Swimming in the Risk Pool

By Demián I. Oksenendler

When is insurance not insurance? More often than you might think. More than a few of us have been in a similar conundrum: A case with strong liability facts, significant damages, and a defendant facing excess exposure – sometimes even in multiples of its policy limits. Yet, the insurer won't be reasonable. Threats of an "open policy" are ignored. Unphased by accusations of bad faith, the insurer wants to press on towards trial. Perplexed by the carrier's behavior, we start to question ourselves: Did we value the case accurately? Did we give the client the right advice? Are we missing something? If the defendant is insured by an alternative risk transfer entity, such as a risk pool, then the answer to all three of those questions could well be "yes."

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Risk Pools and Risk Retention Groups

Over multiple decades, but mostly concentrated in the 1980's, both the California and federal governments have created several different types of alternatives to regular insurance. This article addresses three of the most common types. On the federal level, the McCarran-Fergson Act of 1945 delegated the regulation of insurance to the states. (15 U.S.C. § 1012.) In 1986 however, the Congress passed the Liability Risk Retention Act. It created an exception to McCarran-Ferguson, and allowed for the creation of risk retention groups (RRG's). (15 U.S.C. § 3902.) Previously, but also during that same period, California introduced its own versions of alternative risk transfer entities. The types we see most frequently, and which comprise the main focus of this article, are self-insured government risk pools and nonprofit risk pools. (See Gov. Code § 990.8 [for public and quasi-public entities], Corp. Code § 5005.1 [for private businesses and nonprofits].)

The policy justification for creating and continuing to allow risk pools and RRG's is to permit their members to obtain lower cost liability coverage than they otherwise might be able to obtain from traditional insurers. (See *City of South El Monte v. Southern Cal. Joint Powers Ins. Authority* (1995) 38 Cal.App.4th 1629, 1634.) One of the reasons that it is believed that RRG's and risk pools can charge lower premiums is because they are exempt from certain regulations. While RRG's and risk pools have distinct financial structures from standard insurance carriers, the key differences for our purposes relate to how they can treat their insureds/members.

At the federal level, the Liability Risk Retention Act contains broad preemption language, and immunizes RRG's from certain types of claims against them. (42 U.S.C. § 9673(a).) One type of claim that RRG's can avoid is a direct action by a judgment creditor. In California, if an insurer does not pay a judgment, the creditor can file a lawsuit directly against that insurer to try to collect it, up to the policy limit. (Ins. Code § 11580.) RRG's, however, have been held to be immune from such lawsuits. (*Wadsworth v. Allied Professionals Ins. Co.* (2014) 748 F.3d 100.)

Importantly, RRG's must comply with state "unfair claim settlement practices law." (42 U.S.C. § 9673.) The effect of that part of the Act has not been fully tested in California. For instance, it appears to be an open question in California whether RRG's can be held liable for bad faith when they unreasonably fail to settle or refuse to defend their insureds.

By contrast, California risk pools have even more freedom – or more protections, depending on how you look at it – than RRG's. Indeed, the Government Code and Corporations Code both expressly provide that risk pools "shall *not* be considered insurance *nor* be subject to regulation under the Insurance Code." (Gov. Code § 990.8(c); Corp. Code § 5005.1(b)(1), emphasis added.) Despite multiple challenges over the years, our courts have consistently held that the Legislature meant what it said. (E.g., *Orange County Water Dist. v. Assn of Cal. Water etc. Authority* (1997)

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54 Cal.App.4th 772, 775; *City of South El Monte, supra,* 38 Cal.App.4th at 1634; see also *Schools Excess Liability Fund v. Westchester Fire Ins. Co.* (2004) 117 Cal. App.4th 1275, 1285-1287 [private entity insured by a risk pool while providing services to a risk pool member].)

The Court of Appeal in *City of South El Monte* examined the topic in-depth (specifically in the context of a government risk pool), and stated it plainly: "principles governing insurance carriers and insurance law have no applicability, absent consent of the parties to the pooling agreement." (*City of South El Monte, supra,* 38 Cal. App.4th at 1639.) Instead, "questions of coverage are properly answered by relying on rules of contract law that emphasize the intent of the parties." (*Ibid.*) In other words, risk pools might look like insurers and sound like insurers, but they do not have to act like insurers unless they choose to do so.

It is difficult to overstate the significance of risk pools' statutory exemption from California insurance law. From the perspective of the pools, essentially, all bets are off. The myriad rules, sub-rules, and nuances of policy interpretation (and the decades of caselaw underlying them) no longer apply. Statutory notice requirements are unenforceable, as are the consequences (such as coverage remaining in force, despite non-payment of premium) for failing to follow them. Coverage restrictions that would not be permissible in regular insurance policies (e.g., auto liability coverage provisions that exclude accidents that occur while driving under the influence, or uninsured motorist exclusions for resident relatives) are allowed. Moreover, while every contract obligates the parties to act fairly and in good faith, the enhanced damages that would be available when an insurer breaches those obligations are arguably gone when the source of coverage is a risk pool. Reconsidering the hypothetical at the start of this article, if the defendant's surety is a risk pool, its seemingly irrational decision to force an excess liability case to trial suddenly makes more sense. If the surety feels it has no obligation to protect its insured, then why not gamble on a trial?

