

MEMORANDUM OF LAW

DATE: April 29, 1992

TO: Larry Gardner, Labor Relations Manager

FROM: City Attorney

SUBJECT: Insurance Rebates

You have requested a legal opinion concerning the legality of the City's action in retaining the rebates from Cigna Life Insurance plans offered through the flexible benefit plan.

By way of background, the City last year paid \$555,878.00 in life insurance premiums for City employees. The City is the policyholder. The rebate received from the insurance company was \$231,172.00. Individual members of the group insurance plan pay premiums for the insurance benefit for the year. Individual members receive the full benefit even when Cigna provides rebates to the policyholder. Premium costs are set by the company and are based upon the group aspect of the policy. Should an individual employee purchase a similar policy on individual basis, the premiums would undoubtedly be higher. Surplus balances are returned to the policyholder based upon the actual monies paid out by the company over the course of the policy year.

California Insurance Code Section 10214 provides:

Section 10214. Dividends and premium refunds

If hereafter any dividend is paid or any premium refunded under any policy of group life insurance heretofore or hereafter issued, the excess, if any, of the aggregate dividends or premium refunds under such policy over the aggregate expenditures for insurance under such policy made from funds contributed by the policyholder, or by an employer of insured funds contributed by the policyholder, or by an employer of insured persons or by union or association to which such insured persons belong, including expenditures made in connection with the administration of such policy, shall be applied by the policyholder for the benefit of such insured employees generally or their dependents or insured members generally or their dependents. For the purpose of this section and at the option of the policyholder, "policy" may include all group

life and disability insurance policies of the policyholder. (Emphasis added.)

As noted previously, the City is the policyholder. No excess dividends exist after the City's premium costs and administrative costs are calculated. That is, the amount paid for premiums and the cost of administering the plan is more than the amount rebated to the City by Cigna. In the case of *Luksich v. Kaiser Steel Corp.*, 245 Cal. App. 2d 373 (1966) the plaintiff argued that "excess" meant: "the 'aggregate expenditure for insurance' by Kaiser defendant was the net premiums retained by the insurance carrier and that the experience rating refunds premium refunds received from those insurance carriers represented monies that should have been applied by Kaiser for the benefit of the insured employees." *Id.* at 375.

The court further explained that:

Plaintiff argues for the interpretation that there was an "excess" in the premiums returned which should be applied for the benefit of plaintiff and her fellow employees, because the "aggregate expenditures for insurance" referred to in the statute, equals the premiums paid less the amount returned; that the premiums returned are "excess" because they are "left over."

The court, however, disagreed and said: "Since the premium refunds received by defendant were indisputably less than its contributions, the statute relied on by plaintiff California Insurance Code section 10214 affords her no rights thereto." *Id.* at 375.

The City, as did Kaiser in the *Luksich* case, paid more in premiums than it received in rebates. Thus, there are no excess premiums. This was reiterated by the court in *Keniston v. American Nat. Ins. Co.*, 31 Cal. App. 3d 803, 810 (1973) where the court said:

A policy of group insurance is a contract, and the rights and duties of the parties thereto are governed by the provisions of the master policy. Therefore, where the master policy expressly provides that premium refunds or dividends are to be paid to the policyholder, the individual members of the group insured under the policy have no right to receive such payments from the insurer. (Citations omitted.)

Therefore, under the terms of the City's group policy which provides that rebates be paid to the policyholder, the employees have no rights to the rebated money.

Additionally, I have spoken to Bob Blum, our tax consultant. He

has indicated that no problems exist under section 125 of the Internal Revenue Code ("IRC") due to the City's retention and use of the rebated funds.

Therefore, under the California Insurance Code and the IRC, the City has acted in good faith and with a proper exercise of its rights by retaining rebated insurance funds.

If you have any further questions, please feel free to call me.

JOHN W. WITT, City Attorney

By

Sharon A. Marshall

Deputy City Attorney

SAM:mrh:351(x043.2)

cc D. Cruz Gonzalez

ML-92-43