SUPERIOR COURT OF NEW JERSEY – APPELLATE DIVISION

IN THE MATTER OF BULLETIN NO. 22-11	APPELLATE DIVISION DOCKET NO: A-001626-22 ON APPEAL FROM THE AGENCY DECISION ENTERED ON DECEMBER 20, 2022, BY THE STATE OF NEW JERSEY, DEPARTMENT OF BANKING AND INSURANCE

BRIEF FOR APPELLANT RECIPROCAL ATTORNEY-IN-FACT, INC.

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PRELIMINARY STATEMENT

The Department of Banking and Insurance (the "Department") issued a December 20, 2022 Bulletin[1] purporting to "clarify" the laws and regulations applicable to reciprocal exchanges in this State, which is the subject of the present appeal by Reciprocal Attorney-in-Fact, Inc. ("RAF"), as the attorney-in-fact for New Jersey Physicians United Reciprocal Exchange ("NJ PURE") pursuant to Rule 2:2-3. On its face, the Bulletin appears straightforward—reciprocal exchanges are, and always have been, required to comply with the New Jersey Insurance Holding Company Systems Act, N.J.S.A. 17:27A-1 to -14 (the "Holding Act"), as well as Statement of Statutory Accounting Principle No. 25 ("SSAP No. 25") regarding certain related party transactions. This begs the question: If the language of the Holding Act and SSAP No. 25 clearly supported the Department's position, what did the Department need to "clarify" in the first place? The answer, candidly, is nothing. The Department issued the Bulletin, not to clarify, but to unilaterally and improperly change New Jersey law, contrary to its own prior interpretations and actions and the language of both the Holding Act and SSAP No. 25.

Indeed, the Department's pronouncements shocked reciprocal insurers, who have operated for decades under a set of laws, rules, and regulations that are different from other insurers as approved by the Department. Through countless financial

[1] 2022 Bulletin No. 22-11 (the "Bulletin") is attached as Ja1-2.

examinations of reciprocals, as well as its public statements and actions, the Department has repeatedly admitted that: (1) New Jersey reciprocal exchanges are exclusively regulated by the Reciprocal Exchange Act, N.J.S.A. 17:50-1 to -19 (the "REA"); (2) the Holding Act does not apply to reciprocal exchanges; and (3) new legislation would be required to bring reciprocals within the ambit of the Holding Act. The Department failed to enact such legislation. Thus, rather than properly amending the REA or the Holding Act, the Department seeks to achieve its goal through improper rulemaking under the Administrative Procedure Act (the "APA"). New Jersey law is clear that an agency determination effecting a material change in existing law, or altering the "status quo," must comply with the APA, or it will be deemed invalid. Here, the Department completely disregarded the APA, adopting the Bulletin without providing any public notice, comment or hearing in violation of the APA's procedural and substantive due process protections and interfering with RAF's right to contract with individual subscribers. Accordingly, the Department's action was substantively and procedurally deficient.

In addition to its new interpretation of the Holding Act, the Department is using the Bulletin to misapply and misuse language of SSAP No. 25 to subjectively regulate AIF fees paid by individual subscribers to the exchange. SSAP No. 25 governs accounting and disclosures for transactions between affiliates and related parties. The AIF for a reciprocal exchange is considered to be a related party to the

exchange, as it exercises control over and makes decision on behalf of the exchange. A transaction between the exchange itself and the AIF may implicate SSAP No. 25. In contrast, AIF fees, which are set forth in the Power of Attorney (the "POA") filed with the Department, are paid individually by each new subscriber as a pre-requisite to join the exchange, and do not involve a related party transaction between the AIF and the exchange itself. SSAP No. 25 has never been used by the Department to regulate transactions between individual subscribers to an exchange and the AIF because the payment of AIF fees is an arm's length transaction between two willing and unaffiliated entities—the individual subscriber and the AIF—who lack common interests or control/ownership. Indeed, NJ PURE has filed over seventy quarterly and annual financial statements, and the Department has never once sought to regulate RAF's AIF fees through SSAP No. 25 until now.

Accordingly, RAF appeals from the Bulletin because it is an improper and unilateral pronouncement of new law that has broad implications to all reciprocal exchanges and their respective AIFs. The Department's actions are clearly arbitrary, capricious, unreasonable and ultra vires and specifically designed to inhibit the development of a proper record. For all these reasons, this Court must strike the Bulletin and compel the Department to observe the APA's substantive and procedural due process requirements before imposing a sea change of regulation on reciprocals and their AIFs.

STATEMENT OF FACTS AND PROCEDURAL HISTORY[2]

A. Background of Regulation of Reciprocal Exchanges in New Jersey

Passed in 1945, the REA provides the authority to enter into reciprocal insurance contracts and exclusively regulates reciprocal exchanges, except where specifically stated. N.J.S.A. 17:50 et seq. The REA makes clear that "[s]uch contracts and the exchange thereof and such subscribers, their attorneys in fact and representatives shall be regulated by this act, and by no other statute of this State relating to insurance, except as herein otherwise provided." N.J.S.A. 17:50-1 (emphasis added); Ja79[3] (issuing certificate of authority pursuant to N.J.S.S.A. 17:50-1). Reciprocal exchanges are extremely rare entities. While there are three legal vehicles through which to provide insurance: 1) traditional for-profit stock companies 2) mutual insurance companies; and 3) reciprocal exchanges, approximately 98+% of the insurance industry is comprised of the first two types. See https://www.govinfo.gov/content/pkg/CHRG-111hhrg56778/pdf/CHRG-111hhrg56778.pdf). The United States has less than thirty-five active reciprocal exchanges, while there are over 3,000 active stock companies. Id.

By statute, a reciprocal exchange separates the two main functions that traditionally exist within a single insurance company—the executive management

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[2] The Procedural History and Statement of Facts have been combined for clarity and the convenience of the court.

[3] Ja refers to the Joint Appendix.

company and the insurance operation itself. N.J.S.A. 17:50-1 et seq.; Ja67-68, Sec. 10. By doing so, it isolates the function of the insurance operation (namely the reciprocal exchange)—allowing the insurance entity alone to be organically operated on a not-for-profit basis—stripping an incentive for executives inside the entity to purposely underprice risks in order to report profits on a short-term basis so it can trigger compensation. Id. In fact, while rare, some of the world's best performing insurance entities are reciprocals, such as USAA, Farmers Insurance Exchange, and Erie Insurance Exchange. See https://www.govinfo.gov/content/pkg/CHRG-111hhrg56778/pdf/CHRG-111hhrg56778.pdf.

Reciprocals are legally held to more stringent financial guidelines than traditional insurance companies. N.J.S.A. 17:50-1 et seq. Reciprocal exchanges cannot have outside stockholders who, in turn, can be enticed to profit from policyholders, because reciprocals are not-for-profit, and they generate additional capital organically from their insureds. Ja67-68. In summary, a reciprocal exchange operation is a fundamental self-help form of insurance, where a management company manages the operations of the exchange on behalf of the unsophisticated policyholders who simply want a lower cost insurance policy to cover their risk. N.J.S.A. 17:50-1 et seq.; see also https://www.pureinsurance.com/newsroom/pures-reciprocal-model.

As a result, the standalone financial solvency requirements for reciprocal exchanges are more stringent than those required of traditional stock companies (i.e. liquidity ratio requirements for certain capital levels to be maintained above the standards required of other insurance entities). N.J.S.A. 17:50-5. Indeed, the REA contains intentionally arduous and demanding standards to ensure the financial health of the reciprocal and its subscribers. Id. For example, in addition to general solvency requirements, reciprocal exchanges are also subject to a "liquidity test," which requires them to maintain a prescribed level of cash and investments compared to certain liabilities at all times. Id. Any decrease below that level automatically requires the attorney-in-fact to contribute its own funds to make up the deficit, to avoid the immediate liquidation of the reciprocal. Id. No similar requirements exist for other insurance entities. See generally N.J.S.A. 17.

As a prerequisite for an individual to obtain insurance from the reciprocal, he or she must execute an unrelated party contract with the AIF—the Power of Attorney ("POA")—that segregates the AIF from the not-for-profit reciprocal exchange. Ja67-68. The AIF and the subscriber do not possess common interests or control/ownership. See CURE v. Sherrod Vans, Inc., 2013 WL 3820937, n.1. The subscriber's rights and obligations are: a) statutorily prescribed; and b) clearly set forth in the POA, a form which is filed with the Department and which the Department repeatedly reviews. N.J.S.A. 17:50-3. Only the subscriber and the AIF

are parties to the POA; the Exchange (i.e., the entire collective group of subscribers itself) is not a party. Id.