Strategies for Dealing with Risk Pools

Facing a risk pool may seem daunting. Theoretically, it can leverage its statutory protections by acting against its "insureds'" interests to push every case to trial, believing that its exposure is capped at its policy limit, and knowing that many claimants will give up and settle for less than full value. Those that press on and achieve excess verdicts will face the added challenge of collecting from public entities or nonprofits who are either impecunious or have special protections against attachment and forfeitures. But the battle is not futile, if you know where to look.

Get the documents

A prerequisite to any strategy for facing a risk pool is to know that it is a risk pool. There are multiple ways to find out. First, if the matter is in litigation, then the contract can be obtained through discovery. The Code of Civil Procedure provides for "discovery of the existence and contents of any agreement under which any insurance carrier may be liable to satisfy in whole or in part a judgment that may be entered in the action or to indemnify or reimburse for payments made to satisfy the judgment." (C.C.P. § 2017.210.) Black letter law say the documents are discoverable, so ask for them. Second, the risk pools that insure public entities are usually public entities themselves. Consequently, they are subject to public records laws and must respond to public records requests. Some even have their own pre-printed forms for this purpose, available on the web.

Once obtained, the contract should state clearly whether the surety is a risk pool, RRG, or other entity. California and federal law require that such contracts clearly disclose that information. (15 U.S.C. § 3902(a)(1)(I) (RRG's); Corp. Code § 5005.1(b)(2).) The details of contract setting forth the terms of the relationship between the defendant and its surety are essential to formulating a plan of attack.

Look for incorporation of the Insurance Code and other helpful law

As the *City of South El Monte* court noted, risk pools are free to subject themselves to some or all of California's insurance laws. Risk pools do this more often than they might realize. If a policy does not conform to California law on its face, but incorporates all or part of the Insurance Code, then the law is read into it, regardless of the contract language. (E.g., *Hartford Fire Ins. Co. v. Macri* (1992) 4 Cal.4th

318, 324 [uninsured motorist statute].) Importantly, incorporation of a statute also incorporates the judicial interpretation and application of that statute. (*Clark Bros. v. N. Edwards Water Dist.* (2022) 77 Cal. App.5th 801, 816-820.) The rules governing policy interpretation, construction of ambiguities in favor of coverage, etc., are back in play. The contract between the pool and its member will set forth which (if any) of California's insurance laws the pool has agreed to follow, and by extension, the case law that interprets it.

I recently resolved a case that turned on incorporation. My client (a passenger in a stopped car) suffered serious injuries in a collision caused by an underinsured motorist. The car carrying my client had insurance through a nonprofit risk pool. The plain language of the risk pool contract did not comply with the Insurance Code, and purported to exclude underinsured motorist coverage for that vehicle, even though the named insured had never signed a waiver. [1] Consequently, when my client's former counsel presented an underinsured motorist claim, the risk pool denied coverage.

When the case came to me, I inspected the contract closely. On doing so, it became apparent that the contract had expressly incorporated California's uninsured motorist statute.[2] I filed suit for breach of contract, bad faith, and declaratory relief. I argued that the risk pool could not take advantage of its special status to avoid paying my client's claim because it had promised to follow our state uninsured motorist statute. The pool had nowhere to hide. It had to expand its coverage – in direct contravention of the express contract language – to cover my client's injuries. I filed a motion for summary adjudication of my client's declaratory relief cause of action on the coverage issue. The case settled on confidential terms before the hearing.

The practice pointer here is that when facing a risk pool, review the contract carefully. It may incorporate (either expressly or implicitly) the Insurance Code or other helpful law that you can use to your client's benefit.

Check assets, and try your case with open eyes

Sometimes, the pooling contract is a dead end. It makes the required disclosures, does not incorporate any helpful law, and does not otherwise provide any openings that can force the surety to step up and protect its insured. In such cases you and your client will have to make an informed choice about how to proceed. What are the collection options in the event of an excess verdict? Corporations (even members of risk pools) are subject to attachment of their assets. (Corp. Code § 5005.) Public entities are more difficult to enforce against, but can be compelled to pay. (E.g., Gov. Code § 970.2 [writ of mandate].) Before deciding whether to go to trial against a defendant insured by risk pool, conduct an asset search and consult with a competent debt collection attorney so you can give your client the best advice, and you can both walk into trial with eyes open and a plan for success. ■

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[1] That topic will be the subject of a future article. Stay tuned.

[2] The contract also did not comply with the Corporations Code's disclosure/disclaimer requirements.