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Washington's Definition Of Improper Rebates May Shift

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On Oct. 26, 2017, Washington Administrative Law Judge ("ALJ") Lisa N.W. Dublin wrote the latest chapter in the ongoing legal feud between the state's insurance commission and California-based insurance broker Zenefits, ruling that while the insurance commission's previous consent order and legal determination were erroneous, Zenefits was still in violation of Washington's anti-rebate statute because it offered its clients "full HR integration." We provide a recap of how we got here, the ALJ's order and what the order means for insurance brokers.

How We Got Here: Zenefits' Business Model, Anti-Rebate Statutes, and the Washington Consent Order

From 2013 to 2015, Zenefits' meteoric rise took the insurance world by storm, with the company reaching a valuation of $4.5 billionwithin two short years. Zenefits' business model: offer to small businesses free software-as-a-service (SaaS) for human resources functions, like onboarding, payroll, benefits and vacation tracking, and make money on broker fees when users of the software choose to buy insurance from it.

But there was at least one hiccup. Most states prohibit insurance brokers from offering to pay to an insured — as an "inducement" to purchase insurance — any "rebate" or "any other valuable consideration" not expressly provided for in the insurance policy. That means that if you are a an insurance broker and want to give a new customer, for example, sports tickets as a welcome-aboard gift, it would be wise to look at your state's anti-rebate laws before doing so. Among brokers and others who follow the insurance industry, the question arose: Does the provision of free software to the general public constitute an inducement under state anti-inducement laws — even when access to the software is not conditioned on purchasing insurance?

The majority of states that sounded off on the topic — for example, Montana, North Carolina, Arizona, Maryland — found that the practice does not amount to an improper rebate. The rationale for such an approach was straightforward. As explained by the Louisiana Insurance Commissioner, "Where the thing of value is available to the general public, the recipient of the thing of value has received no special favor or advantage through the contract of insurance."

The Office of the Insurance Commissioner for the State of Washington (the "OIC"), however, reached a different conclusion.

On Nov. 21, 2016, the OIC and Zenefits entered into a consent order, with the OIC finding that Washington law prohibited Zenefits from "offering valuable software functions or other valuable benefits for free or at less than fair market value to the public." As a result, Zenefits was in the odd position of being required to charge its customers for a product — its software platform — that it previously gave away for free. Subsequently, Zenefits challenged the consent order before an ALJ and, on Oct. 26, 2017, the ALJ issued her order.

The ALJ's Order: The OIC Was Wrong, But Zenefits' Business Model Would Violate the Anti-Rebate Statute Anyway

The ALJ reviewing the OIC's consent order came to two key conclusions.

First, she disagreed with the OIC, stating that, "Contrary to the Consent Order entered into by the parties in November 2016 ... [Washington law does] not prohibit Zenefits ... from offering valuable software functions or other valuable benefits free or at less than fair market value to the public."

The OIC had argued that "an inducement to insurance does not require a quid pro quo, and that the free HR services available to everyone are sufficiently connected with the purchase of insurance, even after insurance has been purchased, to satisfy [Washington's anti-rebate statute]." But the ALJ rejected this argument, reasoning that:

> Zenefits' free core HR services promote innovation and help small businesses grow, which is good for Washington. The policy concerns for insureds that [the Deputy Commissioner] identified are outweighed by the value that free, mobile HR applications provide to Washington businesses. Because the connection between Zenefits' free core HR services to the public, and the purchase of insurance, is tenuous, Zenefits does not violate [Washington law] in offering and providing them to Washingtonians.

Second, the ALJ found that Zenefits' provision of "Full HR Integration" to those who purchased its insurance did violate Washington's anti-rebate laws.

To appreciate this point, some background on the functionality of Zenefits' software is useful. According to the ALJ, Zenefits has four tiers of HR services available. At the bronze level, certain core HR services — account setup, access to the dashboard, on-boarding and off-boarding of employees and paid-time-off tracking — are free to all, regardless of whether they purchase insurance. Also at the Bronze level, customers have access to the employee benefits management app, where they can purchase insurance products from among Zenefits' offerings and obtain benefits management services. Customers are not obligated to purchase insurance through Zenefits to take advantage of the other HR apps at this level. However, customers cannot obtain Zenefits' employee benefits management services, unless they purchase insurance products through Zenefits.

At the next level, the Silver level, at a cost of $5 per month per employee, customers have access to premium HR applications, including time-off management, managing and tracking federal of compliance deadlines, and ACA assistance. Customers at the silver level may also access all bronze-level offerings. At the next level, the gold level, at a cost of $8 per month per employee, customers have access to payroll

management features, as well as all the apps available at the silver level. For $12 per month per employee, customers can access the platinum level of apps, which includes all the apps available at the gold, silver and bronze levels, as well as access to a live HR specialist.

For its insurance customers, Zenefits provides what the ALJ referred to as "full HR integration." That is, Zenefits connects its customers' HR systems together, from payroll to health insurance, so that they and their employees can manage all of their HR needs in one online dashboard.

