STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
DEPARTMENT OF BUSINESS REGULATION
233 RICHMOND STREET
PROVIDENCE, RHODE ISLAND 02903

Heritage Healthcare Services, Inc., Petitioner,	:	
v.	:	**DBR No. 05-I-0156**
The Beacon Mutual Insurance Company, Respondent.	:	

DECISION

I.
Travel

The first two issues involved in this matter were submitted to the Department in the form of a consumer complaint from Heritage Healthcare Services, Inc. ("Heritage") against Beacon Mutual Insurance Company ("Beacon"). Under the Department's complaint handling process, the complaint was sent to Beacon for response. Once the response was received both the complaint and response were evaluated by the Department to determine whether or not the substance of the matter justified regulatory action. Based upon the allegations contained in the complaint, the insurers reply and the Departments' review of relevant statutes, the Department did not find that administrative action was warranted. On March 9, 2005 correspondence was sent to the parties indicating that the Department declined to take regulatory action on the complaint.

On July 21, 2005 Heritage wrote to the Director inquiring as to how an appeal could be taken from the March 9, 2005 correspondence. On August 15, 2005 the Department wrote to Heritage indicating that the Department would treat this matter as a

Petition for Declaratory Relief under R.I.G.L. § 42-35-8 and requested that both parties file substantive briefs for consideration. Prior to the time scheduled for submission of briefs, the Department was contacted by counsel and informed that a third issue had been referred to the Department by the Superior Court. As a result, the Department suspended the date scheduled for submission of briefs to allow all three issues to be considered in one Decision. On October 7, 2005 Heritage filed an amended complaint. Initial and reply briefs were filed by both parties. Neither party requested oral argument.

The instant petition is decided by the Director pursuant to Central Management Regulation 3 and R.I.G.L. § 42-35-8.

II.
Issues

As indicated in the Travel above, there are three issues[1] before the Department for consideration. Those issues are:

1. Whether R.I.G.L. § 27-9-51 prohibition against "excess profits" is applicable to Beacon and, if so, whether that statute supports Petitioners complaint.
2. Whether Beacon was statutorily authorized to form Castle Hill Insurance Company and whether Beacon is statutorily authorized to write workers compensation insurance outside the state of Rhode Island.
3. What is the meaning of the language in Beacon's enabling legislation that its purpose is to provide workers compensation insurance at the "lowest possible price."

[1] Heritage's brief indicates that there are four issues. The Department, however, has determined that the second and third issues are sufficiently similar so that they will be addressed together.

III.
Discussion

As noted in Beacon's reply brief, Heritage's argument seems to be that if any or all of the issues are resolved in its favor that the Department must order that Beacon pay dividends to Heritage. Heritage has not briefed the authority of the Department to order such a remedy. Beacon's reply brief points out that the power to declare a dividend is a discretionary power vested solely in the company. 2003 P.L. ch 410 § 10(6).

A. Applicability of R.I.G.L. § 27-9-51

Heritage's complaint requests that it be awarded "excess profits" from Beacon pursuant to R.I.G.L. § 27-9-51. In support of this request Heritage argues:

- Upon inquiry regarding the filing of excess profit reports to various employees of the Department, Heritage received an opinion from Eugene Daigneault that Beacon was required to file such reports.[2]
- Beacon writes in the voluntary market and must, therefore, file excess profit reports with the Department pursuant to R.I.G.L. § 27-9-51.
- R.I.G.L. § 27-9-51 requires all insurance carriers to file excess profit reports.
- R.I.G.L. § 27-9-51 has been violated because "NCCI prepares this form" rather than the Department and NCCI acts on Beacon's behalf with regard to excess profits reports.
- Contrary to the Departments interpretation, R.I.G.L. § 27-9-51 was not repealed by implication when the "Fresh Start" provisions were enacted.

[2] These statements were made in a deposition over objection of counsel that Mr. Daigneault was not an attorney and did not have the authority to make a statement as to Departmental policy. Counsel for Heritage was notified of this fact on many occasions and was aware that the matter was pending an internal legal ruling from the Department. The statements are not admissible as evidence in this matter.

- The legislature amended R.I.G.L. § 27-9-51 in 2002 showing that they intended for it to remain in force.
- The Department failed to enforce R.I.G.L. § 27-9-51 "…resulting in millions of dollars being lost that was owed to the policyholders."

Beacon objects to Heritage's complaint and makes the following arguments:

- R.I.G.L. § 27-9-51 does not provide a private cause of action. The reporting requirements of R.I.G.L. § 27-9-51 are exclusively within the Department's regulatory jurisdiction.

Discussion

R.I.G.L. § 27-9-51 provides:

> **Excess profits for workers' compensation and employer's liability insurance prohibited. –** (a) Each insurance group shall file with the department prior to July 1 of each year, on a form prescribed by the department, the following data for workers' compensation and employers' liability insurance:
>
> (1) The calendar year earned premium;
>
> (2) Accident year incurred losses and loss adjustment expenses;
>
> (3) The administrative and selling expenses incurred in Rhode Island or allocated to Rhode Island for the calendar year; and
>
> (4) Policyholder dividends applicable to the calendar year.
>
> (b) Excess profit has been realized if the underwriting gain is greater than the anticipated underwriting profit plus five percent (5%) of earned premiums for the three (3) most recent calendar years;
>
> (2) As used in this section with respect to any three (3) year period, "anticipated underwriting profit" means the sum of the dollar amounts obtained by multiplying, for each rate filing of the insurance group in effect during that period, the earned premiums applicable to the rate filing during that period by the percentage factor included in the rate filing for profit and contingencies, the percentage factor having been determined with due recognition to investment income from funds generated by Rhode Island business. Separate calculations need not be made for

consecutive rate filings containing the same percentage factor for profits and contingencies.

