

Fidelity & Deposit Co. of Maryland

SELF-INSURANCE

Insolvency of self-insured employer

When the terms of the bond require that the penal sum of the bond be forfeited to the Department if the self-insured employer has defaulted and is insolvent, the Department can require the entire bond to be forfeited. ...*In re Fidelity & Deposit Co. of Maryland*, BIIA Dec., 14 13348 (2015) [*Editor's Note*: The Board's decision was appealed to superior court under Thurston County Cause No. 15-2-01209-3.]

Scroll down for order.

1 Co.¹ and to address the additional issues raised by Fidelity in this appeal: that the Department's
2 order is barred by statute of limitations and is an unenforceable penalty.
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4 We fully resolve this appeal on the basis of the cross-motions for summary judgment filed by
5 Fidelity and the Department. In reaching our decision, we considered:
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- 7 1. Fidelity's Notice of Appeal.
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- 9 2. The Jurisdictional History, as amended, stipulated to by the parties on June 18, 2014.
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- 11 3. The Department's Motion for Summary Judgment and Memorandum Supporting.
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- 13 4. Declaration of James Nylander and attached Exhibits 1 through 5.
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- 15 5. Fidelity's Response in Opposition to the Department's Motion for Summary Judgment.
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- 17 6. Declaration of Paul Friedrich in opposition to the Department's Motion for Summary
18 Judgment and Exhibit A attached thereto.
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- 20 7. Fidelity's Motion for Summary Judgment.
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- 22 8. Declaration of Paul Friedrich in Support of Fidelity's Motion for Summary Judgment, and
23 attached Exhibits A through L.
- 24
- 25 9. Department's Response to Fidelity's Motion for Summary Judgment.
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- 27 10. Fidelity's Reply in Support of its Motion for Summary Judgment.
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- 29 11. Department of Labor and Industries' Reply in Support of its Motion for Summary
30 Judgment.
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- 32 12. The transcript of oral argument of the parties held on December 5, 2014.
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- 34 13. Arguments contained in Fidelity's Petition for Review.
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- 36 14. Argument contained in the Department's Response to Fidelity's Petition for Review.

37 The material facts are not disputed.

38 **B. Substantive Facts**

39 Between January 1, 1997, and February 10, 2003, Spiegel was a self-insured employer with
40 the Department of Labor and Industries. Spiegel, Inc., did business in Washington as the retail
41 clothing store known as Eddie Bauer.

42 Under RCW 51.14.020(2), the Department required Spiegel to supplement its self-insured
43 financial ability by depositing a surety bond with the Department. It initially provided a bond written
44 by United Pacific Insurance Company (United Pacific), but replaced that bond effective
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46 ¹ BIIA Dec., 09 22005 (2011).
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1 December 27, 1997, with a bond written by Fidelity. The Department released its interest in the
2 United Pacific bond, returning it to United Pacific on February 28, 1998.
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4 The Fidelity bond states:

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6 3. The condition of this obligation is that the principal, as a self-insurer, may default in
7 its obligation under the provision of the Industrial Insurance Act of the State of
8 Washington, Title 51 RCW, as now or amended. If the principal, as a certified self-
9 insurer, will pay all sums that become due according to the provisions of the Industrial
10 Insurance Act, this obligation shall be null and void; otherwise to remain in full force.

11 4. The surety agrees that the obligation of this bond shall cover and extend to all past,
12 present, existing and potential liability of said principal, incurred as a self-insurer, to
13 the extent of the penal sum of the bond without regard to specific injuries, date or
14 dates of injury, happenings or events.

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17 6. If the principal shall suspend payments or shall become insolvent or a receiver shall
18 be appointed for its business, the undersigned surety will become liable to the
19 Department of Labor and Industries to the extent of the bond without regard to any
20 proceedings for the liquidation of said principal. If the principal otherwise defaults
21 after 10 days demand, on any payments or obligations due under the provisions of the
22 Industrial Insurance Act, as now or amended, the surety will become liable to the
23 Department to the extent of the bond. The surety agrees that any payment of its
24 liability under this bond will only be made directly to the Department of Labor and
25 Industries.

