

## Insurtech Alert

October 30, 2017

### Key Points

- Washington Administrative Law Judge rules that Zenefit's provision of free software to general public does not infringe on the state's anti-rebate laws due to value it provides to Washington businesses; however, availability of "full HR integration" to its customers constitutes a violation
- Insurtech companies and brokers should be mindful of the complex state-by-state anti-rebate framework when developing their business models



### Washington Administrative Law Judge: Zenefits' Provision of Free Software to General Public Does Not Constitute an Improper Rebate, but its Provision of "Full HR Integration" to Purchasers of Insurance Does

From 2013 to 2015, California-based insurance producer Zenefits' meteoric rise took the insurance world by storm, with the company reaching a valuation of **\$4.5 billion** within 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 has been 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. 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 have sounded off on this 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 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 an Administrative Law Judge (ALJ), and, on October 26, 2017, the ALJ (Lisa N.W. Dublin) issued her **Order**.

The ALJ 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 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.

While 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, the ALJ found that those services are different because they “fall short of the full HR integration Zenefits freely offers only to its insurance customers.”

In other words, the ALJ seems to be signaling that a broker may offer software or services that are related to the sale or servicing of the policy purchased, but may cross a line by offering software or services that are not related—for instance, “full HR integration.” This point is potentially telling. It suggests that Washington, whose OIC consent order had made it an outlier in this area, has fallen into line with larger states, like New York and Illinois, both of which have issued guidance—including lists of services—on the

types of services that brokers may offer without running afoul of anti-rebate laws. See, e.g., New York [guidance](#) (stating that a broker may provide a service not specified in the insurance policy without violating anti-rebating provisions of insurance law if—among other things—“the service directly relates to the sale or servicing of the policy”).

The parties have until November 17, 2017, to file further briefing on the ALJ’s initial order.

Akin Gump Strauss Hauer & Feld LLP continues to actively monitor developments as this field evolves.

**Contact Information**

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