(c) Each insurance group shall also file a schedule of Rhode Island loss and loss adjustment experience for each of the three (3) most recent accident years. The incurred losses and loss adjustment expenses shall be valued as of December 31 of the accident year, developed to an ultimate basis, and two (2) twelve (12) month intervals after this, each developed to an ultimate basis so that a total of three (3) evaluations will be provided for each accident year. For reporting purposes unrelated to determining excessive profits, the loss and loss adjustment experience of each accident year shall continue to be reported until each accident year has been reported at eight (8) stages of development.

(d) Each insurance group's underwriting gain or loss for each calendar accident year shall be computed as follows: The sum of the accident-year incurred losses and loss adjustment expenses as of December 31 of the year, developed to an ultimate basis, plus the administrative and selling expenses incurred in the calendar year, plus policyholder dividends applicable to the calendar year, shall be subtracted from the calendar year earned premium to determine the underwriting gain or loss.

(e) For the three (3) most recent calendar-accident years, the underwriting gain or loss shall be compared to the anticipated underwriting profit.

(f) If the insurance group has realized an excess profit, the department shall order a return of the excess amounts after affording the insurance group an opportunity for a hearing and complying with the provisions of the Administrative Procedures Act, chapter 35 of title 42. The excess amounts shall be refunded in all instances unless the insurance group affirmatively demonstrates to the department that the refund of the excess amounts will render the insurance group insolvent under the provisions of this title.

(g) Any excess profit of an insurance group offering workers' compensation or employers' liability insurance shall be returned to policyholders in the form of a cash refund or be returned to policyholders in the form of a credit toward the future purchase of insurance. The excess amount shall be refunded on a pro rata basis in relation to the final compilation year earned premiums to the workers' compensation policyholders of record of the insurance group on December 31 of the final compilation year.

(h) Cash refunds to policyholders may be rounded to the nearest dollar;

> (2) Data in required reports to the department may be rounded to the nearest dollar;
>
> (3) Rounding, if elected by the insurance group, shall be applied consistently.
>
> (i) Refunds shall be completed in one of the following ways:
>
> (i) If the insurance group elects to make a cash refund, the refund shall be completed within sixty (60) days of the entry of a final order indicating that excess profits have been realized; or
>
> (ii) If the insurance group elects to make refunds in the form of a credit to renewal policies, the credits shall be applied to policy renewal premium notices which are forwarded to insured more than sixty (60) calendar days after the entry of a final order indicating that excess profits have been realized. If an insurance group has made this election, but an insured after this cancels his or her policy or allows his or her policy to terminate, the insurance group shall make a cash refund not later than sixty (60) days after the termination of the coverage;
>
> (2) Upon completion of the renewal credits or refund payments, the insurance group shall immediately certify to the department that the refunds have been made.
>
> (j) Any refund or renewal credit made pursuant to this section, for the purposes of reporting under this section for subsequent years, shall be treated as a policyholder dividend applicable to the year in which it is incurred.

Petitioners complaint to the Department and its brief in this action complains that Beacon has failed to "file reports" and that the Department has "failed to enforce" R.I.G.L. § 27-9-51. However, Petitioner does not indicate that Beacon realized an "excess profit" under the statute. Rather, Petitioner argues that Beacon should not have made certain investments and had it not made such investments additional funds would have been available to policyholders. This is not the substance of R.I.G.L. § 27-9-51. R.I.G.L. § 27-9-51 provides a strict regulatory formula solely for the Department's use and

consideration. It does not provide a method by which individual investments or expenditures of insurers may be analyzed or judged.

Petitioner further claims that R.I.G.L. § 27-9-51 has been violated because NCCI prepares the report form and "NCCI acts on Beacon's behalf" with regard to excess profits. The Department is unsure of the relevance of these allegations, however, they are both false. NCCI, as the state's advisory organization merely circulates the form prepared by the Department. Petitioners statement seems to misperceive the role of an advisory organization in workers compensation insurance. NCCI, as the advisory organization approved by the Department, performs a number of functions in the Rhode Island workers compensation market. Among those functions is the distribution of forms approved by the Department to its members, or in Beacon's case a subscriber who pays for the service. The mere distribution of a form by the advisory organization charged with that responsibility in no way implicates NCCI actions as "acting" on behalf of Beacon.

Beacon's position is that R.I.G.L. § 27-9-51 does not provide for a private cause of action. While the Department agrees with this position, it is the jurisdiction of the Court and not the Department to make such a determination.

Petitioner omits from its brief the fact that Beacon has filed reports and/or correspondence with the Department with regard to this statute with which Petitioner has been provided copies. The reports filed by Beacon did not report any "excess profit" under the statute and advanced the position that since they exist as the statutory residual market and the statute applied only to voluntary writings, that it was not applicable.

