Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Washington State Should Amend Its Anti-Rebate Laws

By **Nicholas Gregory and Shawn Hanson** (July 3, 2018, 3:05 PM EDT)

Nicholas Gregory

Shawn Hanson

For followers of the insurance brokerage industry, it's been clear for some time now that something strange is happening in Washington state. Two years ago, Washington's Office of the Insurance Commissioner ordered[1] insurance broker Zenefits to stop giving away its software — free of charge — to the state's consumers. The result: Washington's consumers had to pay for a product that the residents of every other state in the nation received for free. Given the OIC's charge to protect consumers, it was a bizarre result, and one that left more than a few observers scratching their heads. As Forbes[2] put it: "It's not every day that the government steps in to make a company raise its prices."

Zenefits later challenged[3] the order, which led to a decision[4] by an administrative law judge siding with Zenefits on the issue. But the victory was short-lived. In late November of 2017, a subsequent administrative reviewing officer reversed[5] the ALJ and sided with the OIC, again requiring Washington's residents to pay for something they would otherwise get for free.

Now that the dust has settled (Zenefits did not appeal that final ruling to the Washington Superior Court), we take a step back and provide a summary of how Washington got to this point and where it should go from here, concluding that, because there is no policy justification for applying the state's anti-rebate laws to gifts to the general public, Washington should follow Utah's lead and amend its laws.

Zenefits' Business Model

From 2013 to 2015, California-based insurance producer Zenefits' meteoric rise took the insurance world by storm,[6] with the company reaching a valuation of $4.5 billion within two short years. Zenefits' business model relied on offering to small businesses free software-as-a-service for human resources functions, like onboarding, payroll, benefits and vacation tracking, and making money on broker fees when users of the software chose to buy insurance from it. And while hordes of consumers were wild about the new, efficient and easy-to-use software, there was at least one hiccup: anti-rebate laws.

Anti-Rebate Laws: Model Language and Policy Rationales

The insurance industry has its regulatory quirks. One such quirk is the prevalence of so-called "anti-rebate" laws, which generally prohibit an insurer or insurance broker from providing a gift or "rebate" to customers as an "inducement" to purchase insurance. As a result, while in many industries firms compete fiercely for consumers by offering coupons, reduced prices, discounts, special offers and rebates, such activity is largely prohibited in the insurance brokerage space.

And while that sounds like an easy concept, the statutes themselves — which vary from state to state — are hardly exemplars of clarity. For example, here is the NAIC's model law, which prohibits:

> ... knowingly permitting or offering to make or making any life insurance policy or annuity, or accident and health insurance or other insurance, or agreement as to such contract other than as plainly expressed in the policy issued thereon, or paying or allowing or giving or offering to pay, allow, or give, directly or indirectly, as inducement to such policy, any rebate of premiums payable on the policy, or any special favor or advantage in the dividends or other benefits thereon, or any valuable consideration or inducement whatever not specified in the policy; or giving, or selling, or purchasing or offering to give, sell, or purchase as inducement to such policy or annuity or in connection therewith, any stocks, bonds or other securities of any insurance company or other corporation, association or partnership, or any dividends or profits accrued thereon, or anything of value whatsoever not specified in the policy.

In its purest application, the law would prevent a broker from, for example, providing a $500 rebate to one insured, but not to another insured who purchased an identical policy. But it is not at all clear that the law would prevent Zenefits (or any other company), from providing free software to the general public, regardless of whether any policy was issued. Indeed, the language itself applies only to "giving ... as inducement to such policy ... any special favor ... valuable consideration or inducement whatever not specified in the policy." Put simply, the NAIC model law strongly suggests that for an impermissible rebate to exist, there must be a policy.

But even if the NAIC model law could plausibly be read to cover Zenefits' business model, is there a policy justification for preventing millions of consumers from obtaining free services?

Proponents of anti-rebating laws typically offer rationales that fall into two camps[7]: (1) those concerned with the harmful impacts rebates could have on markets (i.e., insurer solvency); and (2) those concerned with preventing discrimination on the part of insurers or insurance producers. But neither of these rationales supports applying anti-rebating laws to Zenefits' business model.