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28 10. This bond is continuous in form and will remain in full force and effect unless
29 terminated in the manner hereinafter provided. If the bond is terminated, it is
30 understood and agreed that the surety will remain liable, under the provisions of this
31 bond, for future payments on covered obligations incurred prior to the termination.
32 The surety shall be released from its liability if the principal provides replacement
33 surety acceptable to the Department for payment of the obligations covered by the
34 bond.²

35 On March 17, 2003, Spiegel filed for Chapter 11 protection in bankruptcy court. On the
36 same day, the Department wrote Spiegel a letter communicating it knew of the Chapter 11
37 bankruptcy filing and requested a copy of the petition and a letter of intent about payment of
38 benefits on claims filed by Spiegel employees during the self-insured period. Spiegel responded to
39 the Department by letter on March 21, 2003, stating it intended to continue payment of benefits on
40 workers' compensation claims that occurred during the self-insured period.
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47 ² Exhibit 1 to Declaration of James Nylander in support of Department's summary judgment motion.

1 In 2005, Spiegel sold off its Eddie Bauer assets to a corporation named Eddie Bauer
2 Holdings, Inc. Eddie Bauer Holdings, Inc., covered its workers through the Washington State Fund.

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4 On November 1, 2005, Fidelity wrote a letter to the Department stating that Fidelity was
5 canceling its \$460,000 surety bond effective December 27, 2005. The Department acknowledged
6 Fidelity's notice of cancelation of its bond by letter dated November 18, 2005. In its letter, the
7 Department informed Fidelity the bond would continue to remain in full force and effect for any
8 industrial injury or occupational disease that might have occurred during the period of Spiegel's
9 self-insured operations in Washington up to the penal sum of the bond, regardless of its
10 cancelation.
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14 Four years later, on November 2, 2009, Spiegel notified the Department it would no longer
15 administer any of its self-insured claims; had suspended further payment of benefits; and tendered
16 administration of its claims to the Department.
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19 On November 3, 2009, the Department of Labor and Industries sent a letter to Fidelity
20 regarding Spiegel's decision to default on their self-insured obligations and demanded Fidelity remit
21 the entire penal sum (\$460,000) of the bond to the Department.
22

23
24 On December 7, 2009, the Department closed the only self-insured claim of Spiegel's that
25 was then open. As part of its claim closure, the Department paid out \$24,454.17 in benefits, of
26 which \$21,810.51 was for a permanent partial disability award and interest and the remainder for
27 medical treatment.
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30 Spiegel failed to file required quarterly self-insurer reports as required by WAC 296-15-221
31 for the fourth quarter of 2009; first, second, third, and fourth quarters of 2010; and first, second, and
32 third quarters of 2011, and failed to pay quarterly self-insurer assessments, as required by
33 WAC 296-15-223 through 229, corresponding to said quarters totaling \$2,357.39.
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36 On January 16, 2014, the Department issued its Notice of Decision in which it made demand
37 on Fidelity for \$460,000, the full penal sum of the bond.
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39 **C. Analysis**

40 Fidelity disputes the Department's right to the full penal sum of the bond based on several
41 arguments. First, it contends that because it canceled or terminated the bond before its principal
42 defaulted, it can only be liable for actual damages incurred by the Department, and this is limited to
43 approximately \$24,000 in unpaid benefits and approximately \$2,000 in unpaid assessments. As
44 part of this argument, Fidelity acknowledges it may become indebted to the Department for
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1 additional sums, up to the full penal amount, but **only** if the Department pays out benefits on claims
2 arising from Spiegel's self-insured period. To further support its position, Fidelity argues that the
3 Department's decision to demand the full penal sum of the bond is an unenforceable penalty under
4 Washington surety law. Finally, Fidelity argues that the Department's ability to demand for
5 reimbursement of claim costs is barred by the statute of limitations in RCW 51.16.190, and its claim
6 for assessments is barred by RCW 51.48.131. We address Fidelity's statute of limitations argument
7 first.
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12 1. The Department's demand is not barred by RCW 51.16.190 or RCW 51.48.131.