The POA must be signed and executed by each individual policyholder, as the exchange is a product of individual contracts executed by the AIF and the policyholders. Id. at -7. The AIF does not have control over the terms of a reciprocal exchange, as evidenced by the fact that policyholder's signature is required. Id. If the individual subscriber does not agree to the POA/AIF Fee, he/she is free to decline coverage and seek insurance from another carrier. Id. No AIF, including RAF, can unilaterally increase or agree to increase the AIF Fee. Id. at -3, -7.

The individual subscriber, not the exchange, pays the AIF Fee to the AIF after signing the POA. Id. at -7. The AIF Fee is a percentage of each individual subscriber's premium as a fee for managing the reciprocal exchange. Id. In some situations, the exchange simply collects and forwards the AIF Fee to the AIF; effectively acting as a passthrough clearinghouse. The individual subscriber and the AIF remain independent. Id. The AIF cannot unilaterally increase its fees. Id. Therefore, the AIF's financial incentive is simply to make the reciprocal exchange grow so the AIF can make profits. See Delos v. Farmers Group, 93 Cal App. 3d 642, 652 (4th Dist. 1979).[4] The only way to grow a reciprocal exchange is to provide

[4] The Court can take notice of the operations of reciprocals as stated in other judicial opinions, , congressional and NAIC hearings. N.J.R.E. 201. Marchak v. Claridge Commons, Inc., 261 N.J. Super. 126, 131-32 (App. Div. 1992).

better service or better rates than the competition. Id. Both of these motives align with what a policyholder wants—better service and better rates. Ja67-68. In contrast, in a traditional stock company, the executives of the company are primarily focused on one item for their compensation—namely profits. Id. The desire to make profits from their policyholders does not always align with the desires of the policyholders, which is why reciprocal exchanges are considered the most altruistic forms of insurance. Id.

B. The Holding Act Does Not Apply To Reciprocals.

In 1970, twenty-five years after it enacted the REA, the Legislature enacted the Holding Act, which was based on the National Association of Insurance Commissioner's ("NAIC") model Insurance Holding Company System Regulatory Act. N.J.S.A. 17-27A-1. The NAIC model act does not specifically define "insurer," instead noting that "insurer shall have the same meaning as set forth in Section [insert applicable section]." https://content.naic.org/sites/default/inline-files/MDL-440.pdf (alteration in original). Thus, the NAIC left the decision on what types of insurers are subject to the terms of the states' respective holding acts up to the state legislatures to decide. Id.

Unlike other states, New Jersey's Holding Act does not include reciprocal insurance exchanges in its provisions or any of its relevant definitions. N.J.S.A. 17:27A-1(d). Specifically, the Holding Act defines an "insurance holding company

system" as "two or more affiliated persons, one or more of which is an insurer" and "[a] mutual holding company system resulting from a mutualization and reorganization of a health service corporation pursuant to [N.J.S.A. 17:48E-46.5]." Id. The Holding Act defines "insurer" as "any person or persons, corporation, partnership or company authorized by the laws of this State to transact the business of insurance or to operate a health maintenance organization in this State." N.J.S.A. 17:27A-1(e). Similarly, the Holding Act defines "person" as "an individual, a corporation, a limited liability company, partnership, an association, a joint stock company, a trust, an unincorporated organization, any similar entity or any combination of the foregoing acting in concert." N.J.S.A. 17:27A-1(f). Noticeably absent from the relevant definitions is a reciprocal insurance exchange. Id. at (d-f).

This is crucial because the Holding Act imposes different reporting and oversight requirements than the REA. Compare N.J.S.A. 17: 27A-1 et seq. with N.J.S.A. 17:50-1 et seq. When passing the Holding Act, the Legislature could have specified that it applies to reciprocals, as the Legislature has with other laws. See infra. For example, N.J.S.A. 17:23-21, which relates generally to reports and examinations of insurance companies, defines "Insurer" to include a "reciprocal exchange." See, e.g., N.J.S.A. 17:30C-1 to -31 (the Rehabilitation and Liquidation Act) (applying to reciprocals); see also N.J.S.A. 17:23-41 (definitions relating to the corporate governance of insurers, which defines "Insurer" to include "reciprocal

insurance exchanges," while notably (and separately) identifying "Insurance group" to mean "those insurers and affiliates included within an insurance holding company system as defined in section 1 of P.L.1970, c. 22 (C.17:27A-1) [the Holding Company Act]"); N.J.S.A. 17:23B-1 (Insurance Regulatory Information System, which defines "Insurer" to include a "reciprocal exchange"); N.J.S.A. 17:29C-1.1 (Cancellations and Renewals, which also includes "reciprocal exchange" within its definition of "Insurer"). Like the above examples, the Holding Act could have included an omnibus definition of "insurer," or referred to the REA itself, but did not do so. N.J.S.A. 17:27A-1(d). Instead, the Legislature chose to exempt reciprocals from the requirements of the Holding Act. N.J.S.A. 17:27A-1. Cognizant of the REA's exclusive jurisdiction over reciprocals, the Department has never successfully required stand-alone reciprocal exchanges to comply with the Holding Act, until now. Ja74-76. To the contrary, in its examinations and management letters, the Department has repeatedly admitted that legislation was necessary in order for it to require reciprocals to comply with the Holding Act statutes, including complying with SSAP No. 25.[5] Id.; See also Transaction ID#E1554683-03312023.

[5] Notably, the Department objected to the inclusion of these documents as part of the record, but that does not change reality or the history of its actions. Ja1-80.

The NAIC developed such a model act in November 1990 and adopted it in June 1991. See Reciprocals Working Group Report of Special Insurance Issues (E) Committee, NAIC Proceedings – 1991 Vol. IIB at 1091-1096 ("1991 NAIC Report"). However, the NAIC recommended the model act for deletion in 2004 and formally deleted it in September 2004. See Reciprocals Working Group Report of Special Insurance Issues (E) Committee, NAIC Proceedings – 2004 2dQ at 1251 ("1994 NAIC Report"). State regulators, including the Department, were given the opportunity to comment on or oppose the removal of the model legislation and not one did. Ibid. The New Jersey Legislature **never** adopted any legislation that imposed upon reciprocals the reporting requirements that the Department now seeks, including the now defunct NAIC model act.[6] See 1991 NAIC Report and 1994 NAIC Report.

Moreover, in 2010, the NAIC submitted written testimony to Congress to explain the role of the Holding Act to insurance providers and to answer questions regarding the insurers regulated by the Holding Act. https://www.govinfo.gov/content/pkg/CHRG-111hhrg56778/pdf/CHRG-111hhrg56778.pdf.[7] As a supplement to this testimony, the NAIC attached a list of

[6] The NAIC is an organization, founded in 1871, governed by the chief insurance regulators from the 50 states (including New Jersey), the District of Columbia, and five U.S. territories to coordinate regulation of multistate insurers. See https://content.naic.org/about.

[7] The Court can also take judicial notice of this congressional testimony.

every single insurer in the United States, identifying whether the Holding Act applied, based upon information provided by state regulators. Id. NJ PURE is included and is specifically identified as **not** being subject to the Holding Act. See https://www.govinfo.gov/content/pkg/CHRG-111hhrg56778/pdf/CHRG-111hhrg56778.pdf at p. 142. Thus, the Department's position in 2010 was that NJ PURE was not subject to the Holding Act—since that time, NJ PURE and RAF have not altered their corporate structure, and no laws, rules, regulations, or amendments to existing law have been passed to change the Department's position. Ja67-68.

This just confirms that when its legislative amendment failed, the Department dropped the Holding Act applicability issue for nearly twenty years. Id. Indeed, the Department did not raise the issue of the applicability of the Holding Act or SSAP No. 25 to AIF Fees during NJ PURE's subsequent quarterly and annual financial statements. Id. Instead, the Department remained silent and accepted the status quo until now. Id.

To be clear, the Department repeatedly acknowledged to NJ PURE and other reciprocals during its examinations and follow-ups that they were not subject to the Holding Act, and therefore the only way to apply these requirements to reciprocals would be to pass a new statute. See Ja67-68. That never occurred and, to date, the Department has never required reciprocals to comply with the Holding Act. Id. Indeed, if the Holding Act applied, reciprocals would have been required to file the

following forms with the Department on an **annual basis**: 1) Insurance Holding Company System Annual Registration Statement ("Form B"); and 2) Summary of Changes to Registration Statement ("Form C"). See N.J.S.A. 17:27A-1 to -14. Reciprocals would also have been required to file a "Form D" to provide advance notice of significant affiliate transactions or modifications to existing affiliate agreements. Id. None of these forms have ever been requested by or filed with the Department. Ja72-76. Despite this, the Department is now claiming that reciprocal exchanges are, and always have been, subject to the Holding Act pursuant to its newly issued Bulletin. [8]

C. SSAP No. 25.

All insurance entities are, of course, required to comply with all Statutory Accounting Principles, which are articulated in NAIC's handbook and adopted by statute in all jurisdictions, including New Jersey. Ja48-65. These principles promulgate various reporting and disclosure requirements for a variety of financial transactions. Id.

