STATE LAWS RESTRICTING THE OPERATION OF RISK RETENTION GROUPS—NECESSARY PROTECTION OR ILLEGAL REGULATION?

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I. INTRODUCTION AND BACKGROUND

An insurer wishing to solicit policyholders in a state must generally satisfy state licensing requirements and qualify to conduct business in the state.[1] Obtaining licensure in a number of states and maintaining that right is a significant undertaking for insurers, particularly for those doing business on a nationwide basis. Under certain circumstances, however, the federal Liability Risk Retention Act (LLRA)[2] allows entities, known as risk retention groups (RRGs), to operate in all states without additional regulatory approval once regulatory requirements have been satisfied in a state of domicile.[3] The approval of RRGs resulted from congressional efforts to expand the availability of insurance in certain markets by simplifying insurance regulations.[4]

An RRG consists of a group formed to self-insure risks and whose members have similar risk exposures.[5] The original Product Liability Risk Retention Act of 1981 authorized RRGs only in the product liability and completed operation insurance fields and limited membership to product manufacturers, wholesalers, distributors, and retailers.[6] In 1986, however, the Act was amended and broadened by an amendment to the LRRA,[7]

1. *See, e.g.*, CAL. INS. CODE § 1631 (West 2005 & Supp. 2011) ("[A] person shall not solicit, negotiate, or effect contracts of insurance, . . . unless the person holds a valid license . . . ."); FLA. STAT. ANN. § 626.112 (West 2005 & Supp. 2010) ("[N]o individual, firm, partnership, corporation, association, or any other entity shall act . . . directly or indirectly, as an insurance agency, unless it complies with s. 626.172 with respect to possessing an insurance agency license . . . ."); IOWA CODE § 522B.2 (2011) ("A person shall not sell, solicit, or negotiate insurance in this state for any line of insurance unless the person is licensed . . . ."); VT. STAT. ANN. tit. 8, § 3361 (2009) ("A foreign or alien insurer shall not transact business in this state unless it first obtains . . . a license . . . ."); WASH. REV. CODE ANN. § 48.17.060 (West 2010) ("A person shall not sell, solicit, or negotiate insurance in this state for any line or lines of insurance unless the person is licensed . . . .").

2. 15 U.S.C. §§ 3901–06 (2006).

3. *See id.* § 3902; U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-536, RISK RETENTION GROUPS: COMMON REGULATORY STANDARDS AND GREATER MEMBER PROTECTIONS ARE NEEDED 2 (2005) [hereinafter RISK RETENTION GROUPS].

4. *See* BAIRD WEBEL, CONG. RESEARCH SERV., RL 32176, THE RISK RETENTION ACTS: BACKGROUND AND ISSUES 1 (2003), *available at* http://www.policyarchive.org/handle/10207/bitstreams/1900.pdf.

5. *See* 15 U.S.C. § 3901(a)(4); *see also* RISK RETENTION GROUPS, *supra* note 3, at 1.

6. *See* Product Liability Risk Retention Act of 1981, Pub. L. No. 97-45, 95 Stat. 949.

7. *See* Risk Retention Amendments of 1986, Pub. L. No. 99-563, 100 Stat.

which enabled RRGs to offer most forms of commercial liability insurance to any businesses or state or local governmental entity, so long as the members were engaged in the same business or exposed to similar risks.[8] The development of RRGs may result in greater and more affordable access to insurance particularly during "hard" markets, meaning when "the supply of insurance [is] down, insurance prices [are] up, and underwriting standards [are] more stringent."[9] The National Risk Retention Association (NRRA)[10] reports that RRGs currently generate over $2.5 billion in annual premiums in addition to insuring a wide range of businesses,[11] including a significant proportion of healthcare entities.[12]

Nondomiciliary state departments of insurance concerned with protection of state citizens—both policyholders and claimants—may attempt to limit the use of RRGs or interfere with their operations. One typical area of concern for states is protecting the public from inadequate, excessive, or unfairly discriminatory rates.[13] While it may be argued that

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8. *See id.*; *see also* WEBEL, *supra* note 4, at 5. "Liability" insurance under the LRRA, however, does not include "an employer's liability with respect to its employees other than legal liability under the Federal Employers' Liability Act (45 U.S.C. 51 et seq.)." *See* 15 U.S.C. § 3901(a)(2)(B). Commercial liability risks include the risk, for example, that a physician may be held liable for medical malpractice, but they do not include the risk that the physician's office could burn down. WEBEL, *supra* note 4, at 2.

9. *See* WEBEL, *supra* note 4, at 1.

10. "[T]he NRRA represents RRGs and purchasing groups before legislative bodies, executive agencies, and the courts. The NRRA advocates the interest of its members, which include 69 RRGs . . . ." Letter from Robert H. Myers, Jr., Gen. Counsel, Nat'l Risk Retention Ass'n, to Gene Dodaro, Comptroller Gen., U.S. Gov't Accountability Office (Mar. 8, 2011) (on file with author) [hereinafter Myers].

11. *See* Press Release, Nat'l Risk Retention Ass'n, NRRA Calls for Federal Action to Halt Interference by Some States in Risk Retention Group Operations (Mar. 14, 2011), *available at* http://www.nrra-usa.org/files/NRRAReleaseGAO3142011.pdf.

12. *See* Nicole Williams Koviak, STUDENT, *An Insurance Perspective on the Medical Malpractice Crisis*, 13 ANNALS HEALTH L. 607, 610 (2004) (discussing the growth of RRGs within the healthcare industry).

13. *See, e.g.*, ARIZ. REV. STAT. ANN. § 20-383 (2002) ("An insurer shall not charge rates that are excessive, inadequate or unfairly discriminatory."); CAL. INS. CODE § 1861.05 (West 2005 & Supp. 2011) ("No rate shall be approved or remain in effect which is excessive, inadequate, unfairly discriminatory . . . ."); FLA. STAT. ANN. § 627.031 (West 2011) ("To promote the public welfare by regulating insurance rates as herein provided to the end that they shall not be excessive, inadequate, or unfairly discriminatory . . . ."); IOWA CODE § 509.17 (2011) ("Rates shall not be excessive, inadequate or unfairly discriminatory."); VT. STAT. ANN. tit. 8, § 4685 (2005) ("Rates

the concern with excessive premium amounts will be policed by a free market economy, that theory does not hold true in the case of inadequate rates. Policyholders in search of more affordable rates may be attracted to lower priced policies.[14] Such policies may present a danger to policyholders and injured claimants if the collection of insufficient premiums results in an insurer's inability to pay claims. Pursuant to the LRRA, state rating codes are inapplicable to RRGs,[15] and the LRRA grants nondomiciliary states only limited rights in regard to RRGs in hazardous financial condition.[16] These exemptions lead to an understandable concern on the part of nondomiciliary states regarding a lack of control over rate regulation in respect to RRGs.[17]

In addition to rate regulation, RRGs are also exempt from most other nondomiciliary state regulatory requirements.[18] For example, under the LRRA, an RRG must satisfy the surplus and capital requirements of only the domiciliary state,[19] and RRGs are exempt from nondomiciliary state

shall not be excessive, inadequate or unfairly discriminatory."); VA. CODE ANN. § 38.2-1900 (2007) ("The purpose[] of this chapter [is] to: . . . [p]rotect policyholders and the public against the adverse effects of excessive, inadequate or unfairly discriminatory rates . . . ."); WASH. REV. CODE ANN. § 48.19.020 (West 2010) ("Premium rates for insurance shall not be excessive, inadequate, or unfairly discriminatory."); *see also* NAT'L ASS'N OF INS. COMM'RS, PROPERTY AND CASUALTY MODEL RATING LAW § 1, at 775-1 (2008) ("The purpose[] of this Act [is]: . . . [t]o protect policyholders and the public against the adverse effects of excessive, inadequate or unfairly discriminatory rates . . . .").

14. *Cf.* RISK RETENTION GROUPS, *supra* note 3, at 43 (discussing the regulatory "race to the bottom").

15. *See* 15 U.S.C. § 3902(a) (2006).

16. *See id.* § 3902(a)(1)(E)(i) (stating nondomiciliary states may require an RRG to submit to a financial examination if the commissioner in the RRG's state of domicile has not begun or has refused to initiate an investigation); *id.* § 3902(a)(1)(H) (stating a nondomiciliary state may seek an injunction against RRGs believed to be in hazardous financial condition); *see also* RISK RETENTION GROUPS, *supra* note 3, at 2 ("LRRA partially preempts state insurance laws by allowing an RRG's formation and operations to be regulated primarily by the state in which it is chartered, its domiciliary state, even when it sells insurance in other states.").

17. *See* WEBEL, *supra* note 4, at 9 (commenting on the concern over "the danger to consumers from a limitation on states' regulatory authority").

18. *See* 15 U.S.C. § 3902 (providing, with limited exceptions, that RRGs are exempt from state regulation).

