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Unique Damages Concept …

Applied's SolutionOne Targeted in New Lawsuit

Applied Underwriters has been sued by an employer again, this time in New York. There are some interesting twists to this case, and quite an interesting damages theory.

The suit is about the way Applied structures, sells, and operates its SolutionOne workers' comp and payroll program. The plaintiff maintains that the Berkshire Hathaway (NYSE: BRK.A) subsidiary uses an unfiled and unapproved Reinsurance Participation Agreement (RPA) to siphon off money that should be reserved to pay claims.

In California, some but not all SolutionOne programs have a structured RPA.

The lawsuit calls the program "an illegal, unlicensed and fraudulent scheme that has left injured workers in New York exposed to significant, imminent risk." Plaintiff maintains that SolutionOne is set up as a "reverse Ponzi scheme" that promises savings but shifts all the risk back to the insured. That phrasing appears to have garnered the lawsuit a bit of national attention.

The lawsuit also alleges that Applied then siphons off premiums through an "excess loss agreement" with a captive insurance entity in the Berkshire family of companies.

The SolutionOne program packages payroll processing with workers' comp coverage. Like EquityComp, some insureds in the program are required to sign an unfiled and unapproved RPA that the New York plaintiff argues "materially alters the terms of the policies which are approved by New York State."

"Unlike a Ponzi scheme where early victims are paid with the investments of others, Berkshire Hathaway's reverse Ponzi scheme requires insureds to cover each other's losses," says the company in legal filings. "Because the scheme contained no element of risk transfer to an insurer, the scheme was both a fraud on the New York Plaintiff, which thought it had insurance and on the citizens of New York State whose workers were exposed to catastrophic losses limited to the creditworthiness of Plaintiff itself."

Unusual Damages Theory

The company is seeking a $6 million bond and at least $18 million in trebled damages.

Plaintiff's expert, a former assistant chief examiner with the New York Department, in a sworn statement, calculated the damages based upon .72% of premium (or expected loss costs), (the amount of losses expected – California assumes .65%). He then multiplied Continental's own filed loss cost modifiers of 1.186 and 1.280 which it used during the active term of the agreement, as well as the loss development factors that AUCRA uses to account for incurred but not reported claims. The expert opined that applying AUCRA's "most conservative LDF" of 5.5270 to Continental's loss costs produced a "value at risk" total of just over $6 million. Continental was the underlying carrier providing statutory coverage.

It appears the plaintiff is using the same factors against Applied that Applied uses to charge insureds. In other words, just using its own calculations in reverse.

It asked the court to require Applied to post a $6 million bond as security. The New York Plaintiff argues that under New York insurance law unlicensed entities must post a deposit as a condition to filing any pleadings in a lawsuit. Experts hired by The New York Plaintiff estimates that this is the amount of the company's overall exposure to workers' comp losses sustained during its time in

Brokers should check their files – or the insured's - to determine if clients in the SolutionOne program have RPAs. Applied has been known, according to court cases, to go directly to insureds and require them to sign documents the broker hasn't seen and isn't familiar with.
Nicholas Roxborough of Roxborough, Pomerance, Nye & Adreani says "Brokers who find such RPAs might want to read them to determine whether or not there is joint and several liability, and in any event, may want to carefully consider recommending the employer contact counsel."

SolutionOne and a prior program offered by Applied.

Multiple Violations

The lawsuit alleges that Applied is violating numerous laws in New York, including having unlicensed entities collect premiums from New York businesses and illegally linking the workers' comp coverage to other services such as the payroll processing. The New York Plaintiff also maintains that Applied is violating state law by selling reinsurance to a non-insurance entity. "Because reinsurance contracts between a non-insurance company such as The New York Plaintiff and an insurance company like Applied, specifically AUCRA, are forbidden by New York law, the RPAs are illegal, void and unenforceable and against public policy," the lawsuit maintains.

The New York Plaintiff's lawsuit alleges that these actions are violations of the Donnelly Act and expose Berkshire to trebled damages. The New York Plaintiff maintains that the program's requirement for a three-year commitment also violates New York law.

The lawsuit makes numerous references to the recent enforcement actions in California against Applied and its EquityComp program, including the decision in the Shasta Linen case. EquityComp also used unfiled and unapproved RPAs that include arbitration clauses and applied hefty loss development factors to claims if the policy is canceled or non-renewed.

Request Challenged

Applied's response to the lawsuit maintains that the plaintiffs participated in the program for four years without complaint, but "now demand to be excused because they incurred additional Program costs based on their own loss history. In short, Plaintiffs are seeking to avoid contractual obligations they purposefully assumed by participating in the program."

Applied continues its assertions that the RPA is a separate legal contract. "The RPA, a captive insurance profit and loss-sharing plan between The New York Plaintiff and AUCRA, is not an insurance policy, nor does it purport to be," Applied maintains in its legal filing.

Applied is asking the court to deny The New York Plaintiff's request for an injunction barring arbitration noting that Applied has not made any demands for arbitration. Applied also challenges the request for the $6 million bond. It maintains that "there is no basis for requiring a bond because the only Defendants who provided insurance to Plaintiffs are authorized New York insurers." Both Continental Indemnity Company and California Insurance Company are licensed carriers. "New York Insurance Law section 1213 provides for a bond only for 'unauthorized foreign or alien insurers. Here there are no foreign or alien insurers who provided insurance to Plaintiffs," Applied says. But the question of admission in New York is the issue.

The New York Plaintiff's lawsuit includes as an exhibit an order in a similar case requiring AUCRA and other members of the Berkshire group to file a $1.4 million bond to contest the lawsuit. The order cited Section 1213 of New York law.