

INSURANCE ALERT

HOT TOPICS IN INSURANCE: UPDATE ON THE ACA, HOLDING COMPANY SYSTEMS, RATINGS CASE AND ADDITIONAL INSURED STATUS

I. FEDERAL AFFORDABLE CARE ACT

A. Health Insurance Exchange

1. At this time, Pennsylvania Governor Tom Corbett has decided that Pennsylvania will not operate a state-based health insurance exchange under the federal Patient Protection and Affordable Care Act (“ACA”). Consequently, the federal government would operate any health insurance exchange in the Commonwealth. The Governor did leave the door open to re-evaluate this decision in the future. The U.S. Department of Health and Human Services (“HHS”) is receptive to a state converting later to a state-based health insurance exchange.

2. Legislators and their Committees in the Pennsylvania General Assembly have engaged in active discourse about the effect of the ACA on the Commonwealth’s insurance marketplace. Representative Anthony DeLuca, the Minority Chairman of the House Insurance Committee, reintroduced legislation (“H. B. 225”) that would establish a state-based health insurance exchange drawing from a National Association of Insurance Commissioners’ (“NAIC”) model law. On January 22, 2013, H. B. 225 was referred to the House Insurance Committee.

3. Unfortunately, on March 2, 2013, HHS suspended enrollment in high risk health insurance programs for uninsured individuals who have preexisting conditions. In Pennsylvania, this high risk pool program, called “PA Fair Care,” supported more than 6,500 Pennsylvanians at the time of HHS’ suspension of the enrollment.

B. Medicaid

1. Governor Corbett has stated that Pennsylvania will not expand Medicaid under the ACA unless the Commonwealth is granted some concessions. On April 2, 2013, the Governor met with the HHS Secretary, Kathleen Sebelius, to discuss the Governor’s concerns with expansion, including the cost to the Commonwealth. Medicaid provides an array of health and long-term care services to the vulnerable uninsured population including children, pregnant women, families, people with disabilities and seniors.

2. Representative Mark Cohen introduced a resolution to the Pennsylvania House of Representatives (“H. R. 115”), urging Governor Corbett to reconsider his position against Medicaid expansion and to accept federal funding to expand Medicaid eligibility under the ACA. On March 11, 2013, H. R. 115 was referred to the House Health Committee.

C. Health Insurance Rates

1. It is not clear what health insurance rates might look like with the full implementation of the ACA. Although Pennsylvania consumers might expect that their rates will go down or remain unchanged, the Pennsylvania Insurance Department (“Department”) indicates that certain segments of the population, such as young, healthy residents, might experience rate increases under the ACA. One of the reasons for such increase is that insurers have traditionally used health status as a rating factor, which provides the

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young and healthy with more favorable rates, and the ACA removes the health status factor from consideration for ratemaking. See Consedine Testimony before the Pennsylvania House Appropriations Committee, February 28, 2013.

D. CHIP

1. Under the ACA, there has been uncertainty regarding whether children and teens, who are currently enrolled in Pennsylvania's Children's Health Insurance Program ("CHIP"), will be moved to Medicaid. CHIP is Pennsylvania's program to provide health insurance to uninsured children and teens who are not eligible for and enrolled in Medicaid. HHS is indicating that there may be some flexibility about how children and teens in the CHIP program will be treated in the implementation of the ACA. See Medicaid Program, 78 Fed. Reg. 19918 (April 2, 2013).

II. INCREASED REGULATORY AUTHORITY OVER INSURANCE HOLDING COMPANY SYSTEMS

Pennsylvania's Insurance Company Law of 1921 was amended by Act 136 of 2012 (P.L. 1111, No. 136) ("Act 136"). Act 136, which reflects many of the updated provisions in the NAIC model holding company law and regulation, generally became effective in early September, 2012. In a December 20, 2012 memorandum to chief executive officers and presidents of Pennsylvania domestic insurers, Deputy Insurance Commissioner Stephen Johnson, CPA, highlighted certain of the requirements under Act 136 that broaden the Department's regulatory authority.

A. General Requirements of Act 136

The following is a sampling of certain requirements under Act 136, which increases the regulatory authority of the Department.