19. *See id.* § 3901(a). With limited exceptions, an RRG must be chartered and licensed to do business as a liability insurance company in only one state. *See id.* § 3901(a)(4)(C); *see also* Karen Gantt, *Federal Tax Treatment of Medical Malpractice Insurance Alternatives for Nonprofits*, 52 DRAKE L. REV. 495, 512–13 (2004) (discussing capital and surplus requirements).

mandates involving the filing of policy forms for regulatory approval.[20] For obvious reasons, a state with minimal capital and surplus requirements engaging in lax supervision of policy forms may be an attractive domicile for an RRG.[21] Regulators in nondomiciliary states may reasonably link a domiciliary state's less-than-zealous regulatory supervision and low capital and surplus requirements with a greater threat of insolvency. As recognized by the United States Government Accountability Office (GAO) in a 2005 report, preemptive aspects of the LRRA have "resulted in a regulatory environment characterized by widely varying state standards and limited regulator confidence in the system."[22] The GAO found evidence confirming some states have created lenient regulatory requirements for RRGs in order to attract their domicile.[23] States may engage in a "regulatory race to the bottom" for purposes of generating jobs and revenue flowing from taxation of RRG insurance premiums.[24] A later

20. *See* 15 U.S.C. § 3902(a), (d) (noting that while states are entitled to receive filings by RRGs regarding such matters as coverage, deductibles, and rating classifications, nondomiciliary states have no authority to disapprove such filings); *see also* RISK RETENTION GROUPS, *supra* note 3, at 25 ("LRRA's regulatory preemption has allowed states to set regulatory requirements that differ significantly from those of traditional insurers, and from each other, producing limited confidence among regulators in the regulation of RRGs.").

21. *See* Maureen A. Sanders, *Risk Retention Groups: Who's Sorry Now?*, 17 S. ILL. U. L.J. 531, 541–42 (1993) (noting because of lower capital and surplus requirements, RRGs are only using a few states for their state of domicile).

22. RISK RETENTION GROUPS, *supra* note 3, at 5.

23. *See id.* at 6.

24. *See id.* at 43. Evidence amassed by the GAO on the issue included: a willingness by some states to charter RRGs that provide vehicle service contracts—a practice criticized by a number of regulators based upon dangers to consumers; a reduction by a leading domiciliary state in the amount of capitalization required for an RRG to incorporate as a stock insurer; and a willingness by some states to charter entrepreneurial RRGs that have been accused of lacking financial integrity because their survival depends on attracting new members. *See id.* at 45–46, 53. Additional evidence in support of a "race to the bottom" is that the GAO Report on RRGs reflects that none of the leading six domiciliary state regulators at that time recommended the LRRA be changed to permit RRGs to have guaranty fund protection. *See id.* at 60. If RRGs were eligible for guaranty fund coverage, state resources could be endangered due to RRG failure. *See* 5 LAW AND PRAC. OF INS. COVERAGE LITIG. § 58.18 (David Leitner et al. eds., 2011) ("The main purposes behind the creation of guaranty funds are 'to provide a mechanism for the payment of covered claims . . . , to avoid excessive delay in payment and to . . . minimize financial loss to claimants or policyholders because of the insolvency of an insurer. . . .' Guaranty funds typically derive their pool of money from a tax assessed on all insurers licensed to do business within the state based on each insurer's in-state volume of business."

2011 GAO report recognizes that lower capitalization requirements continue to be a factor in regard to the domicile of RRGs.[25] Citing its earlier report, the GAO recognized concern by state regulators that a domiciliary state regulator who does not have "skin in the game" cannot protect insureds outside the domiciliary state affected by an RRG's insolvency.[26]

Finally, the LRRA specifically provides that insurers operating under the Act may not participate in state guaranty funds set up by state governments to provide assistance to claimants in the event of an insurer's insolvency.[27] Congress expressed the view that a ban on guaranty fund protection would encourage RRGs to set and establish adequate premiums and reserves because there would be no other source of funds to pay claims.[28] While a reasonable position may be that policyholders who seek more affordable premiums should be allowed to accept risks presented by RRGs, a legitimate state concern involves the position of injured claimants who seek to collect judgments from an insolvent RRG. Insolvency concerns are illustrated by the fact that Tennessee's estimated losses from three failed RRGs in the state could exceed $200 million.[29]

Not surprisingly, efforts by state departments of insurance to limit the

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(footnotes omitted)). Accordingly, states with less strict requirements would not likely be in favor of guaranty fund protection for RRGs.

25. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-16, RISK RETENTION GROUPS: CLARIFICATIONS COULD FACILITATE STATES' IMPLEMENTATION OF THE LIABILITY RISK RETENTION ACT 20 (2011) [hereinafter GAO-12-16].

26. *Id.* at 23.

27. RISK RETENTION GROUPS, *supra* note 3, at 11.

28. According to the Act's legislative history, there were two reasons for the exclusion of RRGs from state guaranty funds. "First, risk retention groups are not full-fledged multi-line insurance companies, but limited operations providing coverage only to member companies, and only for a narrow group of coverages. Second, there will be a strong incentive for risk retention groups to set adequate premiums and establish adequate reserves if each member knows there is no other source of funds (other than its own corporate assets) from which to pay claims." Pub. L. 97-45, *reprinted in* 1981 U.S.C.C.A.N. 1432, 1445; *see also* RISK RETENTION GROUPS , *supra* note 3, at 50 n.80 (discussing the lack of guaranty fund protection); Robert W. Minto, Jr., *Captives and RRG's in the Reinsurance Environment*, *in* REINSURANCE LAW & PRACTICE 2006: NEW LEGAL & BUSINESS DEVELOPMENTS IN A CHANGING GLOBAL ENVIRONMENT 837, 876, 933 (Practising Law Institute ed. 2006) ("LRRA does not mandate that RRGs disclose to their insureds that they lack state insurance insolvency guaranty fund protection.").

29. *See* Minto, *supra* note 28, at 936 (footnote omitted).

activity of RRGs have led to significant conflict.[30] Decisions vary regarding the extent of the preemptive effect of the LRRA.[31] This Article addresses the continuing controversy surrounding the limits of state authority in regard to regulation of RRGs and the means by which states may attempt to protect citizens and claimants by limiting the role of RRGs.

II. STATUTORY EXCEPTIONS TO THE LRRA'S PREEMPTIVE EFFECT

Pertinent restrictions on state regulatory authority contained in 15 U.S.C. § 3902(a) of the LRRA and typically referenced in cases addressing preemption are as follows:

> (a) [A] risk retention group is exempt from any State law, rule, regulation, or order to the extent that such law, rule, regulation, or order would—
>
> > (1) make unlawful, or regulate, directly or indirectly, the operation of a risk retention group except that the jurisdiction in which it is chartered may regulate the formation and operation of such a group and any State may require such a group to—
> >
> > > . . . .
> > >
> > > (B) pay, on a nondiscriminatory basis, applicable premium and other taxes which are levied on admitted insurers and surplus lines insurers, brokers, or policyholders under the laws of the State;
> > >
> > > . . . .
> > >
> > > (H) comply with an injunction issued by a court of competent jurisdiction, upon a petition by the State insurance commissioner alleging that the group is in hazardous financial condition or is financially impaired;
> >
> > . . . .
> >
> > (4) otherwise discriminate against a risk retention group or any of its members, except that nothing in this section shall be construed to affect the applicability of State laws generally applicable to persons or corporations.[32]

Section 3902(e) of the Act authorizes courts "to enjoin . . . the solicitation or sale of insurance by, or operation of, a risk retention group

30. *See infra* Part III.
31. *See infra* Part III.
32. 15 U.S.C. §§ 3902(a)(1), (a)(1)(B), (a)(1)(H), (a)(4) (2006).

that is in hazardous financial condition or is financially impaired."[33] Additionally, in connection with the 1986 amendments to the LRRA, Congress passed a number of provisions preserving the role of the states regarding insurance regulation,[34] including 15 U.S.C. § 3905, which provides, in pertinent part, the following:

> (a) Nothing in this chapter shall be construed to exempt a risk retention group or purchasing group authorized under this chapter from the policy form or coverage requirements of any State motor vehicle no-fault or motor vehicle financial responsibility insurance law.
>
> . . . .
>
> (d) Subject to the provisions of section 3902(a)(4) of this title relating to discrimination, 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 regardless of whether coverage is obtained directly from an insurance company or through a broker, agent, purchasing group, or any other person.[35]

III. CONFLICTING AUTHORITY REGARDING THE PREEMPTIVE PROVISIONS OF THE LRRA IN RELATION TO RRGS

Of course, pursuant to the Supremacy Clause of the U.S. Constitution, Congress has the power to pass legislation preempting state law.[36] The issue in cases that construe the LRRA in relation to RRGs is the extent to which Congress has preempted state law.[37] A pertinent issue in considering the LRRA's preemptive effect is the impact of the

33. *Id.* § 3902(e)(2).

34. *See* Risk Retention Amendments of 1986, Pub. L. No. 99-563, 100 Stat. 3170 (1986); *see also* Mears Transp. Grp. v. Florida, 34 F.3d 1013, 1017–18 (11th Cir. 1994) (discussing the 1986 amendments).

35. 15 U.S.C. § 3905(a), (d).

36. *See* U.S. CONST. art. VI, § 1, cl. 2.