The first rationale is based on the idea that insurers could be forced into an arms race of excessive rebates, ultimately threatening the industry's ability to pay claims. But that rationale is inapplicable to Zenefits' situation because Zenefits is a broker, not an insurer. Therefore, its solvency bears no relation to any payments ultimately made to a policyholder.

The second rationale is also inapplicable because Zenefits provides free software to the general public — insured and non-insured alike — so there is no risk that one consumer will receive a better deal than another.

The Majority View

Perhaps because of the absence of policy justifications for prohibiting gifts to the general public, the majority of state insurance departments that have sounded off on the issue have found that such conduct does not constitute impermissible rebates. In its written demand for a hearing in Washington, Zenefits included numerous examples of state guidance on this issue.

In Louisiana, for example, the Insurance Commissioner explained that: "[i]n such situations [unconditional gifts to the general public] it cannot be reasonably asserted that the thing of value served as valuable consideration or inducement to the contract because its recipient could obtain the thing of value irrespective of any contractual relationship regarding insurance. 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."

Similarly, Montana's Office of the Commissioner of Securities and Insurance stated: "Current data clearly shows that the [Zenefits] platform is not functioning as an inducement as the vast majority of users do not also use Zenefits as their insurance broker."

And North Carolina's Department of Justice opined that: "Zenefits is not engaging in rebating in violation of [North Carolina's anti-rebating laws]. Zenefits is not offering its free platform in exchange for brokering insurance business. Consumers are not penalized for not using Zenefits as its insurance broker."

Numerous other states — Connecticut, Maryland, New York, Kansas, Tennessee, Michigan, Indiana, Arizona and Rhode Island — have all issued some form of similar guidance.

The Case of Washington State

The crux of the OIC's grievance against Zenefits centered around two provisions of Washington's insurance code: (1) RCW 48.30.140; and (2) RCW 48.30.150. The provisions were similar, but not identical, to the NAIC model language.

RCW 48.30.140 stated that:

> (1) ... **no** insurer, **insurance producer**, or title insurance agent **shall, as an inducement to insurance, or after insurance has been effected**, directly or indirectly, offer, promise, allow, give, set off, or pay to the insured or to any employee of the insured, any rebate, discount, abatement, or reduction of premium or any part thereof named in any insurance contract, or any commission thereon, or earnings, profits, dividends, **or other benefit**, or any other valuable consideration **or inducement whatsoever which is not expressly provided for in the policy.**

(Emphasis added). RCW48.30.150 stated that:

> (1) **No** insurer, **insurance producer** title insurance agent, or other person **shall, as an inducement to insurance, or in connection with any insurance transaction**, provide in any policy for, or offer or sell, buy, or offer or promise to buy or give, or promise, or allow to, or on behalf of, the insured or prospective insured in any manner whatsoever . . .

> (c) Any prizes, **goods**, wares, gift cards, gift certificates, or merchandise of an aggregate value **in excess of one hundred dollars** per person in the aggregate in any consecutive twelve-month period ... .

(Emphasis added). Not surprisingly, Zenefits and the OIC's interpretation of these two provisions were dramatically different.[8] To simplify ruthlessly, Zenefits argued that the provisions above did not apply unless a broker provided something of value to an insured in exchange for taking out a policy (i.e., a quid pro quo arrangement). In other words, Zenefits argued that, before there can be an impermissible rebate, there must be an insurance transaction.

Washington, on the other hand, argued that the plain language of the provisions (e.g., "an inducement to insurance, or in connection with any insurance transaction") showed that that a rebate can exist even when no policy is issued.

As noted above, an ALJ initially reviewed the OIC's order, balanced the purported policy rationales, and determined 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.

But the officer responsible for reviewing the ALJ, again reversed course. Unlike the ALJ, the reviewing officer gave virtually no consideration to policy justifications, instead focusing his interpretation on the text of the provisions and statutory scheme as a whole.

As for 48.30.140, the reviewing officer found that the term "inducement," as defined in Webster's Third New International Dictionary (the use of which was dictated by case law), referred to an action which "lures or entices." Because Zenefits was enticing customers with something of value (regardless of the success of the enticement), it was providing an impermissible rebate.