Contrary to Heritage's allegations, the Department has considered this statute with regard to Beacon.

R.I.G.L. § 27-9-51 is a remnant of the statutory scheme that was applicable to workers compensation prior to the formation of Beacon. In 1982, when R.I.G.L. § 27-9-51 was enacted, insurers participating in Rhode Island's workers compensation system were all private insurers. The "residual market"[3] was served by these insurers in the form of a quota share reinsurance treaty commonly referred to as the "Pool." In the 1980's all insurers writing workers compensation insurance in Rhode Island were required to participate in the pool in the same proportion as their participation in the voluntary market. R.I.G.L. § 27-9-51 was one of a number of changes to the workers compensation laws enacted during the 1980s in reaction to a collapsing workers' compensation market. R.I.G.L. § 27-9-51 is a result of the mistaken assumption that conduct of insurers, rather than rising claims costs, was causing the rising premiums and collapse of the market. These "reforms" did not positively affect the market and by 1990, the workers compensation market in Rhode Island essentially collapsed.

In response to this collapse a number of changes occurred. One was the formation of Beacon Mutual as the statutory residual market pursuant to 2003 P.L. ch. 410.[4] As a result of this change, Beacon must accept all "residual market" risks and no other insurer shares in the losses on that business. Due to the upheaval and need for a "transition" to a different workers compensation system, a number of other statutes were

[3] A "residual market" is the method by which a State assures that those employers who cannot obtain insurance voluntarily from an insurer are assured that they can purchase the policy that they are required to hold by law.

[4] This statute was originally enacted as R.I.G.L. § 27-7.2-1 *et seq.* In 2003 Beacon successfully had legislation introduced that ultimately passed to have it moved from the General Laws to the Public Laws. This change did not affect the applicability of Beacon's enabling act to its regulation.

enacted during this period. To encourage other insurers to write in the market the legislature enacted the "Fresh Start" provisions. These provisions were designed to "…restore a healthy voluntary workers' compensation insurance market in the state of Rhode Island, and to avert the departure of insurers presently providing workers compensation insurance in the state…" The statute directed that the Department should "…provide for recovery of ninety percent (90%) of any deficits for the policy period beginning the first day of the month beginning after passage of this legislation through December 31, 1992 and seventy five percent (75%) of any deficits for the policy year January 1, 1993 thorough December 31, 1993…"[5]

In 1998 the legislature amended chapter 7.1. A major change in this legislation was the deletion of the statute that required the Departments to approve rates for carriers with less than one percent (1%) of the market. Instead, the changes required filing of Advisory Loss Costs by NCCI for all insurers participating in the market. Out of concern for the stability of the workers compensation insurance system and to allow for the potential unknowns associated with changes to the law the legislature enacted R.I.G.L. § 27-7.1-24 which provided:

> **Transition. –** Insurers and an advisory organization are not required to immediately refile rates previously approved. For three (3) years after the effective date of this act[6], any member or subscriber of an advisory organization is authorized to continue to use all rates and deviations filed or approved for its use until the insurer makes its own filing to change its rates, either by making an independent filing and adopting an advisory organization's approved prospective loss costs, or modifications of those loss costs.

[5] R.I.G.L. § 27-7.1-22 was repealed in 2002 as a result of an omnibus bill that removed all expired dates in statutes. R.I.G.L. § 27-9-51 was amended in this same omnibus bill. This type of omnibus bill is done periodically by the Rhode Island legislature without hearing. It is the Department's understanding that such omnibus bills are intended for nonsubstantive changes by legislative counsel rather than for deliberative consideration of legislators.

[6] The Act was effective on July 7, 1998.

In 2001, the legislature amended R.I.G.L. § 27-7.1-24 to extend the time period of explicit authorization from three to five years while adding a final sentence providing

> No advisory organization shall file, and the department of business regulation shall not accept a filing by an advisory organization, as to proposed changes in rates previously approved unless the filing shall include relevant data through July 7, 2003.

Between 1998 and January 1, 2005, therefore, the legislature in essence froze workers compensation rates in Rhode Island.[7] Thus, during this seven year period the legislature essentially stated that whether rates were excessive or inadequate was not the inquiry to be made. Rather, insurers were specifically directed as to what rates were to be used during the given time period by specific legislation. Since NCCI was barred from filing, and DBR from accepting a rate filing, the legislature essentially declared that insurers would rate on their filings as of 1998 without change since individual insurer did not have sufficient credible data to submit independent filings during this time period. This was so whether or not the insurer's premium was inadequate or excessive. Only with the approval of the NCCI Advisory Loss Cost filing effective January 1, 2005 was this changed.[8]

Fully cognizant of all of these various changes through 2001 the Department considered the continued applicability of R.I.G.L. § 27-9-51 to workers compensation.

The workers compensation market prior to the major reforms done in response to the collapse of the market in the late 1980's is significantly different from the market

[7] This is true because "…relevant data through July 7, 2003…" would not be available until the middle of 2004. Once the data is available, the advisory organization would be able to make a rate filing. The rate filing is then considered and approved, disapproved or modified by the Department. This is exactly what occurred, with the NCCI Advisory Loss Costs filing being made in mid 2004 and the Advisory Loss Costs approved effective January 1, 2005.

