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PREEMPTION OF STATE INSURANCE LAWS FOR RISK RETENTION GROUPS: PROPOSALS FOR REGULATORY CLARITY

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A risk retention group (RRG) has successfully asserted the right to sell its members primary first-dollar automobile liability insurance policies in Nevada, overcoming objections by the Nevada Commissioner of Insurance and the Nevada Department of Business and Industry Division of Insurance (Insurance Division) that such insurance can only be offered by "authorized insurers" and not by RRGs. On July 22, 2011, the federal district court in Nevada held that Nevada's financial responsibility statutes were preempted under the Liability Risk Retention Act of 1986 to the extent that the state law prohibited RRGs from issuing first-dollar automobile liability coverage. The court also permanently enjoined the state insurance regulator from enforcing the financial responsibility statutes based upon the issuance of first-dollar automobile liability coverage by the RRG to its members. The case has been appealed, so the U.S. Court of Appeals for the 9th Circuit may have the final say in the current litigation. However, if pending federal legislation is enacted, the newly created Federal Insurance Office will be charged with resolving preemption disputes under the Liability Risk Retention Act of 1986.

The Nevada dispute began in early 2010, when the Nevada Department of Motor Vehicles (DM") requested that the Nevada Insurance Division provide a list of insurers authorized to write automobile liability insurance. The Nevada Motor Vehicle Code requires that owners of motor vehicles registered in Nevada who are not self-insured must obtain a "motor vehicle liability policy," which is defined as a policy issued by "an insurer authorized to transact business" in Nevada. Nev. R. Stat. § 485.055(1). Because Section 679A.030(1) of the Nevada Insurance Code defines an "authorized" insurer as a company holding a certificate of authority, the Insurance Division provided the DMV with a list of authorized insurers; this list did not include registered RRGs. Beginning in April 2010, the DMV began to notify members of the Alliance of Nonprofits for Insurance, Risk Retention Group (ANI) that they could not register their vehicles in Nevada because they were not in compliance with their obligation to obtain and maintain insurance from an authorized insurer.

Thereafter, on May 20, 2010, the Nevada Insurance Division notified ANI that it was not authorized to issue primary first-dollar automobile liability insurance policies in Nevada. The Insurance Division did not object to RRGs writing auto liability insurance in excess of the minimum financial responsibility limits required under Nevada law because, under Nevada's laws, coverage in excess of the mandatory financial responsibility limits is not required to be provided by an authorized insurer. Nev. R. Stat. § 485.055(2).

Following a hearing, on July 21, 2010, the Nevada commissioner issued Findings of Fact, Conclusions or Law and an Order (the opinion) finding that only companies who hold a "certificate of authority" are "authorized" insurers. The Nevada commissioner ruled that because ANI, a Vermont domestic RRG, held a "certificate of registration" in Nevada,[1] ANI was not an authorized insurer and therefore could not issued first-dollar automobile policies in the state.

1 Under the Liability Risk Retention Act, an RRG must be licensed by the state insurance regulator in its state of domicile but, in the nondomiciliary states in which it operates, the RRG is only required to be "registered" with the insurance regulator.

The Nevada commissioner relied upon both Section § 3905(d) of the Liability Risk Retention Act and two federal appellate cases in reaching the conclusions stated in the opinion. Under the Liability Risk Retention Act, RRGs are generally exempted from state law in nondomiciliary states, subject to certain exceptions. One of the preemption exceptions is set forth in 15 U.S.C. § 3905(d), which states in pertinent part as follows:

> Subject to the [antidiscrimination] provisions of section 3902(a)(4) …, nothing in this chapter shall be construed to preempt the authority of a State to specify acceptable means of demonstrating financial responsibility where the State has required a demonstration of financial responsibility as a condition for obtaining a license or permit to undertake specified activities. Such means may include or exclude insurance coverage obtained from an admitted insurance company, an excess lines company, a risk retention group, or any other source ….

