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Insurtech Alert

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Key Points

- Zenefits' practice of providing free software to the general public constitutes an improper rebate under the state's anti-rebate provisions
- Ruling could have significant impact on brokers' ability to provide complimentary products/services

Zenefits' Saga in Washington State Continues: Reviewing Officer Reverses ALJ and Finds that Provision of Free Software to General Public Constitutes Improper Rebate

On November 30, 2017, Washington Reviewing Officer William G. Pardee issued his much-anticipated findings of fact and conclusions of law regarding whether Zenefits' practice of providing free software to the general public constitutes an improper rebate under the state's anti-rebate provisions. His conclusion: it does. This is a significant step backward from the general trend, which has been to approve these arrangements because they ultimately benefit consumers.

For a full recap of the parties' moves and countermoves to date, see here.

For those who are crunched for time, it is sufficient to know two things:

First, 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.

Second, Zenefits' business model was to offer to small businesses free software-as-a-service for human resources functions, such as onboarding, payroll, benefits and vacation tracking, and make money on broker fees when users of the software choose to buy insurance from it.

So the issue 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?

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The majority of states that have sounded off on this topic have found that the practice does not amount to an improper rebate. The Office of the Insurance Commissioner (OIC), however, initially reached a different conclusion.

On November 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 Administrative Law Judge (ALJ) Lisa N.W. Dublin, and, on October 26, 2017, after conducting evidentiary hearings over a four-day period, Dublin issued her order.

It was a mixed bag for Zenefits.

On the one hand, Dublin **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."

On the other hand, Dublin found that Zenefits' provision of "Full HR Integration" to those who purchased its insurance **did** violate Washington's anti-rebate laws. (As Dublin describes in her order, there are various tiers of functionality found in Zenefits' software.) In other words, it was okay to give the general public—free of charge—the basic software package, but Zenefits ran afoul of anti-rebate laws by giving the premium, fully integrated software package to its customers.

Some argued that Dublin's ruling had the effect of bringing Washington more closely into line with the anti-rebating approach of other states.

But the order issued by Pardee yesterday—in which Pardee reviewed Dublin's findings—brings everything back full circle, once again leaving Washington as an outlier on the issue. While Pardee agreed with Dublin that providing additional functionality in the form of full HR integration constituted a violation of anti-rebate laws, he **disagreed** with Dublin's finding that providing software—free of charge—to the general public was permissible. According to Pardee, this second conclusion was supported by the dictionary definitions of the terms "inducement" (e.g., to entice, persuade or lure) and "valuable consideration" (e.g., services). Pardee summarized both conclusions as follows:

> Simply put, Zenefits, prior to issuance of the Consent Order . . . persuaded, lured, and enticed their customers in the state of Washington to name Zenefits their broker of record (BOR) by giving them a taste of the functionality of their online HR automation platform by letting them access certain free 'core HR services' and the employee benefits management app, which represented

> services or enticements in violation of [anti-rebate law]. . . . Similarly, once a customer named Zenefits as their BOR, they could then access employee benefit management services from Zenefits, with additional functionality, even though not a part of their policy, which also represented services or enticements in violation of [anti-rebate laws.]

Like the two orders before it, this ruling may not be the end of this story. If Zenefits wishes to fight, and win back some of the gains it had made after Dublin's ruling, it has 30 days to appeal to the Superior Court. In other words, stay tuned.

Akin Gump Strauss Hauer & Feld LLP continues to actively monitor developments as this field evolves. If you have any questions concerning this alert or anti-rebating issues, please contact Shawn Hanson or Nicholas Gregory at Akin Gump in San Francisco.

Contact Information

If you have any questions regarding this alert, please contact:

Shawn Hanson
shanson@akingump.com
415.765.9528
San Francisco

Nicholas J. Gregory
ngregory@akingump.com
415.765.9562
San Francisco