[8] The proprietary of Beacons' rating subsequent to January 1, 2005 is within the Department's regulatory jurisdiction and the subject of an ongoing market conduct examination.

subsequent to that time. In 1982, a competitive workers' compensation market existed in Rhode Island. By 1992 Beacon was the "only game in town" so to speak and the legislature had passed legislation to stimulate competition in the market, i.e., R.I.G.L. 27-7.1-22, the "Fresh Start" provision discussed previously.

Over the seven (7) year period from 1998 to 2005, due to concerns about the stability of the workers' compensation insurance market, the legislature took control of the market by significantly restricting the rates that could be charged for workers compensation insurance in Rhode Island. During this period, the legislature was clearly not concerned that rates being charged were excessive, considering that in 2001, in the midst of a significant rate decrease filing by NCCI, they implemented an additional prohibition on filing rates that effectively prohibited consideration of the decrease. The legislature's action was based upon the belief that adequate stable rates would not only provide certainty to Rhode Island employers but also stimulate competition in the market.

R.I.G.L 27-9-51 is clearly anti-competitive and inconsistent with the aforementioned market reforms of the period. In addition, the Departments consulting actuaries concluded that the required "excess profits" reports were not sufficient to derive any meaningful measure of profit. In fact, the requirements of the statute could even be detrimental to the market in that so called "excess profits" could be indicated without any meaningful consideration of losses or even the overall financial viability of the company reporting.

The Department therefore concluded that the clear legislative intent evidenced by all of the aforementioned post-reform changes was to ensure the continued viability of the workers compensation market in Rhode Island by stimulating competition and

controlling rate fluctuations. Other reforms changed the way the courts administered claims, thereby controlling the primary driver of high premium – runaway claim costs.

R.I.G.L §27-9-51 was enacted to address perceived problems in an innately different market than currently exists, though it was clearly intended to ensure that rates charged employers for workers compensation insurance were not excessive. The Department is charged with ensuring that workers compensation insurance rates are not "inadequate, **excessive** or unfairly discriminatory." R.I.G.L. §27-7.1-4.1 (emphasis added). Appropriate rate regulation is therefore the best and only way to fulfill the intent of R.I.G.L. § 27-9-51 today without causing the harm that the legislature clearly intended to avoid in the string of reform legislation passed in the last 15 years.

In addition to these considerations, the Department also has special considerations with regard to Beacon since it is subject to different statutory provisions than other carriers in the market. Beacon was created by the legislature and is, therefore, governed by it's enabling legislation. When first enacted R.I.G.L. § 27-7.2-9.1(c)(i) provided in relevant part "Except as provided from subsection (d), the residual risk program of the fund shall be <u>exempt from rate regulation</u> under Rhode Island law." (emphasis added.) This language remained in the statute until 1996 when it was amended to its current language which provides: "Except as provided in subsection (d), the fund shall be <u>subject to rate regulation under chapter 7.1 of title 27</u>." (emphasis added.) 2003 P.L. ch. 410 §11(c)(1)" During this period the legislature directed:

> Notwithstanding any other provisions of law, immediately upon May 18, 1992, the fund may issue workers' compensation insurance policies at an initial rate not in excess of the rates then in effect for residual market workers' compensation insurance coverage offered by any other insurers within the state of Rhode Island, subject to the discretion of the fund to apply discounts and surcharge multipliers of up to three (3) times the

> premiums that would otherwise be applicable under the rates, with the premium surcharge to be payable as provided in subdivision (d)(3). The fund may continue to issue workers' compensation insurance coverage at the initial rates until the effectiveness of any revised rates filed pursuant to subdivision (d)(1).

During the first period during which Petitioner was insured by Beacon (1993 through 1995) the legislature had affirmatively established that Beacon was not subject to any rate regulation. During the second period (1999 to 2002) Beacon's rates were subject only to the specific provisions of 2003 P.L. ch. 410 § 11(d) and any portion of chapter 7.1 that does not conflict with 2003 P.L. ch. 410 § 11(d). By specifically identifying only chapter 7.1 as being applicable to Beacon, the legislature determined that Beacon was not subject to R.I.G.L. § 27-9-51.

The Department has, therefore, determined after consideration of each of these points, that no order concerning "excess profits" under R.I.G.L. § 27-9-51 is appropriate, and, therefore, declines Heritage's requests to make orders under that section against Beacon.

B. Authority for Establishment of Castle Hill and Beacon's ability to Write "Out of State" Policies

Heritage complains that Beacon does not have the statutory authority to form a subsidiary or to write out of state policies. In this regard Heritage makes the following arguments:

- The purpose of the fund "…was to take care of Rhode Island employers and Rhode Island employees in Rhode Island" and it does not, therefore, have the authority to write polices for employers with no connection to Rhode Island.

- Beacon has no authority to write out of state policies for Rhode Island employers whose employees work and live in another state.
- Beacon's purpose and intent is violated if it is subject to the law of other states through the issuance of policies in those states.
- Beacon has acknowledged that they do not have this authority in their policy endorsements, website and statements of their officers before the legislature which indicate that the company is only licensed to write insurance in Rhode Island.
- The "fronting" arrangement with Fairfield Insurance Company violated this prohibition on the writing of out of state policies.[9]
- The fact that Beacon attempted to change its legislation shows that under the current statutes it is prohibited from writing out of state risks.