37. *See, e.g.*, Nat'l Warranty Ins. Co. v. Greenfield, 214 F.3d 1073, 1074 (9th Cir. 2000) ("We must decide whether the LRRA preempts the Oregon Service Contract Act.").

McCarran-Ferguson Act[38] which expresses Congress's belief that "the continued regulation and taxation by the several States of the business of insurance is in the public interest."[39]

Some decisions, including cases from the Seventh and Eleventh Circuits, take a restrictive view of the preemptive provisions of the LRRA and uphold state laws that effectively foreclose the operation of RRGs in at least some respects.[40] On the other hand, in *National Warranty Insurance Co. RRG v. Greenfield*, the Ninth Circuit—while expressly disagreeing with the Seventh and Eleventh Circuits—strictly enforced the Act's preemptive provisions.[41] The following is an analysis of cases addressing the preemptive provisions of the Act.

A. *Federal Appellate Authority Finding Preemptive Provisions of the Act Inapplicable*

The plaintiffs in *Mears Transportation Group v. Florida*[42] challenged the validity of a Florida statute[43] that required owners of for-hire vehicles, such as cabs and limousines, to purchase state-required insurance from members of the Florida Insurance Guaranty Association only, thus foreclosing the use of RRGs for such coverage.[44] The Eleventh Circuit Court of Appeals upheld the law as a valid exercise of the state's regulatory power, stating that it illustrated "precisely the type of state [financial responsibility] law that Congress expressly excepted from the preemption provisions of the Liability Risk Retention Act."[45] In the court's opinion, through § 3905(d)'s authorization of a showing of financial responsibility on the part of RRGs, "Congress specifically excepted from the Act's

38. 15 U.S.C. §§ 1011–15 (2006) (encompassing the entirety of the McCarran-Ferguson Act).

39. *Id.* § 1011.

40. *See, e.g.*, Ophthalmic Mut. Ins. Co. v. Musser, 143 F.3d 1062, 1070 (7th Cir. 1998) ("[W]e hold that the LRRA does not preempt [Wis. Stat.] § 655.23."); Mears Transp. Grp. v. Florida, 34 F.3d 1013, 1023 (11th Cir. 1994) ("Accordingly, [the § 3905(d)] exception does not apply.").

41. *See Greenfield*, 214 F.3d at 1082 ("[W]e know that, in deciding [this case] as we do, we disagree with the Seventh and Eleventh Circuits. . . . [T]his interpretation best accords with the policy of the LRRA in striking a balance between the desire to permit RRGs to operate freely and the legitimate need of states to regulate RRGs.").

42. *Mears*, 34 F.3d 1013.

43. *Id.* at 1014 (challenging Florida Statute section 324.031 entitled "Manner of Proving Financial Responsibility").

44. *See id.* at 1015.

45. *See id.* at 1014.

preemption provisions those state laws aimed at assuring the financial responsibility of entities subject to state, county, and city licensure laws [and] evidenced its intent to preserve for the states the authority to utilize financial responsibility laws to protect the public."[46]

In *Mears*, the Eleventh Circuit addressed the relationship between § 3905(d) and § 3902(a)(4)'s exemption of RRGs from discriminatory state laws.[47] For the following three reasons, however, the Eleventh Circuit believed the Florida law lacked discriminatory intent. First, RRGs were but one group of insurance carriers precluded from membership in the state's guaranty association.[48] In addition to RRGs, other groups such as surplus line carriers, captive insurers, and reciprocal insurers were precluded from participation in the guaranty fund.[49] Second, the law, characterized by the court as being extremely narrow, only affected "owners and operators of for-hire passenger transportation vehicles and *only* to the first $30,000 in coverage."[50] Therefore, RRGs were not entirely foreclosed from the insurance market. Third, the law served to provide affected citizens the protection of the state insurance guaranty fund, which, in the court's opinion, constituted a "legitimate and rational exercise of the state's traditional authority to act in the public interest," as opposed to illegal discrimination.[51]

In *Ophthalmic Mutual Insurance Co. v. Musser*,[52] the Seventh Circuit also supported state rights in addressing the preemptive provisions of the LRRA in relation to a Wisconsin law requiring certain health care providers to establish proof of financial responsibility through maintenance of insurance with a state-admitted insurer.[53] According to the court,

46. *See id.* at 1018.
47. *See id.* at 1018–19.
48. *Id.* at 1015 n.7.
49. *Id.*
50. *Id.* at 1018.
51. *See id.* The decision in *Mears* was not unanimous. *See id.* at 1019. The dissent stated, "By requiring the purchase of dollar one coverage, [the law] eliminate[d] the [RRG]s' ability to retain risk and thereby discriminat[ed] against [RRGs]." *Id*. at 1020 (Roney, C.J., dissenting) (citing 15 U.S.C. § 3095(d)).
52. Ophthalmic Mut. Ins. Co. v. Musser, 143 F.3d 1062 (7th Cir. 1998).
53. *See id.* at 1065. Wisconsin law mandated that the first $400,000 of professional liability insurance coverage be placed with a state-admitted insurer unless the health care provider was self-insured. *Id.* (citing WIS. STAT. § 655.23(3)(a)). Any liability award in excess of that amount was covered by the Wisconsin Patients Compensation Fund. *Id.* at 1065 n.2. Accordingly, Wisconsin requirements effectively foreclosed RRGs from doing business in the state. *See id.* at 1065.

because the Wisconsin statute did not directly prevent RRGs from providing coverage in Wisconsin, "the main thrust of the LRRA [was] satisfied, and it [was] not obliterated."[54] The court relied heavily upon § 3905(d), which authorizes states to specify acceptable means of demonstrating financial responsibility, and stated pursuant to § 3905(d), "a state can require a licensee to demonstrate that he is insured by a state-licensed insurer, even if this means that non-domestic RRGs turn out to be among the pool of non-qualifying insurers."[55] The court found § 3905(d), which allows states to require proof of financial responsibility, qualified § 3902(a)(1)'s prohibition against regulation of RRGs by nondomiciliary states.[56]

The court further recognized that "in fields traditionally occupied by the states, courts start with the presumption that the historic police powers of the states were not to be superseded by federal law unless Congress has enacted legislation enunciating that preemption was the 'clear and manifest' purpose of Congress."[57] The court quoted the policy declaration of the McCarran-Ferguson Act, stating Congress "made explicit" its intent to leave insurance regulation to the states[58]:

> Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.[59]

Also quoted were the following subsections from § 1012 of the McCarran-Ferguson Act, which emphasize that insurance regulation remains within the authority of the states:

> (a) State regulation. The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> (b) Federal regulation. No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the

54. *See id.* at 1070.
55. *Id.* at 1068.
56. *See id.* at 1068–69.
57. *Id.* at 1066 (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)).
58. *See id.*
59. *Id.* (quoting 15 U.S.C. § 1011).

> purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance.[60]

An interesting aspect of the *Musser* case is that the RRG involved did not raise on appeal the contention that the state discriminated against RRGs in violation of § 3902(a)(4).[61] Notably, however, § 3905(d), which was relied upon by the RRG on appeal,[62] implicates the issue of discrimination based upon its preamble that makes state rights in regard to proof of financial responsibility "[s]ubject to the provisions of section 3902(a)(4) of this title relating to discrimination."[63] At any rate, the Seventh Circuit indicated that in order to prevail on a theory of discrimination under the LRRA, evidence of discrimination based against RRGs as a class is necessary.

> [Section] 3902(a)(4) of the LRRA expressly prohibits states from discriminating against RRGs. While at the lower level OMIC contended that § 655.23[—the state law at issue—]discriminates against RRGs, OMIC has not appealed the district court's determination that § 655.23 does not discriminate against RRGs. In any event, while § 655.23 most definitely discriminates against *out-of-state* insurers (as Wisconsin has the right to do), and while out-of-state insurers may include RRGs, there is no evidence in the record to indicate that RRGs *as a class* face discrimination under § 655.23.[64]

B. *Additional Case Authority Supporting State Rights*

In addition to the federal appellate cases discussed above, other decisions also support state rights in relation to RRGs. For example, in *National Home Insurance Co. v. King*[65] an RRG brought an action to compel arbitration of a dispute involving a home warranty agreement it insured.[66] This action thereby challenged the effect of a Kentucky state law

60. *Id.* at 1066–67 (quoting 15 U.S.C. § 1012).
61. *See id.* at 1065.
62. *See id.*
63. *See* 14 U.S.C. § 3905(d) (2006).
64. *Musser*, 143 F.3d at 1070 n.5.
65. Nat'l Home Ins. Co. v. King, 291 F. Supp. 2d 518 (E.D. Ky. 2003).
66. *See id.* at 520–24. In heated exchanges between the parties leading up to litigation, the homeowner's attorney accused National Home of bad faith, stating, "[Y]our letter . . . is just an attempt to renege on your company's agreement to adjust this claim. In Kentucky, we call that breach of contract. When you are an insurance carrier, it's called bad faith." *Id.* at 523 (citation omitted).