The reviewing officer also relied on the statute's other provisions to support its ruling. For instance, Washington's insurance code contained a provision allowing brokers to make unlimited contributions to bona fide charitable or nonprofit organizations provided there was no obligation for the organizations to become an insured. The reviewing officer reasoned that such a provision would be unnecessary under Zenefits' reading, because under Zenefits' reading any broker could provide items of unlimited value to any person, customer or noncustomer, so long as there was no obligation to become an insured.

Lawyers and other commenters can (and will) argue about whether, as a matter of statutory interpretation, the reviewing officer got it right. Indeed, one's thoughts on the matter may well depend entirely on a preference for a given approach to statutory interpretation (e.g., textualism vs. purposivism), a discussion of which is beyond the scope of this article.[9]

But such concerns are largely beside the point. Even if statutory language can plausibly be read to prohibit a business practice, if the law advances no legitimate policy objective, and its net effect is to harm consumers, then it stands to reason that the legislature should change the law.

Which is precisely what Washington should do here.

Fortunately for Washington, there is no need to reinvent the wheel. Utah's anti-rebate statute[10] states that: "a producer ... may not induce a person to enter into, continue, or terminate an insurance contract by offering a benefit that is not: (i) specified in the insurance contract; or (ii) directly related to the insurance contract." In late 2014, Utah's insurance commissioner seized on this language and set his sights on Zenefits, finding[11] that "Zenefits' offering of up-front, free-to-all, HR benefits violates Utah's insurance inducement and indirect rebating laws."

Public reaction in favor of Zenefits was swift, and included tweets[12] of support not only from legendary Silicon venture capitalist Marc Andressen, but also (oddly), Hollywood actor Jared Leto. Utah's policymakers quickly recognized that there was a problem: the anti-rebate law could plausibly be read to apply to Zenefits' business model, but such application would only serve to harm Utah's consumers. So they jumped to action. Legislators drafted a bill (HB 141) resolving the issue and the bill overwhelmingly passed out of both legislative houses. In April 2015, Governor Gary Herbert signed it[13] into law. The insurance department quickly issued a bulletin[14] explaining that:

> The new language [of HB 141]. . . permits an insurance licensee to offer products or services for free or at a discounted rate, regardless of whether the free or discounted product or service is related to an offer or sale of an insurance product. **The free or discounted products or services must be offered to the general public on the same terms**. ... **The free or discounted products cannot be offered contingent on the receipt of an insurance quote**, sale or future sale of an insurance product. [Emphasis added].

Problem solved.

Briefly, it seemed as if Washington might follow in Utah's footsteps. In fact, just weeks after the insurance commissioner ordered Zenefits to charge its customers for software, a bipartisan duo of state senators[15] introduced a bill (SB 5242) to amend the state's anti-rebating and inducement laws. But after a committee hearing on Jan. 26, 2017, (the video is available online[16]), which featured the testimony of no less than ten witnesses, the bill has stalled in committee ever since.

So what happened?

Here's one theory. Utah's bill perfectly fit Zenefits' business model because it required two elements before a gift could be exempt from anti-rebate laws: (1) receipt of the gift could not be contingent on the purchase of insurance; and (2) the gift must be offered to the general public on the same terms.

Utah's second element is critically important because it ensures that brokers may not discriminate between customers when providing gifts — one of the key policy rationales for anti-rebate laws. If a broker in Utah provides a gift to one customer, it must provide the same gift to the general public as well. The practical implication of this rule is clear: almost all gifts of a certain value — e.g., gifts of money, sports tickets, vacations, etc. — will still constitute impermissible rebates because it will not be practical or economically feasible (or in many cases, even possible) to make the gifts available to the general public. For example, a broker that gifts $500 to any person who clicks on its website, with no requirement that the person purchase insurance, will likely be bankrupt before the first policy is issued. The same is true for almost all other gifts. The notable exception, of course, is software, which can be provided to the general public at virtually no marginal cost.