Beacon argues that it does have the authority to form a subsidiary and that it did so with the Department's approval. Beacon further argues that it has the statutory authority to write out of state policies for the benefit of Rhode Island employers. In this regard Beacon makes the following points:

- P.L. 2003 ch. 410 § 6 provides Beacon with the power to perform all acts necessary "…as fully and completely as the governing body of all other domestic insurance carriers to fulfill the objectives and intent of this chapter.

[9] Heritage's brief seems to contradict this argument in the statement "A fronting agreement is legal and common in the insurance industry." The purpose of every fronting arrangement is to allow an insurer that is not admitted in a particular jurisdiction to indirectly accept risk in that jurisdiction through an admitted fronting carrier. (These arrangements are quite common in the "captive" insurance industry since "captive" companies are typically not admitted in multiple states). Petitioner argues that Beacon may enter into fronting arrangements but not the type that would allow them to indirectly accept risk in states other than Rhode Island. Such an argument is inherently flawed in that there would be no other reason for Beacon to enter into such an arrangement. As stated later in this Order, the Department believes that Beacon's use of fronting is statutorily limited to policies written for non- Rhode Island employees of Rhode Island employers.

P.L. 2003 ch. 410 § 3 explicitly states that Beacon "…shall be deemed for all purposes to be an insurance company organized in accordance with R.I.G.L. § 7-1-5 and 7-1.1-1 *et seq.*" R.I.G.L. § 27-11.1-4 provides that all domestic insurance companies are authorized to invest in subsidiary companies.

- The Department is fully apprised of Beacon's subsidiary companies and issued a license to Castle Hill Insurance Company on December 4, 2003.
- Beacon does not have the authority to insure "non-Rhode Island" employers.
- Beacon's statutory purpose is to serve "…all employers in the State of Rhode Island…" and insuring out of state employees of Rhode Island employers through a fronting arrangement serves that purpose.

Discussion

The Department agrees that Beacon does not have an unfettered right to write business outside of the state of Rhode Island under its statutory mandate. However, the fact that it does not currently write out of state operations of Rhode Island employers is not because of its statutory ability but rather because no other state has granted it a license to do so. No insurer may write business in Rhode Island or any other state unless it is licensed in that state. If another state grants Castle Hill a license, it may write insurance for Rhode Island employers and participate in the residual market consistent with the Undertakings Agreement [10] issued by the Department at the time Castle Hill was licensed.

The Department is confused as to the actual request being made by Heritage. Heritage appears to complain that the Department did not have the authority to license

[10] A true and correct copy of the Undertakings Agreement is attached to this Decision.

Castle Hill. It is unclear, however, how Heritage, who was not even a customer of Beacons' at the time of the formation[11] of Castle Hill has standing to object to the licensing. Additionally, the Department does not see any statutory basis for Petitioners request that the capital used for the formation of Castle Hill should be "returned to policyholders in the form of a dividend." Even if Petitioner were correct in its allegation that Beacon did not have the statutory authority to form Castle Hill, that fact would not lead to the conclusion that the investment in Castle Hill would be returned to policyholders as a dividend. Beacon's statutory surplus, i.e. the amount by which its assets exceed its liabilities, was not impacted in any way by the formation or licensure of Castle Hill. The Castle Hill investment still belongs to Beacon as would any other investment. Its existence is not relevant to a determination as to whether a dividend to policyholders is warranted.

Heritage complains that Beacon wrote out of state business through a fronting arrangement with Fairfield Insurance Company. Nothing in Beacon's enabling statute prohibits a fronting arrangement. As stated in Petitioner's brief, a fronting arrangement is a common practice in the business of insurance. Under a fronting arrangement, a licensed carrier writes the insurance on its name and on its own policy form and cedes back the risk to the assuming carrier. In exchange, the assuming carrier assumes all responsibility for gains and losses under the contract after payment of a "fronting fee" to the fronting company. Nothing in the law prohibits a fronting arrangement. Additionally, Beacon's statutory purpose is to serve all Rhode Island employers. The fronting

[11] It is the Department's understanding that Heritage was a policyholder of Beacons' from December 1993 through December 1995 and September 1999 through September 2002. Castle Hill was licensed in October of 2003. Therefore, even if a policyholder could assert standing to make such a claim (which the Department does not believe it could), Heritage was not a policyholder at the time of the licensing of the company.

arrangement allows Beacon to serve those Rhode Island employers by allowing those employers to obtain a single workers compensation policy for all of the employers operations.

Based on the Undertakings Agreement, if Castle Hill is able to obtain licenses in other states it may write only the out of state operations of Rhode Island employers and the associated residual market required by the particular state to support the voluntary business. This arrangement benefits Rhode Island employers in that they can expand their operations outside of Rhode Island while remaining insured for workers compensation by a single insurer.

Heritage argues that potentially injured employees may not be residents of the state of Rhode Island and, therefore, nonresidents will benefit from this arrangement. Pursuant to Rhode Island law, the residence of the employee is not relevant. Residents of states other than Rhode Island, who work for Rhode Island employers insured by Beacon currently receive benefits for workers compensation injuries suffered in Rhode Island through Beacon. In fact, the law allows access to the Rhode Island court for employees either hired in or injured in Rhode Island. The statutory language in Beacon's enabling act relates only to whether the benefit flows to Rhode Island employers and not their employees.

