, 704(b) and 1065.1. Each occurrence of a violation to each insured shall constitute a separate and distinct violation for purposes of this regulation.