1. Generally, a controlling person of a domestic insurer seeking to divest its controlling interest shall file with the Department, with a copy to the insurer, a notice of the proposed divestiture at least 30 days prior to the cessation of control. 40 P.S. §991.1402(a)(3).
2. A person seeking to acquire control of a domestic insurer (Form A) must provide an acknowledgement that the person and the subsidiaries within its control in the insurance holding company system will provide information to the Commissioner upon request as necessary to evaluate enterprise risk to the insurer. 40 P.S. §991.1402(b)(11.2).
3. The Department can request that the financial statements of an insurance holding company system, including its affiliates, be included with the insurer's registration statement (Form B). 40 P.S. §991.1404(b)(4.1). In so doing, the Department has greater authority to review the financial condition of an insurer's holding company and its affiliates to better evaluate the insurer's financial condition and determine the potential risks posed to the insurer by the holding company system.
4. Insurer registration statements (Form B) must include a statement affirming that "the insurer's board of directors oversees corporate governance and internal controls and that the insurer's officers or senior management have approved, implemented and continue to maintain and monitor corporate governance and internal control procedures." 40 P.S. §991.1404(b)(4.2).

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5. Additional transactions that are now subject to prior notice to the Department (Form D) include, among others, management agreements, service contracts, tax allocation agreements, guarantees and cost-sharing arrangements. Such a transaction may be entered into if the Department has not disapproved it within the thirty (30) days or shorter notice period as permitted by the Department. 40 P.S. §991.1405(a)(2)(v).
6. Beginning in 2014, a new enterprise risk report (Form F) must be filed by March 31st for the previous calendar year, and every year thereafter, by the ultimate controlling person of every insurer subject to registration. The Form F must identify the material risks within the insurance holding company system that could pose enterprise risk to the insurer. 40 P.S. §991.1404(k.1). An enterprise risk generally includes an “activity, circumstance, event or series of events involving one or more affiliates of an insurer that, if not remedied promptly, would likely have a material adverse effect on the financial condition or liquidity of an insurer or its insurance holding company system....” 40 P.S. §991.1401.
7. The Commissioner also has the authority to “certify” a reinsurer so that a ceding insurer may receive credit for reinsurance ceded to a duly certified reinsurer. 40 P.S. §442.1(a).

B. Updates to Regulations Based Upon Act 136

1. The Department has submitted proposed rulemakings to Pennsylvania’s Independent Regulatory Review Commission (“IRRC”) to update Chapters 161 and 163 of the Department’s regulations to, among others, address the requirements to become a certified reinsurer and the factors that may be considered in the evaluation process. IRRC has scheduled a public meeting for April 18, 2013 to discuss the Department’s proposed rulemakings.
2. The Department is also working on draft regulations to update Chapter 25 to reflect the changes to The Insurance Company Law of 1921.

III. FEDERAL COURT WEIGHS DEPUTY COMMISSIONER’S COMMENTS IN REVIEWING A.M. BEST’S DECISION TO DOWNGRADE INSURER’S RATING

In a recent Memorandum Opinion, a Pennsylvania federal judge of the United States Eastern District Court carefully weighed the comments of Pennsylvania Deputy Insurance Commissioner Stephen Johnson regarding the 2010 decision of A.M. Best (“Best”) to downgrade the rating of a Pennsylvania domestic insurer.

A. *Regis Insurance Company v. A.M. Best Company, Inc.*, Civil Action No. 10-3171 (E.D.Pa., March 1, 2013).

1. In the above case, Judge Tucker of the United States Eastern District Court allowed Regis Insurance Company (“Regis”) to continue to pursue defamation and commercial disparagement claims against Best by denying, in part, Best’s Motion for Summary Judgment.
2. Best ultimately downgraded Regis’ rating from B+ to B- after Best learned that Regis’ parent company, Tiber Holding Corporation (“Tiber”), was insolvent. However, Best’s announcement of its 2010 downgrade of Regis did not fully explain that Tiber had judgments placed against it in 2000 and 2002 by the New York Superintendent of Insurance stemming from litigation related to a defunct

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insurance company and that Tiber had been insolvent for almost ten years. During most of this ten-year period, Regis had been operating with a B+ rating from Best.

3. According to the Memorandum Opinion, “[t]here is a marked and appreciable difference between implying that Regis’ parent company is experiencing recent financial difficulties and clearly stating that Regis has been operating for almost ten years *despite* its parent company’s financial difficulties (and that Best is only now learning of it).” *Id.* at 14-15.

4. Deputy Commissioner Johnson, who was deposed in this dispute, had provided a letter to Best following its final decision to downgrade Regis’ rating. In his letter, Deputy Commissioner Johnson stated “I have had two prior conversations with representatives from A.M. Best concerning Tiber’s financial condition and the existing judgment against it and conveyed the opinion of the Department that the financial condition and judgment did not raise any concerns with respect to Regis. As you are aware, Regis has adequate capital, reserves[,] and liquidity to meet its obligations to its policyholders irrespective of Tiber’s financial condition. The Department has seen no evidence to suggest that Regis would not continue to have adequate capital, reserves[,] and liquidity even if Tiber’s financial condition deteriorated to the point where it was necessary for Tiber to file bankruptcy. In fact, even in the event Tiber filed for bankruptcy protection, there is no regulatory requirement that the Department place Regis under supervision.” *Id.* at 6 n.4.