Specifically, as discussed above, SSAP No. 25 governs accounting and disclosures for transactions between affiliates and related parties, which it defines as

[8] The Department demanded that CURE agree to submit to the Holding Act as a condition of its acquisition, despite knowing that CURE disagreed. Ja36-47. No such demand would have been necessary if CURE had already been subject to the Holding Act.

"entities that have common interest as a result of ownership, control, affiliation or by contract." Id. at (4). According to SSAP No. 25, the AIF for a reciprocal exchange is considered a related party to the exchange, and therefore transactions between the exchange itself and the AIF may be subject to SSAP No. 25. Id. Thus, a transaction between the exchange (not the individual subscribers) and the AIF may implicate SSAP No. 25 and its accounting principles.[9] Id. Conversely, a transaction between the AIF and an individual subscriber does not because they are not under common control or ownership. Id.

The Department has demonstrated, however, through action and word that it intends to change this longstanding law and start using SSAP No. 25, contrary to its own plain language, to improperly govern and regulate fees collected from the individual subscribers (i.e., profits earned) by the AIF. Ja1-2. The Bulletin provides:

> SSAP No. 25 refers to related party transactions, including loans, transactions involving the exchange of assets or liabilities, and transactions involving services between related parties. SSAP No. 25, paragraph 4, defines related parties, which definition includes the attorney-in-fact of a reciprocal reporting entity or any affiliate of the attorney-in-fact. Further, paragraph 19 requires transactions involving services between related parties to be on an arm's length basis and meet fair and reasonable standards. In doing so, considerations may include, but are not limited to, management representations along with the opinion of the reciprocal exchange's independent auditor.

[9] For example, if the AIF owned office space and leased that to the Exchange, that lease would be a related party transaction and subject to SSAP No. 25.

> [Ja1-2 (2022 Bulletin No. 22-11: Subject: Compliance With Relevant Laws and Requirements Reciprocal Exchanges, 2022 WL 18427017, at *2).]

This application of SSAP No. 25 is contrary to its plain language and at odds with the REA. Compare Ja1-2 with N.J.S.A. 17:50-1 et. seq. The Department has made clear that it intends to use SSAP No. 25 to scrutinize and ultimately regulate profits of the AIF—that action is unlawful and must be curtailed. Ja1-2. In recent routine financial examinations and other questioning by the Department, for example, it has begun asking reciprocals for the quantum of the AIF fees collected from subscribers and other onerous reporting, allegedly to confirm that those fees are reasonable, arms-length, and market rate. Ja72-76. The Department is declaring its ability to scrutinize and regulate the AIF fees, i.e., the profits of an AIF.[10] Id. For example, the Department's recent questions to RAF, the AIF for NJ PURE, misapplied SSAP No. 25 to the AIF fee and under that false pretense, attempted to scrutinize the profits of RAF:

> This Request is meant to gather information to review the POA service fees for compliance with SSAP No. 25; transactions involving services between related parties. *"SSAP No. 25, paragraph 19 requires transactions involving services between related parties need to be on*

[10] It appears that the Department may seek to rely on NJ PURE's Certificate of Authority (based on the documents it added to the record without a motion). However, that Certificate simply requires RAF to submit a financial statement related to its management of NJ PURE, not its AIF Fees. Furthermore, the reservation of rights does not allow the Department to unilaterally determine what statutes apply to RAF. Ja79. That is the job of the Legislature.

> *an arm's length basis."* Amounts charged (up to 12.5% of DWP as in the current POA) by RAF for current and future services need to be supported by current market rates or on allocations of costs and reasonable in relation to the services provided to NJ PURE.
>
> - Expense analysis performed, if any, by RAF establishing the "up to 12.5%" service fee included in the POA agreement.
> - Description of the process to review / re-perform the expense analysis and POA service fee periodically, if such a process exists.
> - Analysis of actual expenses incurred by RAF for each year, 2017 through 2021, in performing the POA services for these years (itemized if possible) and the fees charged to NJ PURE.
> - RAF's proforma financial [statements] for each of the years, 2017 through 2021.
>
> [See Ja69-70 (Request received from the Department on July 6, 2022 in connection with their 2020 financial examination of NJ PURE).]

The Department then compounded its improper questioning, asking the following:

> In relation to NJ PURE, the Department is following up from your note from Q2 and now requesting an update for Q3. The Department's request relates to the fees incurred by NJ PURE for RAF's services which are charged by an AIF as a related party.
>
> Please provide the Department with the following:
>
> 1. Total service fees charged by RAF to NJ PURE through Q3?
> 2. Were there any service fees due to RAF which were reflected as payables by NJ PURE in Q3?
> 3. An estimate of the gross written premiums for Q4.

> 4. Total service fees to be charged by RAF to NJ PURE in Q4.
> 5. Total service fees to be charged by RAF to NJ PURE for 2022.
>
> To ensure clarity and consistency, please be aware that the services provided and fees charged by RAF are considered a related party transaction subject to SSAP 25 and that all laws and requirements, including but not limited to, NJSA 17:27A-1 through 14, and that the application of relevant SSAPs such as SSAP 25 apply to reciprocals.
>
> [See Ja71(Question received from the Department on December 7, 2022 in connection with their review of NJ PURE's Q3 2022 Quarterly Statement).]

RAF and NJ PURE objected to this request. Id. Only thirteen days later, the Department issued the Bulletin. The Department is clearly now attempting to use SSAP No. 25 and the Bulletin to scrutinize and regulate profits of an AIF. Id.

On January 27, 2023, RAF and NJ PURE submitted a letter to the Department objecting to the Bulletin, the attempted imposition of the Holding Act to NJ PURE and the application of SSAP No. 25 to RAF's AIF Fees, and asked the Department to rescind the Bulletin or stay enforcement, requesting a response on or before February 1, 2023. See Transaction ID#E1554683-03312023. The Department's only response was to note that it was reviewing the letter. Id. Because the Department has acted improperly and not allowed for notice and comment, it claims that these documents are not part of the record on this appeal. But that misses the point; it is precisely because the Department acted improperly in issuing the Bulletin

without developing a proper record that these letters could not have been sent before the Bulletin was issued.

That the Department is improperly overstepping its authority through the issuance of the Bulletin was confirmed by two recent and identical bills introduced in the Senate and Assembly. First, unlike the Department's "Bulletin," these are properly enacted bills. Second, again unlike the Department's "Bulletin," these bills are consistent with and intended to confirm and preserve New Jersey's long-standing principle that contracts between subscribers and the attorney-in-fact for a reciprocal are not related party transactions. See supra pp. 6-7. "Such contracts between subscribers and the attorney-in-fact and any fees charged pursuant to those contracts or arising out of those contracts shall not be construed to be a related party transaction." See S. 3636, 220th Leg. (2023), *available at* https://pub.njleg.state.nj.us/Bills/2022/S4000/3636_I1.PDF; A. 5317, 220th Leg. (2023), *available at* https://pub.njleg.state.nj.us/Bills/2022/A5500/5317_I1.PDF ("Related Party Transaction Bill").

Despite the undisputed history of the Department's treatment of attorneys in fact and the pending legislation intended to preserve same, the Department has persisted in its improper attempts to regulate AIF fees. Ja1-2. Accordingly, RAF filed this appeal. See NOA. The Department filed its Statement of Items Comprising the Record on March 6, 2023. See Ja1-80. On March 31, 2023, RAF

filed a motion for leave to supplement/correct the record because that record did not include its communications with the Department about these issues—including the Department's admissions that it could not impose the requirements of the Holding Act on reciprocals or SSAP No. 25's requirements on the fees paid by subscribers to the reciprocal's AIF without legislation, which predate the Bulletin. See Ja72-76. On April 7, 2023, the Department filed a motion seeking a thirty-day extension of time to respond, which RAF did not oppose. See Transaction ID#E1555971-04072023. On May 10, 2023, the Department submitted its "opposition" in which it conceded that the majority of the documents RAF sought to include in the Appendix were proper. See Ja1-80. Tellingly, the Department objected to including a redacted copy of one of its 2007 examinations in which it admitted that legislation was required; the Department objected not because the statement or document was inaccurate but because other irrelevant information was redacted. Id. The Department objected even as it sought to add more documents to the record to bolster its argument. Id.

On May 11, 2023, RAF sought leave to file a reply brief nunc pro tunc. See Transaction ID#E1562356-05112023. On May 31, 2023, the Appellate Division granted that motion, but denied RAF's motion to supplement the record. See Ja1-80.