In the opinion, the Nevada commissioner also relied upon *Mears Transportation Group, et al. v. Dickinson*, 34 F.3d 1019 (11th Cir. 1994). In the *Mears* case, a Florida statute required that the mandatory minimum financial responsibility limits be provided by a member of the Florida Insurance Guaranty Association. The 11th Circuit held that the Florida statute wa s not preempted because, in U.S.C. § 3905(d), the Liability Risk Retention Act expressly retained a state's authority to specify acceptable means of demonstrating financial responsibility as a condition for obtaining a license or permit. Because captives, surplus lines insurers, reciprocal insurers, and other types of insurers were not members of the Florida Insurance Guaranty Association, and therefore were prohibited from issuing first-dollar automobile liability insurance in Florida, the 11th Circuit also found that the statute did not discriminate against risk retention groups.

Additionally, the Nevada Commissioner relied in the opinion upon *Ophthalmic Mutual Ins. Co. v. Musser*, 143 F.3d 1062 (7th Cir. 1998). In *Ophthalmic Mutual*, a Wisconsin statute required health care providers to provide mandatory minimum limits of professional liability coverage in order to be licensed in the state. The Wisconsin statute provided that only an authorized insurer could provide the required insurance coverage. The 7th Circuit ruled that the state statute was not preempted under 15 U.S.C. § 3905(d), holding that a state can craft its financial responsibility statues without regard to preemption under the Liability Risk Retention Act, provided the state does not discriminate against RRGs.[2]

After the opinion was issued by the Nevada commissioner, ANI commenced an action in federal district court, seeking a declaratory judgment and injunctive relief, to prevent the Nevada commissioner and Insurance Division from interfering with ANI's ability to issue primary first-dollar automobile liability insurance to its members. On July 22, 2011, Judge Mahan issued an order, granting ANI's motion for summary judgment and denying summary judgment to the Nevada commissioner and Insurance Division. In the order, the court ruled:

1) Nev. R. Stat. § 679.030(1) and related statutes and regulations are preempted by the Liability Risk Retention Act of 1986 (15 U.S.C. §§3901-3906);[3]

2) The phrase "authorized insurer" as used in Nev. R. Stat. §679A.030 must be interpreted as including RRGs, thus permitting registered motor vehicle owners in Nevada to satisfy their financial responsibility obligations by obtaining an insurance policy from either an insurer that holds a certificate of authority or a registered RRG; and

2 Surprisingly, the opinion did not discuss Section 485.185 of the Nevada Motor Vehicle Code, which provides that vehicle owners must maintain "insurance provided by an insurance company licensed by the Division of Insurance … and approved to do business" in Nevada or Section 482.215(e) and (f), which requires that applicants for vehicle registrations must provide satisfactory proof that the vehicle owner has insurance provided by an insurance company that is "licensed" and "approved." The opinion also did not discuss Section 233B.034 of the Nevada Administrative Procedures Act which defines a "license" as any certificate, registration, or similar form of permission required by law and obtained from a government agency. Nev. R. Stat. § 233B.034. Because RRGs are required to be registered in Nevada, pursuant to Nev. R. Stat. § 695E.150, it appears these provisions provide support for ANI's argument that RRGs are insurers who are permitted to issue first dollar motor vehicle liability policies under the Nevada Motor Vehicle Code.

3 The court expressly ruled that Nev. R. Stat. § 485.185 (discussed above in footnote 2) and §687A.040 were preempted. Section § 687A.040 requires that licensed insurers be members of the Nevada Insurance Guaranty Association. In the opinion, the Nevada commissioner stated that authorized insurers must belong to the Nevada Insurance Guaranty Association and that 15 U.S.C. § 3902(a)(2) prohibits a state from requiring or permitting an RRG to become a member of a guaranty association. The Nevada commissioner viewed the absence of guaranty association protection as a reason why the term "authorized" insurer, as used in the Nevada Motor Vehicle Code, could not be construed as including RRGs.

3) The Nevada commissioner and Insurance Division are permanently enjoined from enforcing Nev. R. Stat. § 679.030(1) and related statutes and regulations against ANI's members in a manner that would prevent ANI from issuing primary first-dollar automobile liability policies in Nevada.

The Nevada commissioner and Insurance Division have appealed the trial court's decision to the 9th Circuit, where the appeal is currently pending.