13 Fidelity asserts RCW 51.16.190 bars the Department's ability to recover claim costs paid in
14 the 2009 decision because the Department did not properly make demand on the bond within three
15 years of payments made on the self-insurer's behalf. This argument improperly applies statutes not
16 applicable to self-insured employers. Chapter 51.16 RCW governs the Department authority to
17 collect premiums and assessments owed by **state fund** employers. Chapter 51.14 RCW governs
18 the Department's relationship with self-insured employers. Only one reference to Chapter 51.14
19 RCW appears in Chapter 51.16 RCW. That occurs at RCW 51.16.120(2) and is the product of a
20 2010 legislative amendment³ that addresses how the Department will compute a state fund
21 employer's share of pension cost where the pension was awarded due to cumulative effects and a
22 portion of the worker's history was with a self-insured employer who has defaulted or had its
23 certification withdrawn.
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26 The inapplicability of RCW 51.16.190(2) is further seen because it references assessments
27 under RCW 51.48.120. Chapter 51.48 RCW embodies the instances where the Legislature has
28 given the Department authority to assess or recover a penalty. RCW 51.48.120 authorizes the
29 Department to issue a notice of assessment if an employer should default in any payment to the
30 **state fund**. The other sections referred to in RCW 51.16.190 refer to the premiums owed by a
31 state fund employer.
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34 Fidelity's argument that the Department is barred by RCW 51.48.131 from recovering
35 amounts attributable to self-insured assessments misperceives self-insured assessments under
36 RCW 51.14.077 and WAC 296-15-221 through 229 as if they were an assessment subject to
37 RCW 51.48.131. The argument also contradicts rules of statutory construction. RCW 51.48.131
38 applies **only** to the Department's recovery of monies owed by a defaulting **state fund** employer.
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47 ³ RCW 51.16.120(2) was added in the same bill that added subparagraph (3) to RCW 51.14.060.

1 This conclusion is further supported because when the Legislature added RCW 51.48.131 in 1985,⁴
2 special statutes (Chapter 51.14 RCW) applicable to employers opting to self-insure had been in
3 place for nearly a decade and a half. In those special statutes, the Legislature prescribed a
4 separate and specific remedy for the Department when a self-insurer pays none of its claim
5 obligations or self-insured assessments: decertification and taking control of whatever security the
6 self-insured tendered in consideration of being granted self-insured status.⁵ Applying the rule of
7 statutory construction that says where a general statute and a subsequent special statute relate to
8 the same subject matter, the provisions of Chapter 51.14 will prevail unless it appears the
9 Legislature expressly intended to make the general statute controlling.⁶ Nothing in RCW 51.48.131
10 evidences an intent of the Legislature that it apply to self-insurers.

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16 2. Fidelity is liable to the Department for the penal sum of the bond based on the clear
17 language of the bond because Spiegel was both insolvent and defaulted.

18 Fidelity contends that to limit its liability all that is required is to send a notice of cancelation
19 to the Department. It argues that once written notice of cancelation was provided, the bond and
20 statute governing termination clarify that the surety's future liability is limited to actual benefits paid
21 out by the Department and nothing more.

22 The Department contends that RCW 51.14.060 and WAC 296-15-125 are controlling and
23 say the surety is liable for the bond's penal sum when the self-insured employer fails to pay
24 benefits, suspends benefits, or defaults. The only way Fidelity could have escaped liability was if a
25 replacement bond had been put in place after termination. Fidelity does not dispute that the
26 cancelation letter was issued without a replacement bond to cover Spiegel's obligations.