STANDARD OF REVIEW

Regulations are "presumed to be reasonable and valid" and if such regulation is "procedurally regular, it may be set aside only if it is proved to be arbitrary or capricious or if it plainly transgresses the statute it purports to effectuate, or if it alters the terms of the statute or frustrates the policy embodied in it." Matter of Repeal of N.J.A.C. 6:28, 204 N.J. Super. 158, 160 (App. Div. 1985). Any rulemaking that does not "conform[] with basic tenets of due process and provide[] standards to guide both the regulator and the regulated," will be set aside. Lower Main St. Assocs. V. N.J. Hous. & Mortg. Fin. Agency, 114 N.J. 226, 236 (1989). Courts will also set aside rulemaking if it is not "authorized by or consistent with the agency's enabling legislation." Id. at 243.

As such, in reviewing administrative actions, the judicial role is ordinarily confined to three inquiries:

> (1) whether the agency's action violates the enabling act's, express or implied legislative policy; (2) whether there is substantial evidence and records to support the findings upon which the agency based application of the legislative policies; and (3) whether, in applying the legislative policies to the facts, the agency clearly erred by reaching a conclusion that could not reasonably have been made upon a showing of the relevant factors.
>
> [In re Twp. of Warren, 132 N.J. 1, 28 (1993).]

In that context, "[f]ailure to address critical issues, or to analyze the evidence in light of those issues, renders the agency's decision arbitrary and capricious and is grounds

for reversal." Green v. State Health Benefits Comm'n, 373 N.J. Super. 408, 415 (App. Div. 2004).

LEGAL ARGUMENT

I. THE DEPARTMENT'S BULLETIN REQUIRING THE IMPOSITION OF THE HOLDING ACT IS CONTRARY TO THE REA'S PLAIN LANGUAGE AND THE DEPARTMENT'S PRECEDENT. (A1-2).

The Appellate Division defined the term "reciprocal," or "reciprocal insurance," as a

> system of insurance whereby several individuals, partnerships, or corporations underwrite each other's risks against loss . . . through an attorney in fact, common to all, under an agreement that each underwriter acts separately and severally and not jointly with each other. The authority to enter reciprocal insurance contracts is set forth at N.J.S.A. 17:50-1 to -19.
>
> [DeVito v. Sheeran, 165 N.J. 167, 171 n. 2 (2000) (alteration in original).]

Relatedly, N.J.S.A. 17:50-1 provides:

> Individuals, partnerships, trustees and all corporations of this State, herein designated "subscribers," are hereby authorized to exchange reciprocal or interinsurance contracts with each other and with individuals, partnerships, trustees and corporations of other States, districts, provinces and countries, for any or all of the kinds of business for which a company may be formed or authorized to transact under the provisions of chapter seventeen of Title 17 of the Revised Statutes, except life insurance.
>
> [N.J.S.A. 17:50-1.]

The REA, which was passed in 1945, expressly "incorporated a provision that exchanges created under the statute 'shall be regulated by this act, and by no other statute of this State relating to insurance, except as herein otherwise provided.'" In re Reorganization of Med. Inter-Ins. Exch. of N.J., 328 N.J. Super. 344, 355–56 (App. Div. 2000) (quoting N.J.S.A. 17:50–1). Importantly, this Court has held "[a] reciprocal association differs from a mutual company in that it has no corporate existence." Id. at 355.

Conversely, the Holding Act—the statute the Department seeks to apply here—was passed twenty-five years later in 1970, and yet it defines an "insurer" as

> any person or persons, corporation, partnership or company authorized by the laws of this State to transact the business of insurance or to operate a health maintenance organization in this State, except that it shall not include agencies, authorities or instrumentalities of the United States, its possessions and territories, the Commonwealth of Puerto Rico, the District of Columbia, or a state or political subdivision of a state.
>
> [N.J.S.A. 17:27A-1(e).]

The statute defines "person" as "an individual, a corporation, a limited liability company, partnership, an association, a joint stock company, a trust, an unincorporated organization, any similar entity or any combination of the foregoing acting in concert." Id. at -1(f). Thus, the Department's assertion that "[a] reciprocal exchange falls squarely within the definition of insurer in the [Holding Act] as

defined in N.J.S.A. 17:27(A)-1(e)" is incorrect. 2022 WL 18427017, at *1 (Ja2).

The Department recently has claimed that the Holding Act's provisions control, stating that "[a]ll laws and parts of laws of this State inconsistent with this chapter are hereby superseded with respect to matters covered by this chapter." N.J.S.A. 17:27A-13. The Department is again incorrect. The terms of the Holding Act and the REA are not inconsistent; rather, the Holding Act just does not apply to reciprocals. As stated above, the words "reciprocal exchange" do not appear anywhere, nor does the Holding Act express an intention to overrule the exclusive jurisdiction of the REA. This is obvious by the forty years of history since the Holding Act was enacted, during which time the Department never sought to apply it to reciprocals and repeatedly admitted that it did not and could not apply absent new legislation. Rather, it enforced the REA. The Department cannot now simply ignore decades of its own admissions and conduct in regulating reciprocals simply because it wants to impress a new and different interpretation of the law.

This is true regardless of the Bulletin. The Bulletin, which purports to be issued in response to unspecified questions about the regulation of reciprocal exchanges, proclaims, for the first time and without explanation, that reciprocal exchanges are subject to the Holding Act. The Bulletin seeks to reverse the current status of the law.

"When interpreting a statute, [this Court's] main objective is to further the

Legislature's intent," In re Pontoriero, 439 N.J. Super. 24, 35 (App. Div. 2015) (TAC Assocs. v. N.J. Dep't of Envtl. Prot., 202 N.J. 533, 540 (2010)), "in light of the language used and the objects sought to be achieved," Bosland v. Warnock Dodge, Inc., 197 N.J. 543, 554 (2009). This Court "ascertain[s] the intent of the Legislature by first looking to the plain words of the statute," and "give[s] 'the statutory words their ordinary meaning and significance, and read[s] them in context with related provisions so as to give sense to the legislation as a whole." N.J. Election Law Enf't Comm'n v. DiVincenzo, 451 N.J. Super. 554, 576 (App. Div. 2017). The Court further assumes that the legislature is fully aware of existing laws when enacting a new statute. Squires v. Atl. Cty. Bd. of Chosen Freeholders, 200 N.J. Super. 496, 502 (Law. Div. 1985). "Where a statute is clear and unambiguous on its face and admits of only one interpretation, a court must infer the Legislature's intent from the statute's plain meaning." N.J. DYFS & Family Servs. v. I.S., 214 N.J. 8, 29 (2013).

Importantly, "[i]n interpreting a statute, [a court] strive[s] to give effect to every word rather than to ascribe a meaning that would render part of the statute superfluous." Id. at 36. "[I]n order to give proper effect to the Legislature's intent, a provision must be read sensibly within the entire legislative scheme of which it is part." Ibid. "When the plain meaning is unclear or ambiguous, [the court] next consider[s] extrinsic evidence of the Legislature's intent, including legislative history and statutory context." Pontoriero, 439 N.J. Super. at 36. However, "[w]here

plain language 'leads to a clear and unambiguous result, then the interpretive process should end, without resort to extrinsic sources.'" Sterling Laurel Realty, LLC v. Laurel Gardens Co-Op, Inc., 444 N.J. Super. 470, 476 (App. Div. 2016) (quoting State v. D.A., 191 N.J. 158, 164 (2007)).

In interpreting a statute, "[Courts] do not add terms which may have been intentionally omitted by the Legislature, speculate, or otherwise engage in an interpretation which would avoid its plain meaning." State v. Perry, 439 N.J. Super. 514, 523 (App. Div.) certif. denied, 222 N.J. 306 (2015). Pursuant to the doctrine of expression unius est exclusion alterius, the mention of one thing usually implies the exclusion of another. Squires, 200 N.J. Super. at 503.

Here, the Legislative intent is clear. The Holding Act does not, nor was it meant to, apply to reciprocal exchanges. First, the REA, under which NJ PURE was created, excludes the applicability of any other statute unless specifically noted; reference to the Holding Act is glaringly absent from the REA, even though the REA does expressly incorporate other statues, such as the Rehabilitation and Liquidation Act. N.J.S.A. 17:50-1, -5. Next, the Holding Act specifically describes what entities fall under its scope, and it does not include reciprocal exchanges. See id. Therefore, neither the Court, nor the Department, should append "reciprocal exchanges" to the defined terms, nor should they speculate as to whether the Legislature intended this term to be included. Furthermore, NJ PURE is not and cannot be both a reciprocal

exchange and a corporation because as this Court has held, a reciprocal exchange does not have a corporate existence. In re Reorganization of Med. Inter-Ins. Exch. of N.J., 328 N.J. Super. at 355. The Legislature was clearly aware of reciprocal exchanges when it passed the Holding Act and was clearly capable of drafting statutory language ensuring the applicability of the Holding Act to "reciprocal exchanges," but it purposefully did not include them in its scope.[11]

Not only is the Holding Act not incorporated into the REA, but the Department has also repeatedly admitted for the last two decades that the Holding Act does not apply to reciprocals and cannot absent the Legislature passing a new statute, which it never did. See Reciprocals Working Group Report of Special Insurance Issues (E) Committee, NAIC Proceedings – 1991 Vol. IIB at 1091-1096. This rogue action by the Department in attempting to apply the Holding Act through the Bulletin is clearly unlawful on procedural and substantive grounds.