that invalidated arbitration provisions as applied to contracts of insurance.[67] The court upheld enforcement of the state statute, finding it did not make unlawful the operation of RRGs or offend nondiscrimination principles of the LRRA.[68] Instead, the court found that enforcing the statute "put[] [the RRG] on equal footing with all other insurers in Kentucky who are prohibited from enforcing arbitration clauses in agreements with their insureds."[69] Interestingly, the court did not discuss § 3902(a)(1) of the LRRA, which exempts RRGs from state attempts to "regulate, directly or indirectly, the operation of a risk retention group."[70] At least arguably, the state statute regulated National Home by invalidating contractual provisions it required in order to enter into contracts of insurance.[71]

The recent decision of *Shear v. Champagne*[72] addressed whether a Louisiana state statute setting forth a required method of rejecting uninsured motorist vehicle coverage was enforceable against an RRG not domiciled in the state.[73] The form the RRG used for rejection of uninsured motorist coverage was valid in its state of domicile but insufficient under applicable Louisiana law.[74] In ruling that no valid waiver occurred through use of the form, the court relied on § 3905(a) of the LRRA, which subjects RRGs to "'the policy form or coverage requirements of any State motor vehicle no-fault or motor vehicle financial responsibility [insurance] law.'"[75] The court rejected the RRG's argument that the term "financial responsibility law" as used in § 3905(a) applied only to portions of Louisiana law requiring mandatory insurance, not to separate sections of the state's code involving uninsured motorist coverage.[76] In reaching its decision, the court quoted the U.S. Supreme Court decision of *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Co*.[77] as follows:

67. KY. REV. STAT. ANN. § 417.050 (LexisNexis 2005 & Supp. 2011).
68. *See King*, 291 F. Supp. 2d at 531.
69. *See id.*
70. 15 U.S.C. § 3902(a)(1) (2006); s*ee generally King*, 291 F. Supp. 2d 518.
71. *See King*, 291 F. Supp. 2d at 531 (holding the warranty clause unenforceable).
72. Shear v. Champagne, 22 So. 3d 942 (La. Ct. App. 2009).
73. *See id.* at 943–44.
74. *See id.* at 948.
75. *See id.* at 946–47 (quoting 15 U.S.C. § 3905(a)).
76. *See id.*
77. N.Y. State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645 (1995).

> [D]espite the variety of these opportunities for federal preeminence, we have never assumed lightly that Congress has derogated state regulation, but instead have addressed claims of pre-emption with the starting presumption that Congress does not intend to supplant state law. . . . [I]n cases . . . where federal law is said to bar state action in fields of traditional state regulation, we have worked on the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.[78]

The *Shear* court recognized the insurance area is one in which the "historic police powers of the States" have acted "most vigilantly" to protect competing state interests.[79]

Another recent case addressing preemption issues under the LRRA is *OneBeacon Insurance Co. v. ProBuilders Specialty Insurance Co*., which involved allegations that the defending RRG wrongfully failed to participate in the defense of a lawsuit.[80] ProBuilders took the position that policies issued by RRGs should be treated differently from policies issued by other insurers, and that such policies constituted "'insurance like product[s],' rather than simply insurance."[81] The court stated, however, that while the LRRA exempts risk retention groups from discriminatory state laws, RRGs are not exempt from "[s]tate laws generally applicable to persons or corporations."[82] The court further determined that the policies issued by ProBuilders were insurance, "not 'insurance like products,'" and state law governing the construction of insurance policies was fully applicable to them.[83]

Preemption issues in regard to the LRRA are not limited to licensing disputes. For example, the court in *National Home Insurance Co. v. State Corp. Commission* recognized that under the LRRA, a nondomiciliary state may take different restrictive measures than a domiciliary state in regard to a financially troubled RRG.[84] In that case, because of concerns with the RRG's financial condition, Colorado, the state of domicile,

78. *Shear*, 22 So. 3d at 944 (quoting *Travelers Ins. Co.*, 514 U.S. at 654–55).
79. *See id.*
80. *See* OneBeacon Ins. Co. v. ProBuilders Specialty Ins. Co., No. 3:09-CV-36-ECR-RAM, 2009 WL 2407705, at *3 (D. Nev. Aug. 3, 2009).
81. *See id.* at *5 (alteration in original) (citation omitted).
82. *See id.* (quoting 15 U.S.C. § 3902(a)(4)).
83. *See id.* (quoting 15 U.S.C. § 3901(a)(1)).
84. *See* Nat'l Home Ins. Co. v. State Corp. Comm'n, 838 F. Supp. 1104, 1112–13 (E.D. Va. 1993).

imposed limited restrictions and began monitoring the RRG's business activities.[85] The state of Virginia, however, through the Virginia State Corporation Commission, went further, partially enjoining the RRG's operations in Virginia until it "met Colorado's minimum surplus requirements."[86] Upholding Virginia's right to take more restrictive action than the Colorado regulators, the court stated that "Congress properly recognized that states might reasonably differ on the appropriate course of action to follow to protect their citizens when a financially troubled risk retention group seeks to continue doing business in a state."[87] The court, however, abstained and left to the Virginia Supreme Court issues involving whether the Virginia State Corporation Commission properly issued the orders while acting in a judicial capacity as a court of competent jurisdiction under the LRRA.[88]

C. *Federal Appellate Authority Broadly Construing the Preemptive Provisions of the Act*

National Warranty Insurance Co. RRG v. Greenfield[89] is likely the lead case regarding strict enforcement of the preemptive effect of the LRRA. In *Greenfield*, the Ninth Circuit analyzed an Oregon statute that prohibited RRGs from selling reimbursement insurance policies to automobile dealers to cover their liability on motor vehicle service contracts.[90] The court recognized that the heart of the appeal involved the meaning of the exception in § 3905(d) of the LRRA—allowing a state, as part of a financial responsibility law, to exclude coverage obtained from an RRG.[91] Specifically, the state law at issue involved a requirement that automobile dealers wishing to sell motor vehicle service contracts establish financial responsibility, either by proving a net worth of at least $100 million or the existence of a reimbursement policy issued by an "authorized insurer."[92] A requirement to qualify as an "authorized insurer" was

85. *See id.* at 1107–08.

86. *See id.* at 1109 (footnote omitted).

87. *See id.* at 1113.

88. *See id.* at 1120. Under the LRRA, "states may require [an RRG] to comply with an injunction issued by a 'federal or [s]tate court of competent jurisdiction' where the injunction is based upon a petition by the state insurance commissioner alleging that the group is 'in hazardous financial condition or is financially impaired.'" *Id.* at 1114 (quoting 15 U.S.C. § 3902(a)(1)(H) (1993)).

89. Nat'l Warranty Ins. Co. v. Greenfield, 214 F.3d 1073 (9th Cir. 2000).

90. *See id.* at 1074.

91. *See id.* at 1075.

92. *See id.* at 1076 (citing OR. REV. STAT. § 646.267(5)).

membership in the state's guaranty association, a status foreclosed to RRGs.[93] The court found that although the Oregon statute did not mention RRGs by name, it effectively acted as a "categorical exclusion" of all RRGs.[94]

In addressing preemption, the court considered whether § 3905(d) authorizes the exclusion of all RRGs in general, or whether the section only authorizes exclusion of specific RRGs unable to satisfy financial responsibility requirements.[95] Although acknowledging that the text of the LRRA was not "fully determinative," the Ninth Circuit held that states may exclude only specific RRGs failing to meet financial responsibility requirements, not RRGs as a group.[96] A focus of the court in reaching its decision was Congress's "use of the singular word 'group,' rather than the plural risk retention 'groups,'" in § 3905(d).[97] The court believed that if Congress intended to authorize states to exclude all RRGs, the plural form would have been used.[98]

Another factor influencing the court was that § 3905(d) allowed the exclusion of entities other than RRGs based on financial considerations.[99] Specifically, the section references exclusion of "an admitted insurance company, an excess lines company, a risk retention group, or any other source."[100] In the Ninth Circuit's opinion, because admitted insurance companies are authorized to provide insurance coverage within a state, the reference to admitted insurance companies likely contemplated the exclusion of only particular companies that failed to meet standards, not all admitted insurers.[101] The court believed that because RRGs were mentioned in the same clause, comparable reasoning applied, meaning Congress granted the states the power to exclude only particular RRGs.[102]

The Ninth Circuit disagreed with the conclusion of the Eleventh Circuit in *Mears Transportation Group v. Florida*, which held that

93. *See id.* (citing OR. REV. STAT. §§ 731.354, 731.066(1), 734.550).
94. *See id.*
95. *See id.* at 1078.
96. *See id.*
97. *See id.* (citing 15 U.S.C. § 3905(d)) (allowing states to exclude coverage to a "risk retention group" based on financial responsibility concerns).
98. *See id.*
99. *See id.* at 1078–79.
100. 15 U.S.C. § 3905(d).
101. *See Greenfield*, 214 F.3d at 1078–79.
102. *See id.*

interpreting § 3905(d) to reference only individual RRGs rendered superfluous other sections of the LRRA aimed at preserving state authority to exclude financially impaired RRGs.[103] The *National Warranty* court discussed § 3902(e), which provides federal and state courts the authority to enjoin solicitation or sale of insurance by a financially impaired RRG, and § 3906, which authorizes the U.S. district courts to issue orders enjoining an RRG from operating in a state if it is found to be in hazardous financial condition.[104] According to the Ninth Circuit, the conclusion that § 3905(d) references particular RRGs, not all RRGs, helped give those sections meaning and did not render them superfluous.[105] As construed by the court in *National Warranty*, § 3905(d) may result in the exclusion of some, but not all, RRGs; at that point, §§ 3902(e) and 3906 allow federal and state courts to issue injunctions implementing the determination that a particular RRG is "financially impaired" or in a "hazardous financial condition."[106]