5. Judge Tucker noted that there remains a question of whether Best’s downgrade of Regis’ rating placed too great an emphasis on the mere existence of the judgments without giving enough consideration to other mitigating factors, such as the Department’s stated position on what impact Tiber’s judgment could have on Regis. The Court noted that “[a] reasonable jury could find that it was reckless for Best to arrive at such a substantial downgrade knowing that other factors suggest the judgments are not as damning as Best contends.” *Id.* at 19.

6. It is anticipated that the issues in this case will be vetted at an upcoming trial scheduled for May 20, 2013.

IV. ADDITIONAL INSURED STATUS – LESSONS FROM THE DEEPWATER HORIZON INSURANCE COVERAGE LITIGATION

An enforceable indemnity or hold harmless agreement, covered by the indemnitors’ general liability policy (contractual liability) written with adequate limits, is the most frequently used method of transferring most types of risk facing contracting parties. This method of risk transfer has its shortcomings and is usually combined with an obligation that the indemnitor obtain insurance coverage against the loss on behalf of the indemnitee. In some instances a separate policy will be purchased for this purpose. More often, however, the indemnitor will arrange for its own insurance coverage to be modified to cover the indemnitee as well i.e. the indemnitee will be named by endorsement as an additional insured.

A. Additional Insured Endorsement

There are certain advantages of an Additional Insured Endorsement for an indemnitee, in that the Additional Insured Endorsement:

1. Gives the indemnitee direct rights under the indemnitor’s policy.

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2. May provide broader coverage as the indemnitee may avoid the effect of standard exclusions that apply only to the “named insured.” Also avoids deductibles, retentions or retrospective rating features on its own coverage.
3. Provides a second avenue of protection, which may be broader than the hold harmless clause and is available in case of the insolvency of the indemnitor.
4. Precludes subrogation claims on behalf of the indemnitor’s insurer against the indemnitee.
5. Potentially provides “personal injury” coverage that would otherwise not be available based on a contractual indemnity claim.

B. In Re: Deepwater Horizon, Docket No. 12-30230 (5th Cir., March 1, 2013), petition for rehearing en banc filed March 15, 2013.

1. Insurance professionals have in the past argued that the scope of the coverage provided by additional insured status was “automatically” limited to the extent of the contractual liability assumed by the indemnitor. While courts, including Pennsylvania courts, have rejected this view over the years, the Fifth Circuit’s March 1, 2013 decision in *In Re: Deepwater Horizon* should serve as a wakeup call for every policyholder, insurer or broker regarding the need to truly understand and appreciate exactly what additional insured status means.
2. The Fifth Circuit reversed the decision of the District Court which had held that the drilling contract between British Petroleum (“BP”) and Transocean Ltd. (“Transocean”) only required Transocean to name BP as an additional insured with respect to liabilities specifically assumed by Transocean under the terms of the drilling contract. Since, under the terms of the drilling contract, Transocean had no liability to BP for environmental damage occurring under the water, Transocean’s insurers argued that BP was not entitled to coverage.
3. In rejecting this argument, the Fifth Circuit, relying on Texas law, found that because the insurance provisions and the indemnity clauses in the drilling contract were separate and independent, they were bound to look only to the policy itself to determine the scope of the coverage to which BP was entitled.
4. Because the policies did not impose any relevant limitation upon the extent to which BP was named as an additional insured, BP was entitled to coverage for this environmental damage, even though it may not be covered under the indemnity given by Transocean. Given the extent of both BP’s and Transocean’s losses, interesting questions could arise as to entitlement to Transocean’s \$750 million of coverage.
5. The practical lesson learned from *In Re: Deepwater Horizon* is that parties should not grant additional insured status casually or they may find their insurance covering losses of another party that they never intended to cover.

This Insurance Alert is intended to keep readers current on matters affecting businesses and is not intended to be legal advice. If you have any questions, please contact Heidi B. Hamman Shakely at 717.237.6035 or hshakely@eckertseamans.com; Ryan B. Caboot at 717.237.6074 or rcaboot@eckertseamans.com; or David J. Strasser at 412.566.6175 or dstrasser@eckertseamans.com.