II. THE DEPARTMENT'S BULLETIN REQUIRING THE IMPOSITION OF SSAP NO. 25 TO THE AIF FEE IS CONTRARY TO SSAP NO. 25's PLAIN LANGUAGE. (A1-2).

Like the inapplicability of the Holding Act, the Department knows and has acknowledged in its decades of examinations and follow-ups that it cannot apply SSAP No. 25 to RAF's AIF Fees. If that were not sufficient, the Legislature has confirmed this history through pending legislation, which is intended to codify the

[11] See supra page 9.

past practice of the past with respect to reciprocals. See S. 3636, 220th Leg. (2023), *available at* https://pub.njleg.state.nj.us/Bills/2022/S4000/3636_I1.PDF; A. 5317, 220th Leg. (2023), *available at* https://pub.njleg.state.nj.us/Bills/2022/A5500/5317_I1.PDF ("Related Party Transaction Bill"). The impropriety of the Department's actions in unilaterally adopting a contrary Bulletin is obvious.

As a threshold matter, by its plain language SSAP No. 25 does not apply to RAF's AIF Fees, nor has the Department ever applied SSAP No. 25 to NJ PURE, RAF, or any other reciprocal exchange in New Jersey in the manner set forth in the Bulletin.

As set forth above, SSAP No. 25 governs accounting and disclosures for transactions between affiliates and related parties, which it defines as "entities that have common interest as a result of ownership, control, affiliation or by contract." SSAP No. 25(4). Per SSAP No. 25, an Attorney-in-Fact for a reciprocal exchange is considered a related party to the Exchange,[12] and transactions between the Exchange itself and the Attorney-in-Fact may be subject to SSAP No. 25. However, as detailed above the payment of the AIF Fees does not involve any transaction between RAF and the Exchange itself. There is no agreement between the Exchange

[12] NJ PURE's collective group of subscribers is referred to as the "Exchange."

and RAF related to the management fee, and the Exchange does not pay the AIF Fee to RAF.

The AIF fees, which are set forth in the POA signed individually by each new subscriber/policyholder as a pre-requisite to join the Exchange, do not involve a related party transaction between the AIF and the Exchange itself. Rather, the POA is an agreement between two unrelated parties, namely the individual subscriber/policyholder and the management company/AIF.

Thus, the payment of the AIF Fee involves a transaction between the AIF and the individual subscribers—consumers looking for insurance coverage—who wish to obtain insurance through the Exchange. This is an arm's length transaction between two willing and unaffiliated entities. The AIF does not control the individual subscriber's decision.

This is key because such unilateral control is a fundamental trait of a related party transaction. See SSAP No. 25, 4 (referring to common control, ownership or affiliation); Schering-Plough Corp. v. United States, 651 F. Supp.2d 291, 244-45 (D.N.J. 2001) (noting for tax purposes that parties are not acting at arm's length where one had the ability to control the other); Altor, Inc. v. Sec. of Labor, 498 Fed. Appx. 145, 148-49 (3d Cir. 2012) (noting that common operation, management and control refuted arm's length transactions). If RAF controlled the Exchange and the terms to which each policyholder agrees, it could unilaterally alter the fees/other

terms and simply impose a new POA on the Exchange. It cannot. Instead, RAF would need to amend the form of the POA, file it with the Department, and obtain the individual subscriber's signatures as it has done in the past. In fact, RAF had to undergo this arduous process of securing tens of thousands of new POA signatures once during its long twenty-year history.[13] Each individual subscriber has an opportunity to consent to the new POA or seek insurance elsewhere. In other words, the individual subscriber is not and cannot be compelled to participate or commit to the new POA. Thus, the subscriber's payment of the AIF Fee bears none of the characteristics of transactions between related entities that are subject to SSAP No. 25.

Here, the POA—by virtue of both the voluntary execution by each individual subscriber and its transparent terms, including the management fee—requires the mutual assent of two unrelated and uncontrolled parties. The subscriber and RAF are both "willing parties" that are not under the compulsion to buy or sell and are willing to participate in the contract. That is the definition of an arm's length transaction. SSAP No. 25(13). Thus, the relationship between RAF and the

[13] When the Exchange was created in 2003, the POA terms were executed by each individual policyholder; they changed with the approval of a new POA in 2013 for surplus contributions. This change required: 1) an entirely new POA to be filed with the Department; 2) the new POA to be issued and delivered to every individual policyholder; and 3) each subscriber to execute it.

subscriber is an arm's length transaction to which SSAP No. 25 does not apply. See Delaney v. Dickey, 244 N.J. 460, 488 (2020) (noting that in an arm's length transaction both parties are "free to negotiate mutually acceptable contractual terms pursuant to their individual best interests"); JPC Merger Sub LLC v. Tricon Enter., Inc., 474 N.J. Super. 145, 164 (App. Div. 2022) (enforcing contracts that are free from duress, mistake or unconscionability).

With respect to each reciprocal, the Department is well-aware of the amount of the AIF Fee, given that it is and always has been clearly set forth in the POA that the Department has repeatedly reviewed. The Department has never before applied SSAP No. 25 to AIF Fees. Consistent with the pending legislation, the Department has never raised any concern over the management fee or, until now, sought to review AIF's financial information, expenses or pro forma financial statements.

This is because N.J.S.A. 17:50-8 subjects the "records, affairs and financial condition of the exchange" to the Department's review—not those of the AIF. The AIF Fee is not part of the Exchange's "records, affairs and financial condition." It has nothing to do with the financial health of the Exchange or its obligations to subscribers.

III. THE DEPARTMENT'S PAST PRECEDENTS CONFIRM THAT NEITHER THE HOLDING ACT NOR SSAP NO. 25 APPLY. (Ja1-2; Ja72-76).

The plain language of the Holding Act confirms that it does not apply to reciprocals, just as the plain language of SSAP No. 25 confirms that it does not apply to the AIF Fee the subscriber pays. The Department's past practices and own admissions confirm it as well.

As stated, the Department acknowledged that a legislative amendment was necessary to enable it to apply the Holding Act or SSAP No. 25. However, the New Jersey Legislature did not enact any such legislation, and the NAIC unanimously deleted the model law governing Attorney-in-Fact reciprocal exchanges in 2004, on which the Department's recommended legislation was based, and it is no longer in effect.

Following the Department's failure to obtain legislative modification of the statutes to apply to reciprocals, the Department dropped the issue of the applicability of the Holding Act and SSAP No. 25, remaining silent and accepting the status quo until now. Thus, the Department acknowledged the current law in New Jersey does not subject reciprocals to the Holding Act or the AIF Fees to SSAP No. 25, but also admitted that the only way to apply these requirements to reciprocals would be to pass a new statute. To date, the Department has never required NJ PURE to comply with the Holding Act nor has it ever attempted to apply SSAP No. 25 to the contract between RAF and its subscribers.

The pending legislation simply codifies this reality and confirms that the Department is not free to impose SSAP No. 25's requirements on the AIF Fees because it is not a related party transaction. (Related Party Transaction Bill). The Department's Bulletin cannot change this, particularly given that it is the product of improper rulemaking.

Despite this, contrary to all of the above law and precedent, the Department is arguing that NJ PURE is subject to the Holding Act and that because the Exchange simply operates as a pass-through entity that collects fees on behalf of the AIF, that collection is a related-party transaction. By applying the Holding Act and SSAP No. 25—which, again, is simply a reporting/disclosure accounting principle—to the AIF Fee, the Department is attempting to justify a means to its desired end: opening the flood gates to exert control over the profits of the AIF, despite having no statutory or regulatory authority to do so.

Not only is the Department's attempt to apply the Holding Act and SSAP No. 25 unenforceable as improper rulemaking, but it is also simply impossible. The Department cannot simply reverse its position after decades and demand that a business agree that what historically was an "unrelated party transaction" is now a "related party transaction." This is contrary to the plain language, and the intent of, both the Holding Act and SSAP No. 25 and the Department's procedural obligations under the APA.

The law has not changed, nor has the Department's inability to apply the Holding Act or SSAP No. 25. The Department's arbitrary and capricious actions regarding same constitute improper rulemaking and cannot be allowed to stand. In short, both by its words and its actions, the Department has admitted that the Holding Act does not apply to NJ PURE and SSAP No. 25 cannot be applied to AIF Fees absent the adoption of new legislation, which has never occurred.