The court also examined the provision in § 3905(d), which allows the exclusion of an RRG "[s]ubject to the provisions of section 3902(a)(4) . . . relating to discrimination."[107] Under § 3902(a)(4), an RRG is exempt from any state law or regulation that would "otherwise[] discriminate" against an RRG.[108] The *National Warranty* court addressed whether the term "discriminate" prohibited only intended action targeting RRGs or whether it encompassed legislation with an unintended disparate impact.[109] Although acknowledging the meaning of the term "discrimination" is "varied and unsettled,"[110] and conceding the availability of little guidance, the court determined the provision included legislation with a disparate impact as well as legislation evidencing intentional discrimination.[111]

The Ninth Circuit recognized that ruling the LRRA prohibited Oregon from excluding all RRGs was a "close case" and was in

103. *See id.* (citing Ophthalmic Mut. Ins. Co. v. Musser, 143 F.3d 1062, 1070 (7th Cir. 1998); Mears Transp. Grp. v. Florida, 34 F.3d 1013, 1019 (11th Cir. 1994)).
104. *See Greenfield*, 214 F.3d at 1078–79; *see also* 15 U.S.C. §§ 3902(e), 3906 (2006).
105. *See Greenfield*, 214 F.3d at 1078–79.
106. *See id.* at 1079; *see also* 15 U.S.C. §§ 3902(e), 3906.
107. *See Greenfield*, 214 F.3d at 1079 (quoting 15 U.S.C. § 3905(d)).
108. *See* 15 U.S.C. § 3902(a)(4).
109. *See Greenfield*, 214 F.3d at 1081.
110. *See id.* at 1080.
111. *See id.* at 1081.

disagreement with the Seventh and Eleventh Circuits.[112] The court, however, believed its interpretation represented the most "natural reading" of the Act and "best accord[ed]with the policy of the LRRA in striking a balance between the desire to permit RRGs to operate freely and the legitimate need of states to regulate RRGs."[113]

D. *Additional Case Authority Supporting the Preemptive Provisions of the Act*

In *Charter Risk Retention Group Insurance Co. v. Rolka*, an RRG sought a declaratory judgment that the defendants violated the LRRA by enforcing sections of Pennsylvania law that required private carriers to obtain insurance only from insurers "authorized to do business within the Commonwealth," a requirement that excluded RRGs.[114] In refusing to grant the state's motion to dismiss, the court recognized that enforcing the state law against entities other than RRGs did not preclude a finding of illegal discrimination against RRGs.[115] The court disagreed with the defendants' contention that the plaintiff was required to prove purposeful discrimination in order to prevail.[116] The court stated prohibited discrimination can "be established simply on the ground that plaintiff's members are required to show cause why they should not be required to have acceptable insurance, which is not a burden placed on carriers who use licensed insurers and which may cause such members to seek insurance elsewhere."[117] In the court's opinion, § 3905(d) of the Act, which allows states to demand a showing of financial responsibility, means that a particular RRG failing to meet conditions may be excluded from doing business in a state, not that all RRGs may be excluded as a group.[118]

In *Attorneys' Liability Assurance Society, Inc. v. Fitzgerald*, the plaintiff RRGs prevailed in their challenge against a regulatory fee of one-half percent imposed by the State of Michigan on RRGs for direct business risks located within the state.[119] Finding the fee preempted, the court

112. *See id.* at 1082 (citing Ophthalmic Mut. Ins. Co. v. Musser, 143 F.3d 1062 (7th Cir. 1998); Mears Transp. Grp. v. Florida, 34 F.3d 1013 (11th Cir. 1994)).

113. *See id.*

114. *See* Charter Risk Retention Grp. Ins. Co. v. Rolka, 796 F. Supp. 154, 155–56 (M.D. Pa. 1992) (citing 52 PA. CODE § 32.11 (year)).

115. *See id.* at 159.

116. *Id.* at 159 n.8.

117. *See id.*

118. *See id.* at 158 n.6.

119. *See* Attorneys' Liab. Assurance Soc'y, Inc. v. Fitzgerald, 174 F. Supp. 2d

stated, "The fee's very purpose is to facilitate regulation of non-resident risk retention groups, which, with a few minor exceptions, non-chartering states are foreclosed from doing under the LRRA."[120] The court recognized that while allowable monitoring by the state would have a *de minimis* cost, that cost was insufficient to justify a fee above that paid by all insurers, including RRGs.[121] According to the court, "The LRRA's purpose would be thwarted if every state could exact a regulatory fee [that] large from non-resident risk retention groups, since that fee collectively affects prices for coverage, and thus affects the ability to operate."[122]

Similarly, in *National Risk Retention Ass'n v. Brown*, the plaintiffs prevailed in a challenge to a Louisiana state law that mandated nondomiciliary RRGs to maintain certain amounts in capital and surplus and to post either funds or a bond with the state's commissioner of insurance.[123] The state argued that § 3905(d) of the LRRA, subjecting RRGs to state financial responsibility requirements, saved the law from preemption.[124] The court, however, disagreed and stated that "it is clear that [Section 3905(d)] does not apply to groups wishing to act as risk retention groups"; instead it "applies to specified activities for which a state can and does demand a showing of financial responsibility."[125] As an example of such "specified activities," the court cited the state's requirement that underground storage tank owners demonstrate financial responsibility before obtaining a license and noted that "Section 3905(d) is properly applied in that situation to limit the reach of the LRRA."[126] According to the court, "To allow a state to require a risk-retention group which has been chartered in another state to comply with a second state's financial responsibility requirements before it can do business in the second state would frustrate the goals of the federal Act and would allow the second state to avoid the federal exemption from state regulation carefully set out in § 3902(a)(1)."[127]

The court in *Brown* found other state requirements were also

619, 634–35 (W.D. Mich. 2001).

120. *See id.* at 636.

121. *See id.*

122. *See id.*

123. *See* Nat'l Risk Retention Ass'n v. Brown, 927 F. Supp. 195, 199–200 (M.D. La. 1996).

124. *See id.* at 200.

125. *See id.*

126. *See id.*

127. *See id.*

preempted by the LRRA, including a state mandate that RRGs annually file a plan of operation along with an examination fee.[128] According to the court, § 3902(d)(2) of the LRRA requires only that RRGs submit plans of operation at licensure or upon revision, thereby foreclosing a requirement of annual filing.[129] Likewise, the court found the application process imposed on RRGs was broader than that allowed by § 3902(d) of the LRRA, which specifies the documents that may be required by a nondomiciliary state during the application process.[130]

E. *Additional Federal Appellate Authority Addressing Preemption*

In *Preferred Physicians Mutual Risk Retention Group v. Pataki*, the Second Circuit addressed a challenge to a New York state law that provided a free layer of excess insurance protection to physicians and dentists meeting certain qualifications including the maintenance of primary malpractice coverage through a New York licensed insurer—a practice eliminating out-of-state RRGs from participation.[131] In support of its preemption argument, the plaintiff RRG relied on both § 3902(a)(1) of the LRRA, which exempts RRGs from state laws regulating the operation of RRGs either directly or indirectly, and § 3902(a)(4) of the LRRA, which prohibits discrimination against RRGs.[132]

On the issue of alleged illegal regulation under § 3902(a)(1), the RRG claimed the economic impact of the state subsidy on its ability to compete amounted to forbidden indirect regulation.[133] Although recognizing the "expansive" nature of the LRRA's preemptive language,[134] the court found the record insufficient to establish the economic impact of the state subsidy, noting "[t]he mere existence of a competitive advantage to regulated insurers conferred by a New York State statute does not necessarily amount to indirect regulation."[135] For example, the court found a lack of proof as to whether the compulsive impact of the subsidy for physicians was counterbalanced by competitive advantages possessed by

128. *See id.*
129. *See id.*
130. *See id.* at 201.
131. *See* Preferred Physicians Mut. Risk Retention Grp. v. Pataki, 85 F.3d 913, 914–15 (2d Cir. 1996).
132. *See id.* at 915.
133. *See id.* at 916.
134. *See id.* at 915.
135. *See id.* at 917.