27 Beyond citing to RCW 51.14.060 and WAC 296-15-125, the Department argues our decision
28 *In re Great American Insurance Co.*⁷ is on point with the facts of the present appeal and should be
29 followed. In *Great American*, we held that the surety, Great American Insurance, was liable for the
30 penal sum of the principal's bond after the self-insurer, Avado, became insolvent under the bond
31 and applicable statutes in early 2008 upon filing for Chapter 11 bankruptcy protection. Shortly after
32 Avado's Chapter 11 filing, Great American notified the Department it was terminating the bond
33 effective April 16, 2008. Similar to the present case, the Department initially took no action since
34 companies in Chapter 11 often remain in business and keep current in their financial obligations.

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45 ⁴ Laws of 1985 c 315 § 7.

46 ⁵ RCW 51.14.060.

47 ⁶ *State v. Conte*, 159 Wn.2d 797, 803 (2007), citing *Port Townsend Sch. Dist. v. Brouillet*, 21 Wn. App. 646, 655(1978).

⁷ BIIA Dec., 09 22005 (2011).

1 On April 20, 2009, Avado converted its Chapter 11 bankruptcy to a Chapter 7. On July 29, 2009,
2 the Department ordered payment of the penal sum of the bond even though Avado had no open
3 claims or unsatisfied claim costs when it converted its bankruptcy.
4

5 In *Great American*, we held the terms of the bond required payment of the entire penal sum
6 to the Department because the self-insured employer became insolvent, and this was so even
7 though there were no uncompensated claim costs. We explained
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10 Self-insured employers in the State of Washington are responsible for future costs of
11 any claim that occurred during the time they held self-insured status It is not
12 unusual for an injured worker to reopen a claim upon a showing of worsening, or for an
13 occupational disease to be diagnosed well after exposure to the conditions that
14 resulted in the disease. Because Avado no longer holds the status of a self-insured
15 employer, is insolvent, and no longer in existence, the Department is responsible for
16 administration of claims pursuant to RCW 51.14.060. The contractual obligation
17 assumed by GAIC to surrender the penal sum of the bond to the Department if the
18 principal became insolvent, is consistent with the Department's obligation to administer
19 claims as necessary in the future.
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21 The bond issued by Fidelity, like the bond issued by Great American, unambiguously provides
22 that if the principal suspends payment or becomes insolvent, the surety will become liable to the
23 Department for the bond. Fidelity contends, though, that *Zargar v. Columbia Casualty Co.*,⁸ and
24 *White & Bollard v. Standard Acc. Ins. Co.*,⁹ compel a different result, arguing that both stand for the
25 proposition that a surety is only liable for conduct occurring between the effective dates of the
26 surety's bond. Fidelity's reliance on *Zargar* and *White & Bollard* is premised on its belief that its
27 November 2005 notice of cancelation released it from liability. Fidelity's argument ignores the plain
28 language of the bond. It states, at paragraph 6, that "[i]f the principal shall suspend payments or
29 shall become insolvent . . . the undersigned surety will become liable to the Department of Labor
30 and Industries to the extent of the bond." At paragraph 10, the surety shall be released from its
31 liability only if the principal "provides replacement surety acceptable to the Department for payment
32 of the obligations covered by the bond" We find our holding in *Great American* to be
33 consistent with the Washington Supreme Court's holdings in *Zargar* and *White & Bollard*, and reject
34 Fidelity's argument.
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46 ⁸ 181 Wash. 487 (1935).

47 ⁹ 175 Wash. 174 (1933).

1 3. The Department's demand for the bond's penal sum is not a prohibited penalty or forfeiture.