IV. THE BULLETIN CONSTITUTES IMPROPER RULEMAKING AND IS INVALID AS A MATTER OF LAW. (Ja1-2).

As set forth above, the Department's actions are substantively improper; however, even if the actions were substantively proper (which they were not), the APA requires that administrative agencies follow specific procedures when adopting new rules. The Department violated/ignored these procedures in adopting the Bulletin, which is yet another basis on which this Court should reverse the Department's actions.

An administrative rule is an "agency statement of general applicability and continuing effect that implements or interprets law or policy, or describes the organization, procedure or practice requirements of any agency." N.J.S.A. 52:14B-2. Any agency determination that qualifies as an administrative rule must comply with the APA's rulemaking requirements. N.J.S.A. 52:14B-3a(a); In re N.J.A.C. 7:1B-1.1, et seq., 431 N.J. Super. 100, 134 (App. Div.), certif. denied, 216 N.J. 8 (2013) ("If an agency . . . action constitutes an 'administrative rule,' then its validity

requires compliance with specific procedures of the APA that control promulgation of rules.").

Administrative agencies are part of the Executive Branch and are "creatures of legislation," such that their powers are "limited to those expressly granted by statute or fairly implied as necessary." N.J. Dep't of Labor v. Pepsi-Cola Co., 170 N.J. 59, 65 (1980). While agencies have significant authority, their powers are not absolute and they must follow specific rules to be fair, uniform and predictable to members of the regulated community. In general, agencies may not engage in formal action without complying with the APA. An agency's ability to select procedures it deems appropriate to accomplish its statutory mission is limited by "the strictures of due process and of the [APA]." In re Solid Waste Util. Cus. Lists, 106 N.J. 508, 519 (1987); see also In re Provision of Basic Generation Serv. for Period Beginning June 1 2008, 205 N.J. 339, 347 (2011) ("[A]dministrative agency action, and an agency's discretionary choice of the procedural mode of action, are valid only when there is compliance with the provisions of the Administrative Procedure Act . . . and due process."). Included in these procedural requirements are mandatory notice provisions and opportunity for public comment before an agency may set a rule or policy in place. N.J.S.A. 52:14-B-4(a)(1) to (3). Notice and an opportunity to be heard and to gather and submit information is crucial to the overall essence of rulemaking as without it, those affected would have no opportunity to participate in

the process. Because the APA requires the Department to comply with its rulemaking procedures in imposing the Holding Act and SSAP No. 25 to reciprocal exchanges, the informally adopted policies through the Bulletin are invalid.

A. The Bulletin is an Administrative Rule Subject to APA Compliance. (Ja1-2).

The Department's unilateral decisions to apply the Holding Act to reciprocals and to apply SSAP No. 25 to the AIF Fees both represent a complete sea change compared to decades of the Department taking the exact opposite stance. Such agency action is not enforceable as a matter of law as it constitutes impermissible "de facto rulemaking" under the test announced by our Supreme Court in Metromedia, Inc. v. Director, Division of Taxation, 97 N.J. 313, 328 (1984). "When an agency's determination alters the status quo, persons who are intended to be reached by the finding, and those who will be affected by its future application, should have the opportunity to be heard and to participate in the formulation of the ultimate determination." Northwest Covenant Med. Ctr. v. Fishman, 167 N.J. 123, 136 (2001) (quoting Metromedia, 97 N.J. at 330). The Department must comply with the APA before it changes an existing policy that alters the status quo and "substantially impacts the right of [RAF] and others." B.H. v. State of N.J., Dept. of Human Srvs., 400 N.J. Super. 418, 430 (App. Div. 2008). The Bulletin is an administrative rule that must comply with the APA.

In Metromedia, our Supreme Court provided guidance on when a particular

agency action should be considered de facto rulemaking. "Th[is] guidance is important because informal agency action that is de facto rulemaking will be voided for failing to comply with the APA rulemaking procedures." Besler & Co. v. Bradley, 361 N.J. Super. 168, 171 (App. Div. 2003). Agency action may constitute rulemaking **regardless** of the label the agency gives it. Metromedia, 97 N.J. at 331-32 (emphasis added). Agency action will be considered rulemaking when it:

> (1) is intended to have wide coverage encompassing a large segment of the regulated or general public, rather than an individual or a narrow select group; (2) is intended to be applied generally and uniformly to all similarly situated persons; (3) is designed to operate only in future cases, that is, prospectively; (4) prescribes a legal standard or directive that is not otherwise expressly provided by or clearly and obviously inferable from the enabling statutory authorization; (5) reflects an administrative policy that (i) was not previously expressed in any official and explicit agency determination, adjudication or rule, or (ii) constitutes a material and significant change from a clear, past agency position on the identical subject matter; and (6) reflects a decision on administrative regulatory policy in the nature of the interpretation of law or general policy. These relevant factors can, either singly or in combination, determine in a given case whether the essential agency action must be rendered through rulemaking or adjudication.
>
> [Ibid.]

These factors are applicable whenever the authority of an agency to act without conforming to the requirements of the APA is questioned, for example, in adopting orders, guidelines, or directives. In re Protest of Coastal Permit Program

Rules, 354 N.J. Super. 293, 362 (App. Div. 2002) (citing Doe v. Poritz, 142 N.J. 1, 97 (1995)).

Not all factors need to be present for improper rulemaking. Metromedia, 97 N.J. at 332. "The pertinent evaluation focuses on the importance and weight of each factor," not "a quantitative compilation of the number of factors which weigh for or against labeling the agency determination as a rule." In re Provision of Basic Generation Serv., 205 N.J. at 350; see also State v. Garthe, 145 N.J. 1, 6 (1996); In re N.J.A.C. 7:1B-1,1, et seq., 431 N.J. Super. at 135 (noting the factors "need not be given the same weight, and some factors will clearly be more relevant"); Bullet Hole, Inc, v. Dunbar, 335 N.J. Super. 562, 588-89 (App. Div. 2000) (holding an agency action meeting only four of the six factors constituted rulemaking because "in the circumstances of this appeal it is evident that the [action] . . . should have been considered in a formal rulemaking proceeding").

For example, in In re Disapproval of Commercial Insurance Policy Forms of Insurance Company of North America, the Department disapproved Cigna's proposed endorsement containing an absolute pollution exclusion because the Department believed it could exclude coverage for asbestos claims. 264 N.J. Super. 228, 233 (App. Div. 1993) ("Cigna"). Cigna challenged the denial, arguing that the Department had effectively adopted a policy regarding the validity of asbestos exclusions without notice or compliance with the APA. Id. at 234. The Appellate

Division agreed, finding that the Department engaged in improper rule making. Id. at 236. "[T]he widespread, continuing, and prospective effect of an agency pronouncement is the hallmark of an administrative rule." Ibid. The Court noted that the Department's position reflected "an administrative policy that has not previously been expressed in any official or explicit agency determination, adjudication or rule." Id. at 237. The Department could not rely on its "own yet to be expressed policy" to evaluate Cigna's proposed policy exclusion. Id. at 238.

The Bulletin is clearly improper rulemaking that meets all six Metromedia factors. First, the Bulletin will have widespread, continuing and prospective impact on all reciprocal insurance exchanges. Second, although on its face the Bulletin purports to be limited to responding to questions, it is actually improper rulemaking forcing reciprocal exchanges to comply with new, never before applied, regulations governing their financials. Although designed to give the most superficial appearance that the Department has not adopted a process of general application, the Bulletin was undeniably intended to allow the Department to regulate AIF fees. Why did the Department adopt this Bulletin if the REA already has a process in place for financial examinations of AIF fees? Because it knows it is required to amend the REA and as the pending legislation demonstrates, the Legislature does not agree with the Department's position. (Related Party Transaction Bill). Third, here, like in Cigna, the Department is seeking to impose requirements on reciprocal exchanges

and the respective AIFs that are based on a "yet to be expressed policy" regarding the Holding Act and SSAP No. 25. Fourth, the guidelines unlawfully adopted by the Bulletin are not "expressly provided by or clearly and obviously inferable from the enabling statutory authorization." This is because the REA governs reciprocal exchanges, and it is contrary to the Department's guidance. Fifth, the Bulletin "constitutes a material and significant change" in the Department's past position with respect to the Holding Act and SSAP No. 25 and the provisions' plain language. Finally, the Bulletin "reflects a decision on the administrative regulatory policy in the nature of the interpretation of law" because it furthers a new procedure intended to apply to reciprocal exchanges and which it presumably asserts is in accordance with the REA. Metromedia, at 331-32. This is the embodiment of rulemaking that must comply with the APA.