Heritage further objects to Castle Hill's "for profit" status. Castle Hill is a "for profit" entity but its sole owner, Beacon is a "non-profit" mutual insurance company owned by its policyholders. Therefore, any "profit" made by Castle Hill flows solely to its sole shareholder Beacon. Since Beacon is a non-profit independent public corporation organized as a mutual insurance company and owned by its policyholders all "profit"

from Castle Hill flows to those policyholder who are all Rhode Island employers. Again, the Undertakings Agreement guarantees that this arrangement will continue.

Finally, Heritage argues that Beacon "admits" that it does not have the statutory authority to form Castle Hill or write out of state risks in its statements on its website and insurance policies that it does not write such risks. This is a statement of fact not a statement of authority. Neither Beacon nor Castle Hill are licensed in any other state so they are not permitted to write insurance under their own name in any other state.[12] This fact is not an admission that they do not have the statutory authority to do so but rather a statement that they are not currently licensed in any other state. Heritage also cites to statements Beacon has made in support of a bill it sponsored to amend its enabling act. It is true that one of the basis Beacon advocated for the change was that the bill would allow it to write out of state risks. However, the Department's understanding of Beacon's argument was that the proposed amendment was needed because other states were hesitant to issue a license to a "government controlled" entity. That issue has nothing to do with the limitations in Beacons' statutory purpose. Rather, Beacon's position in pursuing this legislation was that government control of their Board kept other states from issuing a license to Castle Hill. While the Department does not agree with Beacon's statements concerning this legislation, it cannot conclude that those statements are an admission as to any limitations on its statutory authority.

C. Meaning of "Lowest Possible Price"

The parties to this administrative action are also engaged in litigation in the Providence County Superior Court. On August 29, 2005, the Honorable Michael

[12] Castle Hill is not licensed in any state other than Rhode Island and has not written any direct business nor has it assumed any business from a fronting company.

Silverstein issued a Decision in PCSC case no. 02-7016 with regard to Beacon's Motion to Dismiss Count III of Heritage's Fifth Amended Complaint. In that Decision, Judge Silverstein directed that "[r]esolution of the meaning of the term in controversy lies in the first instance with the DBR because it is the agency charged with enforcement of the provision."

The "term" at issue is the meaning of the following provision of Beacon's enabling legislation:

> SECTION 3. **Creation of fund.** – (a) The purpose of the fund is to ensure that all employers in the state of Rhode Island have *the opportunity to obtain workers' compensation insurance at the lowest possible price*. It is also the policy and purpose of this act to establish and maintain that the fund shall be the workers' compensation insurance carrier of last resort. The fund is created as a nonprofit independent public corporation for the purpose of insuring employers against liability for personal injuries for which their employees may be entitled to benefits under chapter 33 of title 28 or under 33 U.S.C. Section 901 et seq., and other employer's liabilities incidental to those provisions.

(Emphasis added.)

In support of this position Heritage argues:

- The "lowest possible price" language is contained in Beacon's charter which is a contract between Beacon and its policyholders and relates to the private arrangement between the policyholder and Beacon rather than the Departments' rate regulation.
- Beacon's original capitalization; net earnings in 1997; construction of headquarters in 1998 and 2000; amount of its surplus; amount of its claims reserves; a deposit with the state of Massachusetts for a limited license;

investment in "BMIC"[13]; deposits made in 1998; announcement that no dividends would be paid in 2001; investment of $20 million in Castle Hill; intention to write in other states; letters of credit deposited in Fleet Bank in 2000 and 2001; non-consolidation of its audited financials and large market share evidence that Beacon is not writing insurance at the "lowest possible price."

- Testimony by insureds in the NCCI rate case that premiums for their industries in Connecticut and Massachusetts are lower proves that Beacon is not writing insurance at the "lowest possible price."
- Beacon's practice of placing funds into surplus rather than using all funds available for policyholder dividends shows that they are not writing insurance at the "lowest possible price."
- Adoption of NCCI's rates, as Beacon has done in the past, does not include the statutory consideration of "lowest possible price" because other insurers are not subject to this requirement.

Beacon's contrary arguments are:

- Heritage's arguments evidence a lack of understanding of how worker's compensation rates are set.
- Heritage is attempting to invade a paramount function of the Department – rate regulation.
- Beacon retains the right, like all other insurers, to set premiums based upon the experience of its insureds rather than Heritage's implied argument that

[13] Contrary to Heritage's argument BMIC is not an insurer licensed in Rhode Island. It is a licensed insurance producer.

Beacon must provide insurance at the lowest possible premium under all circumstances.

