Court Invalidates New Regulations Issued by Department of Insurance Concerning Underwriting and Rescission of Health Insurance Policies

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On December 30, 2010, Sacramento County Superior Court Judge Michael Kenny invalidated several recently issued regulations by the California Department of Insurance ("CDI") in response to a challenge filed by the Association of California Life & Health Insurance Companies ("ACLHIC"). ACLHIC was represented by Gregory Pimstone of Manatt, Phelps and Phillips and by Barger & Wolen partner John M. LeBlanc. The regulations were issued by the CDI on August 5, 2010 and attempted to impose a series of underwriting requirements on health insurers and restrict health insurers' ability to rescind health insurance policies in California. A copy of the Court's ruling can be found here.

ACLHIC challenged the regulations on several grounds, claiming that the CDI abused its discretion in adopting the regulations. In particular, ACLHIC argued that the CDI lacked the authority to promulgate the regulations. The Court agreed with the ACLHIC with respect to the key regulations at issue. It held that the CDI lacked authority to issue either 10 California Code of Regulations § 2274.74 or 10 California Code of Regulations § 2274.77. The CDI argued, unsuccessfully, that its authority to issue these sections was found in Insurance Code§§ 790.10 and 12921.

Proposed Section 2274.74, entitled "Standard for Avoiding Prohibited Postclaims Underwriting," would have prohibited a health insurer from rescinding or canceling a policy if it did not comply with certain underwriting requirements set forth in the regulation, including requiring insurers to obtain health history information from a source other than the applicant. The regulation also purported to define medical underwriting by seven enumerated activities required of health insurers, without limiting medical underwriting to those seven activities. Further, the regulation attempted to establish the six activities that a health insurer had to conduct in order to resolve all questions arising from application materials. If a health insurer failed with respect to either of these two items (*i.e.*, any failure to complete the seven enumerated medical underwriting activities or the six activities required to resolve application questions), the regulation barred any rescission or cancellation. Finally, if a health insurer made any error in applying its own underwriting procedures – no matter how minor – the regulation likewise prohibited any rescission or cancellation.

The Court concluded that the CDI lacked the authority to promulgate Section 2274.74. It determined that Insurance Code§ 790.10 only applied to those activities governed by Article 6.5 of Chapter 1 of Part 2 of Division 1 of the Insurance Code (within which section 790.10 falls) and that postclaims underwriting is governed by a separate article outside the reach of Insurance Code§ 790.10. It reinforced this conclusion with the fact that the items prohibited by Insurance Code§§ 790.03, which Insurance Code § 790.10 governs, included an exhaustive list of prohibited business practices, none of which included postclaims underwriting and rescission based thereon. Finally, the Court concluded that Insurance Code§ 12921 only permitted the CDI to enforce existing laws regulating the insurance industry and that it did not provide authority for the CDI to promulgate new regulations.

The Court also invalided Section 2274.77 for these same reasons, as the CDI again relied on Insurance Code§§ 790.10 and 12921 to support its position that it was empowered to promulgate this regulation. Section 2274.77 purported to require an insurer, at the time of issuance and delivery of a policy, to return a complete copy of the application to the insured for review by including it in the same mailing, or other delivery mechanism, as the policy. If the insurer failed to comply with this requirement, it was precluded from using the information in the application as the basis for rescinding or canceling the policy.