Indeed, as many other cases reviewing agency overreach make clear, "[e]very agency action which qualifies as a rulemaking by the standards of Metromedia must conform with APA requirements. In the absence of compliance with APA rule-making requirements, the standards at issue are not enforceable." Hampton v. Dep't of Corr., 336 N.J. Super. 520, 530 (App. Div. 2001) (citing Metromedia, 97 N.J. at 338); see also Besler & Co., 361 N.J. Super. at 178 ("'[A]n agency may not use its power to interpret its own regulations as a means of amending those regulations or adopting new regulations' . . . . The manner in which an agency exercises broad

discretion 'may be governed by the APA.'"); Matter of Assignment of Producers to Travelers Grp., 261 N.J. Super. 292, 302-03 (App. Div.), certif. denied, 133 N.J. 438 (1993) (holding that producer assignment program constituted improper rulemaking but was cured by emergency regulation).

The fact that the Department is seeking to accomplish this change through a "bulletin" is irrelevant. Indeed, the Appellate Division has invalidated similar guidance documents. For example, in In re Adoption of Reg'l Affordable Housing Dev. Program Guidelines, 418 N.J. Super. 387, 389 (App. Div. 2011), the Council on Affordable Housing ("COAH") adopted "guidelines" for the implementation of an amendment to the New Jersey Fair Housing Act. The Court concluded these guidelines "set forth specific standards and conditions for regional planning that COAH will find acceptable in its administration of [the applicable statute]" and therefore constitute rules. Id. at 395.

The Court similarly invalidated Department of Environmental Protection (the "DEP") guidance documents in In re N.J.A.C. 7:1B-1.1 et seq., 431 N.J. Super. 100 (App. Div. 2013) relating to the "waiver" rules excusing certain regulatory compliance. In doing so, it noted the invalidated guidance document "lists specific procedures and instructions that waiver applicants should follow to prove and satisfy each of the four bases for waivers." Id. at 136. The Court held that all six of the Metromedia factors applied to these guidance documents and much of the DEP's

website postings concerning the waiver rules. Id. at 137; see also In re Highlands Master Plan, 421 N.J. Super. 614, 629-33 (App. Div. 2011) (invalidating a "[g]uidance document" promulgated by the COAH that provided formulas for municipalities to calculate "growth projections" that effectively lowered COAH's regulatory requirements).

The law has not changed, nor has the Department's inability to apply the Holding Act or SSAP No. 25. Therefore, any argument that this policy shift is a mere "informal intra-agency document designed to clarify existing policy," must be rejected because it is contrary to the Department's previous policy. B.H., 400 N.J. Super. at 431. Here, because the "change advanced by [the Department is] not merely an internal instruction," but, rather, is a change in existing policy that alters the status quo and "substantially impacts the right of" all reciprocals, the law requires APA compliance. Ibid.

The constitutional rights of those affected by the change command no less formal a process than is set forth in the APA, a concept that the Legislature underscored specifically in passing the APA. See N.J.S.A. 26:2H-5(b). It is clear in light of such strong legislative and judicial recognition of the due process rights of a regulated class that, when an agency materially and significantly changes its position on the application of the Holding Act or the precise circumstances in which SSAP No. 25 is applied to AIF fees, such modifications must be affected through

the formal rulemaking process set forth in the APA. Am. Emp'r Ins. Co. v. Comm'r of Ins., 236 N.J. Super. 428, 432-34 (App. Div. 1989). The Department's arbitrary, capricious, unreasonable and ultra vires actions must be challenged because while "[a]dministrative agencies possess wide latitude in selecting the appropriate procedures to effectuate their regulatory duties and statutory goals[,] . . . this flexibility does not allow an agency to ignore the dictates of the [APA]." St. Barnabas Med. Ctr. v. N.J. Hosp. Rate Setting Comm'n, 250 N.J. Super. 132, 142 (App. Div. 1991).

Despite the clear law that governs how agencies may act and change existing policy, the Department now seeks to sub silentio reverse the thirty-plus year history of regulation of Exchanges through the Bulletin without even attempting to comply with the APA or any due process protections. The Department's attempt to change the law by way of a Bulletin and without any substantive and procedural due process is a blatant example of agency abuse and overreach.

It is no surprise that the Department chose to forego formal rulemaking or a hearing—had the Department complied with the APA, the faulty rationale for applying the Holding Act and SSAP No. 25 would never have seen the light of day. However, because the Bulletin is a rule under the APA and the Department failed to proceed with rulemaking, a hearing, or with any other appropriate process under the APA, the Bulletin should be set aside as invalid and the Department should be

directed to comply with the APA. See N.J. Animal Rights All. v. Dep't of Environ. Prot., 396 N.J. Super. 358, 362 (App. Div. 2007) ("[A]ll agency actions taken subsequent to the adoption of the [earlier pronouncement] were invalid since the initial [pronouncement] did not lawfully exist.").

B. The Department Failed to Comply with the APA When It Published The Bulletin. (Ja1-2).

As set forth above, the Department clearly failed to comply with the APA in adopting the Bulletin.

> "Rulemaking is a legislative-like activity . . . . The purpose of the APA rulemaking procedures is 'to give those affected by the proposed rule an opportunity to participate in the process, both to ensure fairness and also to inform regulators of consequences which they may not have anticipated.'"
>
> [In re Provision of Basic Generation Serv., 205 N.J. at 349.]

"The APA's section on rulemaking notice and opportunity to comment has specific requirements." Id. at 349 n. l. Among those requirements is N.J.S.A. 52:14B-4(a)(2), which compels the agency to "prepare a report for public distribution which provides a set of analysis of the expected impact of the proposed rule." Ibid. Where the due process requirements of the APA are not met in connection with promulgating a regulation, including situations where N.J.S.A. 52:14B-4(a)(2) is not complied with, it is a Court's duty to invalidate the regulation as an improper exercise of the agency's rulemaking power. See Lower Main St.

Assocs., 114 N.J. at 243-44 (invaliding noncompliant regulation and finding courts have a "clear and compelling" duty to set aside a regulation when the agency has misused its rulemaking power).

N.J.S.A. 52:14B-4(a)(2) requires that, prior to adoption of a rule, the agency shall

> (2) Prepare for public distribution . . . and make available for public viewing . . . a statement setting forth a summary of the proposed rule, as well as a clear and concise explanation of the purpose and effect of the rule, the specific legal authority under which its adoption is authorized, [and] a description of the expected socio-economic impact of the rule . . . .

An agency engaged in rulemaking must give notice, principally by publication of the proposed regulations in the New Jersey Register. N.J.S.A. 52:14B-4(a)(1); N.J.A.C. 1:30-5.2(a). Notice must occur at least thirty days before the intended action and must include a statement of the terms or substance of the intended action and the time, place and manner in which comments may be presented. N.J.S.A. 52:14B-4(a)(1); N.J.A.C. 1:30-5.1(b)(9).

In addition to publication in the New Jersey Register, the agency must mail notice to all parties who have notified that agency of its desire to receive advance notice of agency rulemaking activities. N.J.S.A. 52:14B-4(a)(1); N.J.A.C. 1:30-5.2(a)(3). The agency must also provide notice of the rulemaking activity to the news media maintaining a press office in the State House Complex and through

electronic means. N.J.S.A. 52:14B-4(a)(1); N.J.A.C. 1:30 - 5.2(a)(4) – (5). Finally, the agency must afford all interested persons a reasonable opportunity to submit data, views, comments, or arguments, orally or in writing and summarize and respond to the information and comments submitted. N.J.S.A. 52:14B-4(a)(3).

Similarly, the New Jersey Administrative Code requires that rulemaking materials "shall be written in a reasonably simple and understandable manner which is easily readable" and "[t]he document shall be sufficiently complete and informative as to permit the public to understand accurately and plainly the legal authority, purposes and expected consequences of the adoption, readoption or amendment of the rule or regulation." N.J.A.C. 1:30-21(a)(6). The Department's rulemaking process for the Bulletin was fatally flawed because it did not provide the public with complete or accurate notice and disclosure, thereby violating the above-referenced statutory requirements, basic tenets of due process and fundamental principles of fairness. Fed. Pac. Elec. Co. v. N.J. Dep't of Envtl. Prot., 334 N.J. Super. 323, 343 (App. Div. 2000) ("The notice and comment requirements of the APA are not to be lightly applied or regarded as obstacles to be avoided. They are designed to serve the cause of fairness by providing a mechanism for informing the affected public adequately of the operation and impact of proposed administrative rules and regulations which, in these times, govern so much of our day-to-day existence.").

Moreover, in engaging in rulemaking or other agency action, an agency's power is limited to enforcing statutes and regulations, which of course the agency may not disregard. See G.C. v. Div. of Med. Assistance & Health Srvs., 249 N.J. 20, 40 (2021) (noting "[a]n agency cannot ignore or change legislative terms 'or frustrate the policy embodied in the statute'" (quoting T.H. v. Div. of Dev. Disabilities, 189 N.J. 478, 491 (2007)).