RRGs due to their exemption from most state insurance regulations.[136] The court also found the record unclear as to the value of the subsidy to New York insurers.[137]

In support of the RRGs theory, however, the court stated that if the state law "effectively foreclose[d] RRGs from competing in a substantial submarket of New York's physicians, that might constitute indirect regulation of RRGs."[138] Furthermore, if the subsidy caused even a portion of physicians, such as those in a high-risk specialty, to prefer state-licensed insurers over RRGs, that might "still constitute indirect regulation of a sub-market within the medical malpractice insurance industry."[139]

As to the claim under § 3902(a)(4), the court recognized that proof the statute was enacted with discriminatory intent against RRGs would suffice to establish a claim of discrimination under the LRRA.[140] The court noted, however, that discrimination could not be proven merely by a showing that RRGs, among others, were injured by the state law.[141] The court declined to address whether a finding of disparate impact—harm disproportionately suffered by a class regardless of intent—would suffice to establish illegal discrimination under the LRRA.[142] Even assuming the applicability of a disparate impact theory, the court recognized the necessity of proof that the state law disparately affected RRGs rather than a wide group of unlicensed insurers.[143] After acknowledging significant preemptive provisions of the LRRA and making statements supportive of state rights, the Second Circuit found that the record failed to support a grant of summary judgment to either party and remanded the case for further consideration.[144]

On the issue of the level of intent needed to establish discrimination, the better view appears to be that a finding of disparate impact suffices. As set forth above, for example, the Ninth Circuit in *National Warranty Insurance Co. v. Greenfield* broadly construed the preemptive terms of the LRRA and determined that a showing of disparate impact is sufficient to

136. *See id.* at 916.
137. *See id.*
138. *See id.* at 917.
139. *See id.* at 917 n.9.
140. *See id.* at 918.
141. *See id.*
142. *See id.*
143. *See id.* at 919.
144. *See id.*

support a finding of discrimination under the LRRA.[145]

IV. LEGISLATIVE HISTORY

Issues involving preemption in regard to the LRRA are somewhat unusual in that they consider whether federal law operates to require one state's law to control over another, not whether federal law preempts state law.[146] Regardless of that fact, however, decisions regarding preemption in relation to the Act hinge on congressional intent in enacting the LRRA.[147] The ordinary meaning of statutory language may establish preemption, or Congress's mandate of preemption may be implicitly contained in the structure and purpose of a statutory enactment.[148] As referenced above, in considering preemption in relation to the LRRA, historic police powers of the states in areas such as insurance are not generally considered superseded absent a clear expression of the intent to do so on the part of Congress.[149] As illustrated by the conflicting caselaw, it is apparent that the explicit language of the Act fails to clearly define the limits of intended preemption in relation to the Act.[150] Additionally, legislative history is inconclusive as to the extent of mandated preemption.

In support of the preemptive aspects of the Act, the Second Circuit—referencing H.R. 99-865 in *Pataki*—recognized "the legislative history of the Act makes clear that Congress intended to exempt RRGs broadly from state law 'requirements that make it difficult for risk retention groups to form or to operate on a multi-state basis.'"[151] Along similar lines, the court in *Musser* quoted provisions of the 1986 House Report, indicating that financial responsibility laws were not intended to be used to shut out RRGs:

145. *See* Nat'l Warranty Ins. Co. v. Greenfield, 214 F.3d 1073, 1081 (9th Cir. 2000).

146. *See* Shear v. Champagne, 22 So. 3d 942, 944 (La. Ct. App. 2009) (discussing issues involving preemption in relation to the LRRA).

147. *See* Ophthalmic Mut. Ins. Co. v. Musser, 143 F.3d 1062, 1066 (7th Cir. 1998) (citing DeHart v. Town of Austin, 39 F.3d 718, 722 (7th Cir. 1994)).

148. *See Greenfield*, 214 F.3d at 1076 (quoting FMC Corp. v. Holliday, 498 U.S. 52, 56–57 (1990)); *Musser*, 143 F.3d at 1066 (citing Time Warner Cable v. Doyle, 66 F.3d 867, 875 (7th Cir. 1995)).

149. *See Shear*, 22 So. 3d at 944.

150. *See supra* Part III (analyzing the caselaw interpretations of the LRRA).

151. *See* Preferred Physicians Mut. Risk Retention Grp. v. Pataki, 85 F.3d 913, 915–16 (2d Cir. 1996) (quoting H.R. REP. NO. 99-865, at 8 (1986), *reprinted in* 1986 U.S.C.C.A.N. 5303, 5305).

> Some concern has been expressed to the Committee that the authority of States to apply financial responsibility requirements recognized under this Subsection might be misused by a State hostile to risk retention groups. It is suggested that such a State might impose discriminatory requirements, excluding risk retention groups to thwart their operation. Such use of State authority would be contrary to the intent of the Act.[152]

The 1986 House Report further recognized the need for preemption as follows:

> [I]t should be noted that the particular form of this legislation is required because of certain aspects of State law. Some states have created capital and other requirements that make it difficult for risk retention groups to form or to operate on a multi-state basis. Many states prevent insurance purchasing groups from achieving the advantages in rates and terms derived from the economic efficiency of collective purchasing that could contribute to resolving affordability and availability problems or they prohibit purchasing groups altogether. It is necessary to exempt risk retention and purchasing groups from State law, in the respects specified in the Risk Retention Act, in order to achieve the beneficial effects of such groups referred to above.[153]

On the other hand, persuasive legislative history supports the position that under the 1986 LRRA amendments, nonchartering states obtained significant authority over RRGs.[154] For example, in referencing the 1986 amendments, the court in *Musser* noted that "legislative history from the day the Senate passed the LRRA reveal[ed] that Congress specifically intended to preserve for states the right to exclude non-domestic RRGs on the basis of financial responsibility."[155] In support, the court quoted the following statement made by Senator Slade Gorton during debate:

> I am particularly pleased, Mr. President, that language contained in the House bill recognizing the right of a State to require proof of financial responsibility before the undertaking of certain activities and to prescribe the manner for meeting that requirement, is retained in this amendment. As I stated on the floor at the time of the passage of the

152. *See Musser*, 143 F.3d at 1069 (quoting H.R. REP. NO. 99-865, at 19).

153. *See* H.R. REP. NO. 99-865, at 8–9.

154. *See, e.g.*, *Musser*, 143 F.3d at 1068 (quoting 132 CONG. REC. S15,446-01 (daily ed. Oct. 6, 1968) (statement of Sen. Slade Gorton)).

155. *See id.*

> Senate bill, requirements of financial responsibility are usually the result of a State's concern about third parties who might be injured by the insured's activities. In the State of Washington, for instance, many activities require prior proof of insurance by a carrier admitted to do business in the State. Such laws would continue to be valid notwithstanding the fact that they might preclude participation in an out-of-State risk retention group for the purpose of meeting the requirement.[156]

Additionally, during Senate debates on the 1986 amendments, in response to the following question regarding state rights, Senator Gorton received a favorable response from Senator Robert Kaster of Wisconsin, a primary sponsor of the bill who also sponsored the 1981 Act:

> Mr. GORTON. One of my principal concerns about this bill surrounds the significance of participation in a risk retention group for certain State regulatory purposes. For instance, many State regulatory schemes require proof of insurance or financial responsibility before an individual can undertake a hazardous activity such as applying pesticides to the land of another. These requirements are intended primarily for the protection of third parties who may be injured by the activity. My question to my colleague is whether a State must accept participation in a risk retention group as proof of insurance for the purposes of these other regulatory statutes?
>
> Mr. KASTEN. A State would not be required to accept a risk retention group policy as proof of insurance or financial responsibility under any State statute that requires that such coverage can only be provided by an insurer admitted in the State or by a surplus line carrier eligible to offer coverage in the State. If, however, the statute contemplates that such a requirement can be met through coverage by an insurer licensed or eligible in any State, participation in a risk retention group would meet that requirement.[157]

The House Report associated with the 1986 amendments further noted the legislation "augments the authority of non-chartering states to regulate solvency, trade practices and other matters."[158] According to the Report, provisions of the bill ensured RRGs and purchasing groups were

156. *See id.* (quoting 132 CONG. REC. S15,446-01 (daily ed. Oct. 6, 1986) (statement of Sen. Slade Gorton)).

157. *See* 132 CONG. REC. 16,778 (1986).

158. *See* H.R. REP. NO. 99-865 (1986), *reprinted in* 1986 U.S.C.C.A.N. 5303, 5304.

appropriately supervised by regulatory authorities.[159]

The following statement from Representative John D. Dingell, contained in the House Report, further highlights that the 1986 amendments increased the powers of nonchartering states in relation to RRGs:

> Compared to existing law, this bill augments the authority of states in which a risk retention group is not chartered by giving all states more regulatory authority over risk retention groups. H.R. 5225 makes clear that U.S. district courts have the authority to issue nationwide injunctions preventing a risk retention group from operating, if they find that the group is in hazardous financial condition.[160]

The House Report addressed the right of states to specify acceptable means of demonstrating financial responsibility as follows:

> Subsection (c) of the 1986 Amendments also adds in new Subsection 6(d) to the Act providing that subject to the provisions of the Act preventing discrimination against a purchasing group, the Act does not preempt a State's authority to specify acceptable means of demonstrating financial responsibility where the State has required such demonstration as a condition for a license or permit to undertake specified activities. The State may include or exclude insurance coverage obtained from an admitted insurance company, an excess lines company, a risk retention group, or any other source.[161]

The House Report described the balancing attempted by the 1986 amendments by stating, "The Committee intends for the framework established under the bill to strike a balance between the risk retention groups' need to free of unjustified requirements and the public's need for protection from insolvencies."[162] An apparent problem illustrated by over two decades of controversy, however, is that the line between RRGs freedom from unjustified requirements and the public's need for protection is difficult, and likely impossible, to ascertain.