2 The plain language of the Industrial Insurance Act's self-insurance provisions evidences a
3 legislative intent that the state fund not subsidize self-insurers. When deciding whether to certify an
4 employer as a self-insurer, the Legislature provided the Department with the authority, codified at
5 RCW 51.14.020(2)(a), to require the tender of money, securities, letter of credit, or a bond "in an
6 amount reasonably sufficient in the director's discretion insure payment of reasonably foreseeable
7 compensation and assessments" as a condition of certifying an employer as a self-insurer. This
8 language dates back to 1971 when the Legislature first authorized employers to self-insure workers'
9 compensation claims.¹⁰ The Legislature knew at that time, and it remains the case today, that a
10 worker's claim, once filed, is subject to reopening for provision of benefits for the worker's lifetime.
11 While financial liability does not always arise after a claim has been closed, legal liability exists for
12 decades. In apparent acknowledgement of this dichotomy, the Legislature provided guidance to
13 the Department on what it believed a minimum reasonably sufficient amount of security should be:
14 "not less than the employer's normal expected annual claim liabilities and in no event less than one
15 hundred thousand dollars."¹¹

16 Neither the Department nor Fidelity mentioned subparagraph (9) of WAC 296-15-121. We
17 do because we find it informative in resolving this issue.

18 **(9) When could the department consider releasing surety to a former self insurer or its
19 successor?**

20 (a) The department **may** consider releasing surety to a former self insurer or its
21 successor when all of the following have occurred:

22 (i) All claims against the self insurer are closed; and

23 (ii) the self insurer has been released from quarterly reporting for at least ten
24 years.

25 (b) If the department releases surety, the former self insurer remains responsible for
26 claim reopenings and new claims filed for occupational disease incurred during the
27 period of self insurance.

28 (Emphasis added.)

29 Significantly, the rule does not **guarantee** a surety will be released after ten or more years, even
30 where the former self-insurer has demonstrated long-term responsibility over its continuing
31 obligations.

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¹⁰ Laws of 1971, Ex. Sess. c 289.

¹¹ RCW 51.14.020(2)(a).

1 At one point in its argument of unenforceable penalty or forfeiture, Fidelity concedes that a
2 lump sum damages provision in a contract **is** enforceable **if** it represents liquidated damages. For
3 a liquidated damages clause to be enforceable the harm caused by default must be difficult or
4 impossible to estimate and the amount penal sum must be a reasonable forecast of damages.¹²
5 Fidelity's position is that its penal bond bears no reasonable relationship to actual anticipated
6 damages. That position, though, fails to recognize that Spiegel's self-insured liability is not yet
7 extinguished and will not be until all employees whose claims were incurred between January 1,
8 1997, and February 10, 2003, have died. When RCW 51.14.020, WAC 296-15-121, and the
9 language of Fidelity's bond are considered in this inescapable fact, we conclude that the penal sum
10 of Fidelity's is for liquidated damages.
11

12 Based on the undisputed facts, we conclude that the Department's January 16, 2014 order
13 demanding Fidelity remit the entire penal sum of Spiegel's surety bond for \$460,000 because of
14 Spiegel's defaulting on its self-insured obligations is correct as a matter of law. We affirm.
15

16 **FINDINGS OF FACT**

- 17 1. On June 18, 2014, an industrial appeals judge certified that the parties agreed to
18 include the Jurisdictional History, as amended, in the Board record solely for
19 jurisdictional purposes.
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- 21 2. The pleadings and evidence submitted by the parties demonstrate there is no
22 genuine issue on any material fact.
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- 24 3. As a self-insured employer, the Department required Spiegel Inc., DBA Eddie
25 Bauer, Inc., (Spiegel) to provide surety to insure its self-insured obligations to the
26 Department. Spiegel elected to meet its surety obligation through the provision
27 of a surety bond. In 1997, Spiegel replaced its original bond with a bond
28 provided by Fidelity and Deposit Company of Maryland (Fidelity), and Spiegel, as
29 principal, and Fidelity, as surety, posted Self-Insurer's Bond No. 8081076.
30 During the next seven years, the Department required an increase in the amount
31 of the bond three times. In 2002 and thereafter, the penal sum of the bond was
32 \$460,000.
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- 34 4. Self-Insurer's Bond No. 8081076, paragraph 6, provides that if the principal shall
35 suspend payments or become insolvent, the surety becomes liable to the
36 Department to the extent of the bond without regard to any proceedings for the
37 liquidation of the principal. Paragraph 10 provides that the surety shall be
38 released from its liability only if the principal provides replacement surety
39 acceptable to the Department for payment of the obligations covered by the
40 bond.
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46 ¹² PFR at p. 20, citing *Idaho Plumbers and Pipefitters Health and Welfare Fund v. United Mechanical Contractors*,
47 875 F.2d 212 (9th Cir. 1989).