Washington's draft bill, however, failed to include this second element. Instead, it stated[17]:
Nothing in this section prohibits an insurer or an insurance producer from offering or providing goods or services, whether or not the goods or services are directly related to an insurance contract, for free or for less than fair market value, so long as receipt of the goods or services is not contingent upon the purchase of insurance.

While it is not clear whether this departure from Utah's bill was a drafting oversight or simply an additional effort to chip away more aggressively at the anti-rebate framework, it has likely impeded the bill's progress.[18] Indeed, at the Jan. 26, 2017, committee hearing, several commenters made the point that, under the proposed bill, a larger broker could simply provide sports tickets (of any dollar value) to one customer but not another — thereby implicating potential client discrimination.

One of the sponsors of the bill, Sen. Mark Mullet, seized on this issue, asking a Zenefits representative: "Was there ever any attempt to try to narrow the bill down so it's not quite so broad, it's more focused on someone providing a software type application?"[19] While Zenefits indicated that it would be supportive of such an idea, at present Washington's legislators have failed to pick up the torch on the issue. And that failure could be costing Washington's residents some serious money.

According to testimony from the hearing, the average Zenefits customer in Washington now pays over $1000 per year for a service that wouldn't cost them a cent if they were headquartered in California or Oregon. If Washington's legislators are waiting for the right kind of push to action, let's hope the reviewing officer's decision from November is just the push they need.

Nicholas J. Gregory is counsel and Shawn Hanson is a partner at Akin Gump Strauss Hauer & Feld LLP.

[1] https://www.conniff.com/wp-content/uploads/2016-12-Zenefits-order-illegal-inducements.pdf

[2] https://www.forbes.com/forbes/welcome/?toURL=https://www.forbes.com/sites/briansolomon/2016/12/01/zenefits-free-business-model-ruled-illegal-in-washington-state/&refURL=https://www.akingump.com/en/news-insights/washington-administrative-law-judge-zenefits-provision-of-free.html&referrer=https://www.akingump.com/en/news-insights/washington-administrative-law-judge-zenefits-provision-of-free.html#589115517df0

[3] https://www.insurance.wa.gov/sites/default/files/documents/16-0219-demand.pdf

[4] https://www.insurance.wa.gov/sites/default/files/2017-10/16-0219-initial-order_1.pdf

[5] https://www.insurance.wa.gov/sites/default/files/2017-12/16-0219-final-order.pdf

[6] https://www.akingump.com/en/news-insights/washington-administrative-law-judge-zenefits-provision-of-free.html

[7] https://www.rstreet.org/wp-content/uploads/2015/02/RSTREETSHORT8.pdf

[8] https://www.insurance.wa.gov/sites/default/files/2017-12/16-0219-final-order.pdf

[9] For an excellent discussion of the different approaches to statutory interpretation, as well as a prescriptive manifesto on the virtues of textualism, see Scalia and Garner, Reading Law: The Interpretation of Legal Texts (Thompson/West 2012) at xxvii ("Our legal system must regain a mooring that it has lost: a generally agreed-on approach to the interpretation of legal texts . . .").

[10] https://le.utah.gov/xcode/Title31A/Chapter23A/31A-23a-S402.5.html

[11] https://techcrunch.com/2014/12/01/zenefits-utah/

[12] http://fortune.com/2014/12/03/zenefits-utah-ban/

[13] http://fortune.com/2015/04/13/zenefits-utah-ban-insurance/

[14] https://insurance.utah.gov/wp-content/uploads/2015-8Signed.pdf

[15] Senator Joe Fain (R; Majority Floor Leader) and Mark Mullet (D; Democratic Assistant Whip).

[16] https://www.tvw.org/watch/?eventID=2017011327

[17] http://lawfilesext.leg.wa.gov/biennium/2017-18/Pdf/Bills/Senate Bills/5242.pdf

[18] There is a healthy debate to be had about whether anti-rebate laws are ever justified by legitimate policy concerns, but that debate is outside the scope of this article.

[19] Similarly, the OIC's representative also voiced concerns with the reach (as opposed to the subject matter) of the bill, stating that: "OIC is not blind ... to the fact we have something new going on here and we need to figure it out. But this bill goes far beyond a solution to that problem."