Discussion

To fully understand the issue, one must first understand the Department's jurisdiction over rate approval. The Department's jurisdiction over rate approval for Beacon is governed by both 2003 P. L. ch. 410 and R.I.G.L. § 27-7.1-1 *et seq.* All carriers writing workers compensation in Rhode Island have the option of filing their own rates or "…filing a multiplier to be applied to the prospective loss costs that have been filed by…" National Council on Compensation Insurance ("NCCI"). NCCI makes "Advisory Loss Costs" filings[14] that the Department approves, disapproves or modifies based upon an actuarial analysis. Advisory Loss Costs are an estimate of what the losses are projected to be for each proposed classification based upon the data reported to the advisory organization by all carriers writing workers compensation insurance in Rhode Island. Once the NCCI Advisory Loss Costs have been approved, all carriers who wish to "adopt" the NCCI filing may do so by filing their own "loss costs multiplier" which represents the additional costs which will be included in the actual rates charged to employers by that particular carrier. These multipliers include items such as taxes and other administrative expenses as well as a profit component. Each carrier has a different loss cost multiplier based upon its particular circumstance. For example, Beacon's loss cost multiplier would not include a component for profit since profit is not applicable to its operation.

[14] Since 1998 all Rhode Island rates have been based on "Advisory Loss Costs" pursuant to R.I.G.L. § 27-7.1-5.1. Between 1992 and 1998 NCCI filed rates for carriers with less than 1% of market share and advisory loss costs for carriers with more than 1% market share.

This, however, is far from the end of the analysis as to what rate will be charged to a particular employer. Pursuant to R.I.G.L. § 27-7.1-9.1(c) all carriers writing workers compensation insurance in Rhode Island must do so based upon classifications filed by NCCI and approved by the Department. In calculating an individual rate, therefore, the insurer evaluates the particular employer and "classifies" the employees according to this classification system. The premium is then adjusted for that particular employers payroll. Further adjustments for actuarially justified scheduled credits and surcharges and experience rating modifications are made arriving at the premium for that specific employer.

The question, therefore, is whether the inclusion of the words "lowest possible price" alters this system to allow a private cause of action on behalf of an individual employer who claims it was charged more than the "lowest possible price". The Department does not believe that this was the legislatures' intent. Rather, inclusion of this language was a grant of jurisdiction to the Department to review the manner of calculation of the rate of an individual employer to assure that it has been calculated in accordance with the filed and approved elements. In both complaint handling and market conduct reviews, the Department looks at how Beacon calculated rates in the classification of employees, the assessment of scheduled credits and surcharges and application of experience modifications. If the Department finds that Beacon did not appropriately rate a specific employer it is then empowered to initiate administrative action pursuant to R.I.G.L. § 42-14-16 to require that Beacon "…take such action as are necessary to comply…" with the applicable rating provisions.

Heritage's interpretation of the phase "lowest possible price" appears to be an attempt to base a Superior Court action for damages on issues solely within the Department's jurisdiction (i.e. formation of subsidiaries, estimation of loss liabilities, adequacy of surplus). Heritage makes general arguments concerning expenditure by Beacon and then argues that the existence of these expenditures means that a particular insured did not receive a rate at the "lowest possible price." This position is the antithesis to the premise underlying most regulated industries. The cornerstone of any good regulatory system is adequate and effective solvency regulation. If an insurer is not solvent and able to pay claims as they arise, irreparable harm could be done to claimants and other creditors of the insurer. Insurance is essentially a promise that upon the happening of a given occurrence sometime in the future i.e. during the policy period, that the insurer will be able to respond to pay damages incurred within the insurance contract. Hastily derived conclusions based on uninformed analysis of individual expenditures is the antithesis to appropriate regulation. Petitioners analysis refers to individual investments of Beacon and certain administrative expenses. The Department is charged with evaluating insurance companies as a whole and assuring that they remain solvent in order to pay claims. Under Heritage's argument, any policyholder, could present the Court with a series of expenditures and argue that the Court should order damages to a particular employer. This could easily lead to the insolvency of the carrier to the detriment of all policyholders. The legislature could not have intended such a result and the Department will not imply it from these words.

For example, Heritage argues that a "surplus" which is subjectively "large" establishes that Beacon is not offering insurance at the "lowest possible price." There is

no statute which limits the amount of "surplus" or "net earnings" Beacon may have. In fact, there is a statute that requires the Department to take administrative action if Beacon's "surplus" falls below the Risk Based Capital levels established in R.I.G.L. § 27-4.6-1. In fact, R.I.G.L. § 27-4.6-2(d) specifically provides:

> An excess of capital over the amount produced by the risk-based capital requirements contained in this chapter and the formulas, schedules and instructions reference in this chapter is desirable in the business of insurance. Insurers should seek to maintain capital above RBC levels required by this chapter. Additional capital is used and useful in the insurance business and helps to secure an insurer against various risks inherent in, or affecting, the business of insurance and not accounted for or only partially measured by the risk-based capital requirements contained in this chapter.

Petitioners argument that Beacon must use "all funds available for policyholder dividends…" rather than accumulating adequate surplus would at best lead to regulatory action by the Department and surcharges to policyholders and at worst the insolvency of Beacon and economic crisis to the state of Rhode Island. The legislature established Beacon expressly to address a crisis in workers compensation insurance in Rhode Island. The survival of Beacon was of utmost concern to the legislature. It is clear in Beacon's enabling legislation that the survival of Beacon is paramount to the viability of the workers compensation insurance market in the State of Rhode Island. It is nonsensical to pervert the interpretation of Beacon's enabling legislation to require them to operate on the edge of solvency.