It is axiomatic that an agency, while entitled to deference in the interpretation of a statute it is charged with administrating, will be given no deference if the "interpretation of the law" is "outside its charge" or it "gives a provision of [the law] greater reach than the legislature intended." Comm. Workers of Am., Local 1034 v. N.J. State Policemen's Benevolent Ass'n, Local 203, 412 N.J. Super. 286, 291 (App. Div. 2010) (citations omitted); see also Patel v. N.J. Motor Vehicle Comm'n, 200 N.J. 413, 420 (2009) ("An agency's final decision is plainly unreasonable and violates express or implied legislative direction if it gives 'a statute any greater effect than is permitted by the statutory language[,] . . . alter[s] the terms of a legislative enactment[,] . . . frustrate[s] the policy embodied in the statute . . . [or] is plainly at odds with the statute.'" (alterations in original) (quoting T.H., 189 N.J. at 491). Once an agency policy is set, either formally or informally, the agency may not change that policy without due process—that is, without the opportunity for the regulated community to comment on the proposed change. In re CAFRA Permit No. 87-0959-

5 Issued to Gateway Assocs., 152 N.J. 287, 308 (1997) (citing N.J.S.A. 52:14B-5, which includes language indicating mandatory compliance with the requirements of the APA). This is because the Department is barred from unilaterally and precipitously amending policy without affording the regulated community the opportunity to be heard:

> When an agency's determination alters the status quo, persons who are intended to be reached by the finding, and those who will be affected by its future application, should have the opportunity to be heard and to participate in the formulation of the ultimate determination.
>
> [Northwest, 167 N.J. at 136 (quoting Metromedia, 97 N.J. at 330).]

See also B.H., 400 N.J. Super. at 430 (noting agency must follow APA when it "effects a material change in existing law or alters the status quo").

Where an agency pronouncement is a rule under the APA, as was done here, and the agency fails to engage in proper rulemaking, the pronouncement should be set aside and the agency directed to proceed in accordance with the APA. See In re Provision of Basic Generation Serv., 205 N.J. at 362 (reversing Appellate Division and remanding to agency "to commence the process anew, [to] provide the regulated parties and the public with notice and an opportunity to comment"); Grimes v. N. J. Dep't of Corr., 452 N.J. Super. 396, 408 (App. Div. 2017) (remanding "for prompt commencement of rulemaking"); In re N.J.A.C. 7:1B-1.1 et seq., 431 N.J. Super at 133 (finding agency "engaged in de facto rulemaking in violation of the APA's

notice and comment requirements" and invalidated documents "as de facto rulemaking without APA compliance"); N.J. Hosp. Assoc., 227 N.J. Super. at 568 (finding agency allocation decision a "rule" such that "the full panoply of provisions prescribed by the APA should be invoked" and finding those requirements "fundamental").

V. EVEN IF NOT A RULE, THE REQUIREMENTS IN THE BULLETIN VIOLATE THE REA AND ARE OTHERWISE AN ABUSE OF DISCRETION BECAUSE SSAP NO. 25 DOES NOT APPLY TO THE AIF FEE. (Ja1-2).

Even if this Court concludes that the Bulletin is not a rule under the APA, the Court should nonetheless still invalidate the Bulletin for two main reasons. First, through the Bulletin, the Department is attempting to impose the Holding Act on reciprocals and to use SSAP No. 25 scrutinize and regulate profits of an AIF. This application is at odds with the REA, such that if the Bulletin is accepted, it would alter the terms of the REA and frustrate its unique and specific requirements detailed above that apply solely to reciprocals and the objectives sought to be achieved by same. Second, the Bulletin fails to analyze the evidence in light of critical issues, which is a clear abuse of the Department's discretion. The Department grafts words on to the REA that do not appear and improperly seeks to extend the application of SSAP No. 25 to AIF Fees, so that if it finds that AIF fees "do not meet the fair and reasonable standard established by Appendix A-440, [such a finding] may result in (a) amounts charged being recharacterized as dividends or capital contributions, (b)

transactions being reversed, (c) receivable balances being nonadmitted, or (d) other regulatory action." See SSAP No. 25.

To be clear, this interpretation means that if the Department believes that AIF fees are too high, the AIF can be forced to reverse that transaction. This is a complete misuse of SSAP No. 25, and an about-face from decades of agency practice as confirmed by the pending legislation.

VI. THROUGH ITS IMPROPER RULEMAKING THE DEPARTMENT IS INTERFERING WITH RAF'S CONSTITUTIONAL RIGHT TO CONTRACT. (Ja1-2).

Subjecting the AIF fees to the scrutiny of SSAP No. 25 retroactively impairs RAF's constitutional right to contract with its individual subscribers. Indeed, "[b]oth the Federal and New Jersey State Constitutions bar the state legislature from passing any law impairing the obligation of contracts." Moynihan v. Lynch, 250 N.J. 60, 81-82 (2022) (citing U.S. Const. art. I, § 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . .")); N.J. Const. art. IV, § 7, ¶ 3 ("The Legislature shall not pass any . . . law impairing the obligation of contracts, or depriving a party of any remedy for enforcing a contract which existed when the contract was made.")); see also Fid. Union Tr. Co. v. N.J. Highway Auth., 85 N.J. 277, 299 (1981) (noting that United States and New Jersey Constitutions provide "parallel guarantees").

"The essential aim of the Federal and State Contract Clauses is to restrain a state legislature from passing laws that **retrospectively** impair **preexisting** contracts." Id. at 82 (emphasis in original); see also Cleveland & P.R. Co. v. City of Cleveland, 235 U.S. 50, 53-54 (1914) ("It is equally well settled that an impairment of the obligation of the contract, within the meaning of the Federal Constitution, must be by subsequent legislation."). "Contract impairment claims brought under either constitutional provision entail an analysis that first examines whether a change in state law results in the substantial impairment of a contractual relationship and, if so, then reviews whether the impairment nevertheless is 'reasonable and necessary to serve an important public purpose.'" Berg v. Christie, 225 N.J. 245, 259 (2016) (quoting U.S. Tr. Co. of N.Y. v. New Jersey, 431 U.S. 1, 25 (1977)). This inquiry involves a three-pronged analysis: whether 1) a contractual right exists in the first instance; 2) a change in the law impairs that right; and 3) the defined impairment is substantial. Ibid. The answer here to all three questions is a resounding yes.

As stated previously, the AIF fees are set forth in the POA signed individually by each new subscriber/policyholder as a pre-requisite to join the Exchange. The subscriber's rights and obligations, including the AIF fee are clearly set forth in the POA and freely agreed to by the subscribers. If the individual subscriber does not agree to the POA/AIF Fee, he/she is free to decline coverage and seek insurance

from another carrier. Through the Bulletin, the Department seeks to impair the parties' agreement (i.e., the POA) and the relationship established by that agreement so that it can control the profits of the AIF in blatant disregard of the contractual agreement between the subscriber and the AIF. The Department is trying to usurp the free will of RAF and the individual subscribers and upend the contractual arrangement between NJ PURE and its subscribers.

Indeed when "[a] law . . . retroactively applies to a contract previously entered into by parties," the "parties' reasonable expectations" may be upended. Berg, 225 N.J. at 259; see also Energy Rsrvs. Grp., Inc. v. Kan. Power & Light Co., 459 U.S. 400, 411 (1983) (discussing the role that parties' reasonable expectations play in Contract Clause analysis). That concern about legislation reaching back to alter an already-existing contract and causing fundamental unfairness is precisely the issue here.

Further, the Bulletin's impositions on reciprocal exchanges lack any significant and legitimate purpose. The REA, which governs reciprocals, specifically excludes the applicability of any other statute unless specifically noted. The Department, try as it might, cannot rewrite the REA through the Bulletin and use it to hold RAF hostage to the Holding Act and SSAP No. 25. This is at odds with the language of the REA, which has exclusive authority over reciprocal exchanges. In re Reorganization of Med. Inter-Ins. Exch. of N.J., 328 N.J. Super. at

355–56. It is also an improper reading of SSAP No. 25, which by definition does not apply to the AIF Fees paid by the subscribers. The fees paid to the AIF simply are not a "related party transaction" no matter how much the Department wishes they were. Likewise, the Bulletin is grounded in unreasonable conditions and is wholly unrelated to appropriate government objectives. Had the Legislature wanted to incorporate reciprocal exchanges under the Holding Act, it would have done so. It did not. The Department is now attempting to do an end-run around the Legislature's rejection of the Department's proposed legislation by imposing retroactive conditions on the agreements between AIF's and their subscribers. There is no scenario under which that is a reasonable condition in pursuit of an appropriate governmental objective.

In short, the Bulletin should not be permitted to be used as a means to bar enforcement of an otherwise valid contract between the AIF and its subscribers.

CONCLUSION

For the foregoing reasons, the Bulletin should be set aside as improper rulemaking.

Respectfully Submitted,

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