V. THE CONTINUING CONTROVERSY REGARDING RRGS

Not surprisingly, controversy continues to surround the issue of

159. *See id.*
160. *See id.* at 5307.
161. *See id.* at 5316.
162. *See id.* at 5309.

RRGs at the state and federal level. There are ongoing efforts at the federal level to allow RRGs to enter the commercial property insurance market.[163] Additionally, the GAO recently issued a report suggesting the Congress consider clarifying LRRA provisions in dispute.[164] Meanwhile, the states of New Jersey and Nevada are presently embroiled in controversy regarding state rights in relation to RRGs.[165] Awareness of recent proposals and positions taken by industry groups is of importance to states, insurers, and other interested parties and is discussed further below.

A. *Recent Legislative Proposals*

The Risk Retention Modernization Act of 2010 proposed that the sphere of RRGs be extended to commercial property insurance.[166] Amendments further directed the Comptroller General to study attempts by nondomiciliary states to unlawfully regulate RRGs and the legal fees or cessation of business costs incurred by RRGs in resistance to such state action.[167] In connection with the study, possible legislative solutions to "reduce or eliminate costs if a particular risk retention group prevails in a State or Federal court of competent jurisdiction" were to be addressed.[168] An obvious concern of states is possible federal legislation on the payment of attorney fees, expenses for lost business, and other costs that prevailing RRGs incur in litigation challenging state regulations.[169] Additionally, while not directly involved with the issue of preemption, the proposed amendments contained provisions that would have changed notification requirements regarding the lack of guaranty fund coverage.[170]

163. *See* H.R. 2126, 112th Cong. (2011); H.R. 4802, 111th Cong. (2010).

164. *See infra* Part V.B.

165. *See infra* Part V.C.

166. *See* H.R. 4802 § 4. The proposed amendments defined "commercial property insurance" as "insurance that indemnifies a business, nonprofit organization, or governmental entity for damage to, theft of, or destruction of real property or business property, owned by or leased to such business, nonprofit organization, or governmental entity, including insurance that indemnifies a business, nonprofit organization, or governmental entity for damage to, theft of, or destruction of furniture, fixtures, and inventory, from any and all perils or causes of loss and against consequential loss or damage, including business interruption, other than noncontractual legal liability for such loss or damage." *See id.*

167. *See id.* § 6.

168. *See id.*

169. *See id.*

170. A perplexing component of the proposed 2010 Act involved the treatment of warnings regarding the unavailability of state guaranty fund coverage. The LRRA, as originally passed and as it currently stands, provides that states have the

While the Risk Retention Modernization Act of 2010 was not enacted into law, legislative efforts in the area continue. For example, the Risk Retention Modernization Act of 2011 was proposed "[t]o modernize the Liability Risk Retention Act of 1986 and expand coverage to include commercial property insurance, and for other purposes."[171] At this time, Congress has neither expanded the role of RRGs nor clarified their rights although ongoing efforts to induce congressional action are expected.

B. *Continued Federal Interest in RRGs*

Further exemplifying continued interest at the federal level is a new study on RRGs issued by the General Accounting Office (GAO) titled Risk Retention Groups—Clarifications Could Facilitate States' Implementation of the Liability Risk Retention Act."[172] In connection with the report, representatives of the GAO met with RRG owners at the Captive Insurance Companies Association's annual convention in March 2011.[173] The following is an account of complaints made at the meeting regarding inappropriate fees allegedly assessed against RRGs:

> More than a half-dozen RRG owners were present, relaying situations where states required payment of extra fees and had them fill out additional forms. Altogether, they said the fees can mount to

discretionary authority to require notice regarding the lack of guaranty fund protection in an RRG-issued insurance policy. *See* 15 U.S.C. § 3902(a)(1)(I) (2006). The 2010 amendments required, as opposed to leaving optional, notice regarding guaranty funds coverage and mandated the following statement: "If your risk retention group fails, it *may* not be protected by a State insurance insolvency guaranty fund." *See* H.R. 4802 (emphasis added). The change in the language to the effect that a failed RRG "may" not be protected by state guaranty funds is perplexing. Granted, the language could be read to mean that states are prohibited from providing such coverage. On the other hand, to a policyholder, the word "may" could reasonably be understood to indicate at least the possibility of guaranty fund protection. The proposed amendments did not change the longstanding aspect of the law that RRGs are prohibited from participating in state guaranty funds. A change in language from a clear statement that guaranty funds "are not available" to language that RRGs "may" not be protected by state guaranty funds is misleading. Admittedly, many insureds do not read or understand the implication of a lack of guaranty fund protection. *See* Minto, *supra* note 28, at 935–36. Nevertheless, it seems reasonable that accurate notification should be provided.

171. *See* H.R. 2126, 112th Cong. (2011).

172. *See* GAO-12-16, *supra* note 25.

173. *See* Caroline McDonald, *Will GAO Report Remedy Ongoing Risk Retention Group Issues?*, PROP. CAS. 360º (Mar. 28, 2011), http://www.propertycasualty360.com/2011/04/11/will-gao-report-remedy-ongoing-risk-retention-grou.

> thousands of dollars and the forms can require multiple hours to complete. Asked if they considered not paying the fees, the owners said they went ahead and paid them rather than risk being barred from operating in a state.[174]

On March 8, 2011, Robert H. Myers, Jr., General Counsel to the NRRA, sent an eighteen-page letter to Gene Dodaro, Comptroller General, U.S. Government Accountability Office, regarding the ongoing GAO study.[175] After noting limited exceptions granted to nondomiciliary states regarding regulatory matters, Myers stated, "Despite the narrow exceptions, non-domiciliary state regulators have repeatedly, and at great cost to RRGs, exceeded their authority to regulate non-domiciliary, or foreign, RRGs."[176] According to Myers, "[t]he most common and clearly egregious non-domiciliary state violation of the LRRA is the imposition of registration requirements for foreign RRGs beyond those delineated in the LRRA"[177] involving, for example, "filing fees, impermissible information requests, and approval requirements on non-domiciliary RRGs."[178] Myers further addressed discrimination against RRGs stating, "Another prevalent and critical issue facing foreign RRGs is discriminatory practices, usually relating to whether or not foreign RRGs are 'authorized insurers.'"[179]

Recognizing and acknowledging the present confusion involving the role of and rights of RRGs, the GAO in its recent 2011 report suggests the need for congressional action as follows:

> To reduce the varying interpretations of LRRA, which have led to uncertainty and disagreements among RRGs and state insurance regulators, and at the same time continue to facilitate the formation and efficient operation of RRGs, Congress should consider clarifying certain LRRA provisions. For example, clarifying whether (1) RRG registration requirements beyond those currently specified in LRRA are permitted in nondomiciliary states and (2) fees in addition to premium and other taxes could be charged to RRGs by nondomiciliary states in which they operate. Congress also should consider providing a

174. *See id.*
175. *See* Myers, *supra* note 10.
176. *See id.* at 6.
177. *See id.* at 7.
178. *See id.*
179. *See id.* at 10.

more specific definition of the types of insurance coverage permitted under LRRA.[180]

C. *Controversy Generated by Recent State Action*

Clearly those interested in the advancement of RRGs are frustrated by continuing efforts of state governments to intrude on RRG rights. For example, recently proposed legislation in New Jersey required taxicab owners to obtain liability insurance only from state-licensed insurers and members of the New Jersey Property-Liability Insurance Guaranty Association.[181] The NRRA, however, reported that Governor Chris Christie in May 2011 refused to sign the bill, stating it "'would eliminate the role of Risk Retention Groups, which provide a form of self insurance[] and currently issue approximately 65 percent of taxicab liability insurance in the State.'"[182] "The Governor added that the proposed bill may have 'the unintended consequence of making it more difficult for taxicab owners to obtain insurance coverage, leading to higher insurance costs ultimately absorbed by consumers.'"[183]

Additionally, litigation arising in Nevada is pending in the Ninth Circuit and involves an RRG—the Alliance of Nonprofits for Insurance (ANI)—against the State of Nevada and other state-affiliated defendants.[184] The Nevada Department of Insurance issued a cease-and-desist order against ANI, preventing the writing of "first dollar coverage"—or minimum financial responsibility limits for vehicle insurance—because ANI, a foreign RRG, lacked a certificate of insurance issued by the state.[185] Nevada required membership in the state's guaranty fund prior to granting permission to write first dollar coverage.[186] The trial

180. *See* GAO-12-16, *supra* note 25, at 44.

181. *See* Letter from Robert H. Myers, Jr., Gen. Counsel, Nat'l Risk Retention Ass'n, to Chris Christie, Governor, State of New Jersey, at 1 (Mar. 25, 2011), *available at* http://www.nrra-usa.org/files/2011NewJersey.pdf.