The implication that the accumulation of surplus is for anything other than the benefit of policyholders is not correct. However, decisions such as the amount of surplus and whether or not to declare a dividend must be left to the company, with the appropriate administrative supervision of the Department. None of the "points" listed are

anything other than regulatory issues over which the Department has exclusive jurisdiction.

The legislature has granted exclusive jurisdiction to the Department over these regulatory issues and has not provided for public intervention on financial and administrative issues. On the other hand, any insured is welcome to participate in rate hearings that the Department traditionally holds on NCCI Advisory Loss Costs. The problem with the intervention of the courts in this area is that only a portion of the picture will be presented. While most insureds wish to pay lower premiums, second guessing the calculation of those premiums and the financial decisions of the company made with the Department's approval could adversely effect the company and, therefore, all insureds of the company. The law did not, however, leave policyholders without a remedy. The legislature specifically provided that the Department had the authority to review the application of classifications and calculation of rates assigned to a given employer. If an insured believes that a particular rate is inappropriate as applied the legislature has provided a remedy. Under R.I.G.L. § 27-7.1-11.1(a) each approved advisory organization and any insurer which has made its own rate filing must provide a "…reasonable means where any person aggrieved by the application of its rating system may upon that person's written request be heard…" If the insured does not receive the result it desires R.I.G.L. § 27-7.1-11.1(c) provides for an appeal to the Director.[15] All administrative proceedings at the Department, including those under R.I.G.L. § 27-7.1-11.1(c), are subject to the Administrative Procedures Act and, therefore, either party may appeal the Director's decision to the Superior Court pursuant to R.I.G.L. § 42-35-15.

[15] Heritage has gone through the initial appeal under R.I.G.L. § 27-7.1-11.1(a) and has appealed that Decision to the Director. The appeal to the Director is still pending at the Department.

If fact, Heritage is currently engaged in such an appeal before the Department.

Heritage also alleges that "…Connecticut companies pay less for workers' compensation insurance …". The Department is aware of the testimony to which Heritage attributes this conclusion but is compelled to explain that that was the opinion of one individual and not a conclusion of fact in the NCCI decision. The Department has not done a comprehensive comparison of rates in Connecticut versus Rhode Island, however, the testimony of one individual that rates for one company in Rhode Island are higher than a similar company in Connecticut does not lead to the conclusion that all rates in Rhode Island are higher than all rates in Connecticut. In addition to all of the factors which go into the rate for an individual employer, the "loss costs" in each state will vary with the benefits provided by that states laws as well as the predicted frequency and severity of injuries. Individual actions of employers will also effect their rates. Therefore, it is impossible to come to a general conclusion as to what state has "higher" rates without adjusting for all of the variable factors.

Heritage mentions Beacon's market share but fails to indicate how market share supports its argument. However, since an affirmative statement is made that Beacon writes 90% of the market the Department feels compelled to indicate that this assertion is not correct in the terms in which market share is commonly judged – premium volume. Beacon has made public statements that it insures 90% of the employers in Rhode Island, however, its market share in terms of premium volume was 73.3% for year end 2004 and 74.8% for year end 2005.[16]

[16] Market share in Rhode Island is determined from the Annual Statements filed by all insurers licensed to write insurance in Rhode Island. As part of its regulation of insurance companies, the Department receives and maintains this information. Therefore, the Director takes administrative notice of these figures from the records maintained by the Department. The percentage of employers insured by a particular carrier is

Finally, Heritage indicates that Beacon "…normally would adopt whatever rate the DBR and/or NCCI adopted" but that "rates that DBR or NCCI adopts do not take into consideration as to whether such rate is at the 'lowest possible price'." A few points about these comments must be addressed. First, DBR does not "adopt" rates. DBR is the regulator which approves Advisory Loss Costs filed by NCCI and Lost Cost Multipliers filed by insurers. Second, as described in detail above, Beacon has adopted "advisory loss costs" filed by NCCI, not "rates". The "rate" is set by the filing of "loss cost multipliers" for individual carriers which, contrary to Heritages' assertion, does contain different components depending upon the insurer. The employers' individual rate is based on the application of these factors to the particular employer with consideration of employee classification, payroll, experience modifications and actuarially justified scheduled discounts and surcharges.

Heritage asks that if the Department finds that "lowest possible price" provides the Department with jurisdiction rather than a private cause of action that the Department provide "…the factors used and how applied that were different than those used regarding other carriers' rates." As explained above, this request does not comport with the manner in which rates are set. Advisory loss costs represent the expected losses by classification. However, loss costs multipliers, including those filed by Beacon are public records which Heritage may obtain by an access to public records request.

Therefore, it is hereby ORDERED that:

1. Petitioner's request that the Department find that Beacon has violated R.I.G.L. § 27-9-51, is Denied;

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not information which is filed or maintained by the Department. This type of information is compiled by individual carriers. The Department cannot, therefore, take administrative notice of the 90% figure, but does not actively dispute that that figure may be correct.

2. Petitioner's request that the capital used to form Castle Hill Insurance Company be returned to policyholders in the form of a dividend is Denied;

3. Petitioner's request for a statement that the phrase "lowest possible price" allows for a private cause of action is Denied.

The Petition is denied.

Issued this 25th day of July, 2006.

____ original signature on file ____
A. Michael Marques
Director