The RRG industry has claimed the Nevada dispute is just one of a number of situations in recent years where state insurance regulators have declined to abide by the preemption of state laws, as is required by the federal Liability Risk Retention Act. The Liability Risk Retention Act provides that disputes regarding the preemption of state regulation of RRGs are to be heard in a federal or state court of competent jurisdiction. 15 U.S.C. § 3902(f)(2) and (g). However, advocates for RRGs assert that such litigation is costly. Therefore, under a bill pending in Congress, it has been proposed that the director of the newly created Federal Insurance Office be granted the authority to determine whether state insurance laws are preempted under the Liability Risk Retention Act.

H.R. 2126, the "Risk Retention Modernization Act of 2011," was introduced in Congress on June 3, 2011. One purpose of H.R. 2126 is to expand the types of insurance that RRGs can write to include commercial property coverage. See Section 4 of H.R. 2126. The draft bill would also expand the authority of the director of the Federal Insurance Office to undertake the following activities:

1) Upon request of a state or an RRG, make a determination as to whether the state activity involving the regulation of an RRG's operations is preempted; and

2) Conduct periodic surveys and evaluations regarding the extent to which nondomiciliary states are in compliance with the prohibitions contained in the Liability Risk Retention Act and to report to the president and Congress on the Federal Insurance Office's findings.

Under H.R. 2126, a determination by the director of the Federal Insurance Office would be subject to the requirements of the U.S. Code relating to administrative procedure, including notice and an opportunity to present evidence and argument at a hearing, and appellate review would be conducted by the U.S. Court of Appeals for the D.C. Circuit.

At first blush, H.R. 2126 appears to parallel, in some respects, the authority granted to the Federal Insurance Office pursuant to the Dodd Frank Act. Under the Federal Insurance Office Act of 2010 (the FOI Act), the Federal Insurance Office was given various powers, including, but not limited to, making determinations as to whether state insurance laws are inconsistent with or preempted by certain international agreements to which the United States is a party (defined as "covered agreements" under the FOI Act). See 31 U.S.C. § 313(f). However, upon close scrutiny, there are significant differences between H.R. 2126 and the FOI Act.

Under the FOI Act, in addition to following the administrative procedures set forth in the U.S. Code (such as providing notice and an opportunity to be heard to the parties to the dispute), the Federal Insurance Office must pursue several procedural steps before undertaking a determination regarding whether a state insurance law is inconsistent with or preempted by a covered agreement, including:

- publishing notice of the issue regarding the potential inconsistency or preemption in the Federal Register;
- providing a reasonable opportunity for public comment; and
- considering any public comments received before making a determination.

Further, under the FOI Act, in any judicial review, the applicable federal court is to determine the matter de novo. 31 U.S.C. § 313(g).

H.R. 2126, as introduced in Congress, contains no similar provisions regarding the receipt or consideration of comments from interested persons or any de novo judicial review of the Federal Insurance Office's determination. Instead, H.R. 2126 would establish the director of the Federal Insurance Office as an adjudicator of preemption disputes under the Liability Risk Retention Act, with appellate review presumably subject to an abuse-of-discretion standard.

While regulatory clarity may be needed regarding the preemption of state laws under the Liability Risk Retention

Act, in light of government down-sizing, budget restrictions and the significant duties assigned to the Federal Insurance Office under the Dodd Frank Act, one might question whether the creation of a federal dispute resolution mechanism is the most efficient manner of implementing Congress' intent under the Liability Risk Retention Act. One alternative might be to delay consideration of H.R. 2126 until the General Accounting Office releases its report, reportedly due in 2012, on how the federal Liability Risk Retention Act has been interpreted by the various states. Another alternative might be to clarify the preemption provisions in the Liability Risk Retention Act itself, so that insurance regulators, RRGs, and RRG members all have a clear understanding of their respective rights.

In any event, the appeal of the Nevada case and H.R. 2126 should be closely watched, as either or both may prove to be significant in determining the preemption of state laws for risk retention group in future cases.

For further information regarding risk retention groups, the Federal Insurance Office Act of 2010, or the Dodd-Frank Act, please contact Linda Kaiser Conley at 215.665.2099 or lconley@cozen.com, Fran Roggenbaum at 717.975.8806 or froggenbaum@cozen.com, or James R. Potts at 215.665.2748 or jpotts@cozen.com.