According to the ALJ, the fact that Zenefits provides to its insurance customers, but not the general public, the "full integration of their employees' insurance information with payroll and other HR services constitutes an improper rebate." The ALJ's reasoning — which warrants review in full — is provided below:

> Zenefits' position vis-a-vis [Washington's anti-inducement statute] falters, however, at the time customers purchase insurance through Zenefits, or make Zenefits their [broker of record ("BOR")]. At that point, Zenefits makes available to its customers the full integration of their employees' insurance information with payroll and other HR services which (a) goes beyond the terms of the insurance contract, (b) goes beyond mere management of insureds' policies, and (c) is not available to those who do not purchase insurance through Zenefits or make Zenefits BOR. As Zenefits marketing materials proclaim and demonstrate, once customers use Zenefits for insurance, customers can authorize Zenefits to take and move employee information into payroll and other apps, fully integrating employees' insurance information into all relevant aspects of customer' HR services. As Zenefits admits, this full integration, marketed heavily as not just highly convenient, but valued at hundreds of dollars per employee per year, is not available to customers who do not use Zenefits as BOR.

What the ALJ's Order Means for Insurance Brokers

On the surface, the impact of the ALJ's order is straightforward: greater certainty that when a broker provides a gift of software to the general public — and does not condition that gift on the purchase of insurance — that broker is complying with anti-rebate laws. The converse may also be true: Washington may be sending a warning shot to brick-and-mortar brokers, many of whom purchase off-the-shelf software with the intention to provide it — at no charge — to their customers but not to the general public.

On a deeper level, however, this order offers additional insight on how states continue to converge analytically on related issues as well. Separate and apart from the issue of whether a broker can ever offer gifts and services to the general public is the issue of the types of gifts and services a broker can offer to a customer when it does not offer them to the general public. For example, if a broker wants to provide a risk assessment for an insurance customer — but the provision of risk assessments is not expressly set forth in the customer's policy — is there a risk of violation? What if a broker wishes to assist its insurance customer/employer by preparing claims forms or handling billing of former employees for their COBRA coverage?

Fortunately, some states have issued guidance on precisely these issues. New York's Department of Financial Services, for instance, issued a circular letter("Circular No. 9") stating that a broker may provide a service not specified in the insurance policy without violating anti-rebating provisions if — among other things — "the service directly relates to the sale or servicing of the policy or provides

general information about insurance or risk reduction." Circular No. 9 also included an illustrative, non-exclusive list of examples of the types of services that "generally will fall within the scope of services that an insurance producer may lawfully provide in connection with insurance sold by the producer." Examples of permissible services under Circular No. 9 include:

1. Risk assessments
2. Insurance consulting services
3. Insurance-related regulatory and legislative updates
4. Certain claims assistance services (not adjusting)
5. Tax preparation for employer of Schedule A of IRS Form 5500 Employee Benefit Plan Report
6. Information to group policy or contract holders and forms for plan administration, enrollment, insurer website links and FAQs
7. Certain services provided pursuant to COBRA
8. Certain services provided pursuant to HIPPA

By contrast, Circular No. 9 also provides an illustrative, non-exclusive list of examples of services that could run afoul of anti-rebating laws. Generally, the provision of these services at no charge could be unlawful because they are "too attenuated to the provision of insurance, or would otherwise violate the law because the services are not specified in the policy." A simplified summary of examples of questionable services is set forth below.

1. Flexible spending administration services
2. Legal services
3. Payroll services
4. Referrals to discounted third-party services while producer is BOR
5. HR compliance advice not relating to insurance provided
6. Management of employee benefit programs (retirement, time-off/leave of absence, etc.) other than the insurance sold by producer
7. Preparation of employee benefit statements unrelated to insurance purchased
8. Development of employee handbooks, etc. unrelated to insurance purchased
9. Services re employee compensation, discipline, job descriptions, leaves of absence, organizational development, business policies and practices, safety, staffing and recruiting that are not related to insurance purchased

Illinois has offered similar guidance, which is modeled (nearly verbatim) from New York's Circular No. 9.

So what does the guidance from New York and Illinois have to do with the ALJ's order? Only time will tell, but potentially a lot. In the ALJ proceedings, Zenefits argued that its business model was no different from those of other Washington insurance brokers, who provide to their insurance customers services such as educational seminars, benefits helplines and 24/7 online access to employee benefits information. But the ALJ found that those services are different than Zenefits' services because they "fall short of the full HR integration Zenefits freely offers only to its insurance customers."

Given that reasoning, one way to read the ALJ order is to conclude that, in Washington, some services — like educational seminars and benefits helplines — are "directly related" to the sale or servicing of the policy, and other services — such as "full HR integration" — are "too attenuated to the provision of insurance, or would otherwise violate the law because the services are not specified in the policy." In

other words, the ruling suggests that Washington, whose OIC consent order had made it an outlier in the anti-rebate area, has begun to fall into line with larger states, like New York and Illinois, and that a general consensus behind the "directly related" test continues to form. Such a reading, however, creates additional questions. Would New York, for example, consider "full HR integration" to be too attenuated to the provision of insurance to be a permissible service? And if so, how would New York attempt to meaningful parse the lines between software that provides tax, COBRA and HIPAA services but that also assists consumers by, for example, automatically updating HR information that is tied to data regarding employee insurance or benefits information? It seems unlikely — and counterintuitive — that New York or other states would attempt to prevent consumers from accessing such valuable software functions provided at no charge, but given the uncertainty surrounding how anti-rebate provisions will be applied to such new technology solutions, answers at this point remain unclear.

Regardless, however, the ALJ's order may not be the last word in this saga: the parties have until Nov. 17, 2017, to file further briefing on the order.

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