182. *See* Press Release, Nat'l Risk Retention Ass'n, Legislative/Regulatory Impositions on Risk Retention Groups Rejected in New Jersey and Nevada (May 11, 2011) (quoting New Jersey Governor Christie), *available at* http://www.nrra-usa.org/files/newjerseyandnevada.pdf.

183. *Id.* (quoting New Jersey Governor Christie).

184. *See Alliance of Nonprofits for Ins. v. Brett Barratt*, JUSTIA.COM, http://dockets.justia.com/docket/circuit-courts/ca9/11-16836/ (last visited Nov. 27, 2011).

185. *See* Alliance of Nonprofits for Ins., Risk Retention Grp. v. Barratt, No. 2:10-CV-01749, 2011 WL 1466624, at *1 (D. Nev. Apr. 18, 2011).

186. *See id.*; *see also* Patricia-Anne Tom, *Risk Retention Group Seeks Court Order in Nevada Auto Liability Case*, INS. J. (Mar. 18, 2011),

court judge issued a summary judgment ruling in favor of ANI,[187] which has been appealed to the Ninth Circuit.[188]

Clearly, the defendants are faced with distinguishing *National Warranty Insurance Co. v. Greenfield*, the Ninth Circuit decision that overturned an Oregon statute requiring membership in the state's guaranty association[189]—a status denied to RRGs—in order to insure motor vehicle service contracts. The defendants in *Alliance of Nonprofits for Insurance Risk Retention Group v. Barratt* contended at the trial court level that *National Warranty* is "materially distinguishable" based on the facts involved.[190] According to the defendants, RRGs are not entirely foreclosed from writing first dollar coverage because domestic RRGs in Nevada, as opposed to foreign RRGs, may obtain a certificate of authority and issue first dollar coverage.[191] Additionally, the defendants pointed to the fact that ANI failed to explore other avenues for its Nevada members, including applying for a certificate of self-insurance.[192] Defendants further stated that "[s]uch a self-insurance certificate would have covered the minimum automobile liability coverage, leaving [the RRG] free to write the excess liability policies."[193]

The defense in *Barratt* further relied on the fact that the statute at issue involves motor vehicle insurance coverage; § 3905(a) of the LRRA provides that the Act should not be construed "'to exempt a risk retention group . . . from the policy form or coverage requirements of any State motor vehicle no-fault or motor vehicle financial responsibility insurance law.'"[194] The defense claimed that unlike § 3905(d), which makes state rights regarding the regulation of financial responsibility in general subject to provisions of § 3902(a)(4) relating to discrimination, § 3905(a)

http://www.insurancejournal.com/news/west/2011/03/18/190552.htm (explaining the rationale behind Nevada's RRG requirements).

187. *See* Order Granting Plaintiff's Motion for Summary Judgment, Alliance of Nonprofits for Ins., Risk Retention Grp. V. Barratt, No. 2:10-CV-01749-JCM-RJJ (D. Nev. July 22, 2011).

188. *See Alliance of Nonprofits*, *supra* note 184.

189. *See* Nat'l Warranty Ins. Co. v. Greenfield, 214 F.3d 1073, 1074–75 (9th Cir. 2000).

190. *See* Defendants' Opposition to Plaintiff's Motion for Summary Judgment at 13–14, Alliance of Nonprofits for Ins., Risk Retention Grp. v. Barratt, No. 2:10-CV-01749-JCM-RJJ (D. Nev. Feb. 17, 2011).

191. *See id.* at 16.

192. *See id.*

193. *See id.*

194. *See id.* at 18 (quoting 15 U.S.C. § 3905(a)).

"expressly and unconditionally exempts 'all policy form and coverage requirements' of any state motor vehicle financial responsibility insurance law from LRRA preemption."[195] The district court order granting ANI's summary judgment motion was two pages in length and did not closely analyze the issues involved.[196]

Obviously, this case involves a number of hotly contested issues. Robert H. Myers and Cindy Chang recognize this in their article, *RRG Attorneys: Nevada Ignoring Federal Law: Nevada Is Inviting Congress to Take Action*.[197] One might also add that caselaw on the issue invites the U.S. Supreme Court to take action.[198]

VI. CONCLUSION

The broad philosophical question surrounding RRGs involves availability versus reliability. Those who support lax regulation pose this question: "'What happens to a community when a business, a school, or a doctor cannot find or afford insurance?'"[199] On the other hand, those who oppose RRGs and favor strict regulation pose this question: "'What happens to a community if the insurer from which this business, school, or doctor purchases insurance ends up bankrupt or if the policy does not cover what needs to be covered?'"[200]

The position that states may effectively foreclose the operation of RRGs by requiring that authorized insurers to be members of state guaranty funds seems to negate congressional intent authorizing the operation of RRGs and to violate the preemptive provisions of the LRRA.[201] On the other hand, the Act specifically grants states certain

195. *See id.* at 18–19 (quoting 15 U.S.C. § 3905(a)).

196. *See generally* Order Granting Plaintiff's Motion for Summary Judgment, No. 2:10-CV-01749-JCM-RJJ (D. Nev. July 22, 2011).

197. *See* Robert H. Myers, Jr. & Cindy Chang, *RRG Attorneys: Nevada Ignoring Federal Law*, PROP. CAS. 360º (Mar. 15, 2011), http://www.propertycasualty360.com/2011/03/15/rrg-attorneys-nevada-ignoring-federal-law (stating "the RRG industry awaits a decision that may reverberate nationwide").

198. *See supra* Part III (discussing the conflicting caselaw on the national scale).

199. *See* WEBEL, *supra* note 4, at 9.

200. *See id.*

201. *See, e.g.*, Order Granting Plaintiff's Motion for Summary Judgment, Alliance of Nonprofits for Ins., Risk Retention Grp. v. Barratt, *supra* note 187 (granting summary judgment because the various Nevada statutes were in conflict with and preempted by the LRRA); *cf.* Nat'l Warranty Ins. Co. v. Greenfield, 214 F.3d 1073,

rights that ensure the financial stability of RRGs.[202] Based upon the decades of conflict surrounding such provisions, it is apparent the limits of federal preemption in regard to the LRRA are unclear, and that issues involving the struggle between availability and reliability remain to be decided either by further legislation or by action of the U.S. Supreme Court.

For reasons including the lack of guaranty fund protection for RRGs, it is not surprising that state regulators express concern regarding their financial stability. One option for states may be to require proof of the availability of funds sufficient to cover risks if an RRG became insolvent. This could be done through, for example, reserves or letters of credit. In order to set reasonable requirements, actuarial studies would be needed. Requirements tailored to individual RRGs would help avoid claims of discrimination against RRGs as a group. An option to offset the costs of the state government could be to require that studies are performed by actuaries of the state's choosing but at the expense of RRGs. Such steps would likely have the effect of dissuading financially insecure RRGs from attempting to write insurance in states imposing such requirements. Notably, according to a Hawaii regulator, tougher regulations requiring RRGs to annually provide acceptable proof that they were financially capable of meeting consumer claims dissuaded financially unsecure providers from domiciling in Hawaii.[203] Of course, it is likely that the primary concern of most states regarding RRGs is activity on the part of foreign RRGs, not the issue of domicile. Nevertheless, stricter requirements, supported by actuarial reports, would likely discourage the activity of financially unstable RRGs.

Uniform federal regulation of RRGs is another alternative that would likely be attractive to most state regulators. In fact, as recognized by the GAO, "it is difficult to understand why all RRGs and their regulators, irrespective of where they are domiciled, should not conform to a core set of regulatory requirements."[204] Federal legislation regulating RRGs would eliminate or at least reduce any "race to the bottom" resulting from states lowering regulatory requirements in order to encourage the domicile of

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1074–75 (9th Cir. 2000) (holding Oregon's "authorized insurer" requirement prohibited RRGs from selling reimbursement insurance policies to automobile dealers and was therefore preempted by LRRA).

202. *See, e.g.*, WEBEL, *supra* note 4, at 9.

203. RISK RETENTION GROUPS, *supra* note 3, at 45.

204. *Id.* at 66.

RRGs.[205] Additionally, federal enforcement of appropriate reserve requirements would assist in calming the potential fears of state regulators regarding dangers to state policyholders and claimants in the event of an RRG's insolvency.[206]

In conclusion, the decades-old controversy regarding state rights with respect to the LRRA is likely to continue absent action on the part of Congress or the U.S. Supreme Court. There is no end in sight to the conflict between the preemptive effect of the LRRA and actions on the part of state regulators who challenge the breadth of the Act's preemptive provisions. This constant conflict is a problem for regulators as well as RRGs.[207] Accordingly, guidance in the form of congressional amendments to the LRRA or judicial construction of existing law by the Supreme Court seems desirable.

205. *See supra* note 24 and accompanying text.

206. *See* WEBEL, *supra* note 4, at 9 (noting the potential concern over insolvent insurers).

207. In recent correspondence to the Comptroller General, Robert H. Myers Jr., on behalf of the NRRA, stated, "Due to high monetary and business costs associated with legal actions and appeals, many RRGs are forced to comply with requests and requirements that violate the LRRA." Myers, *supra* note 10, at 16.