- 1 5. On March 17, 2003, Spiegel filed a Chapter 11 petition in bankruptcy court.
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- 3 6. On March 21, 2003, Spiegel represented to the Department it would continue
- 4 payment of benefits on workers' compensation claims during the period in which
- 5 Spiegel was a self-insured employer, January 1, 1997, through February 10,
- 6 2003.
- 7
- 8 7. On November 1, 2005, Fidelity sent a letter to the Department stating that it was
- 9 canceling the bond effective December 27, 2005. Spiegel provided no
- 10 replacement surety for payment of the obligations covered by the bond.
- 11
- 12 8. By e-mail dated November 2, 2009, the Department was informed that Spiegel
- 13 was no longer an operating business and would no longer administer its claims.
- 14 As of November 2, 2009, Spiegel ceased filing quarterly reports and annual
- 15 reports, and ceased payment of assessments to the Department. As of
- 16 November 2, 2009, Spiegel was insolvent and had defaulted on its self-insured
- 17 obligations to the Department.
- 18
- 19 9. After Spiegel's default, the Department assumed jurisdiction over all open claims
- 20 and paid benefits to injured workers. At the time of default, Spiegel had one
- 21 open claim. The Department paid \$24,454.17 in this claim. Spiegel also failed to
- 22 pay an estimated \$2,357.39 in assessments for the fourth quarter of 2009, first,
- 23 second, third, and fourth quarters of 2010, and first, second, and third quarters of
- 24 2011.
- 25
- 26 10. On January 16, 2014, the Department issued an order determining that Spiegel
- 27 failed to pay assessments or file mandatory reports with the Department and that
- 28 it had notified the Department it was defaulting on its self-insured obligation.
- 29 Therefore, under RCW 51.14.060 and WAC 296-15-125, the Department
- 30 assumed jurisdiction of Spiegel's claims and made demand upon Spiegel's
- 31 surety, Fidelity and Deposit Company of Maryland, for the entire penal sum of
- 32 Spiegel's surety bond in the amount of \$460,000.

CONCLUSIONS OF LAW

- 32 1. The Board of Industrial Insurance Appeals has jurisdiction over the parties and
- 33 subject matter in this appeal.
- 34
- 35 2. No material facts are in dispute and the parties are entitled to a decision as a
- 36 matter of law as contemplated by CR 56.
- 37
- 38 3. As of November 2, 2009, Spiegel defaulted on its obligations to the Department
- 39 and became insolvent within the meaning of RCW 51.14.060 and WAC 296-15-
- 40 121(8).
- 41
- 42 4. Under Self-Insurer's Bond No. 8081076, Fidelity became liable to the Department
- 43 of Labor and Industries for the penal sum of \$460,000 when Spiegel defaulted on
- 44 its self-insured obligations and became insolvent because of its bankruptcy
- 45 action.
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1 5. The Department order dated January 16, 2014, is correct and is affirmed.
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3 Dated: June 10, 2015.
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5 BOARD OF INDUSTRIAL INSURANCE APPEALS
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9 /s/ _____
10 DAVID E. THREEEDY Chairperson
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13 /s/ _____
14 FRANK E. FENNERTY, JR. Member
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18 /s/ _____
19 JACK S. ENG Member
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