Filed 6/2/09 Ceradyne, Inc. v. Argonaut Ins. Co. CA4/3

NOT TO BE PUBLISHED IN OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

CERADYNE, INC.,	
Plaintiff and Respondent,	G039873
v.	(Super. Ct. No. 07CC01316)
ARGONAUT INSURANCE COMPANY,	O P I N I O N
Defendant and Appellant.	

Appeal from an order of the Superior Court of Orange County, Thierry Patrick Colaw, Judge. Affirmed in part; Reversed in part.

Nielsen, Haley & Abbott; James C. Nielsen, Jennifer S. Cohn, Thomas H. Nienow for Defendant and Appellant.

Roxborough, Pomerance & Nye; Nicholas P. Roxborough, Drew E. Pomerance and Michael L. Phillips for Plaintiff and Respondent.

California's system for compensating workers injured on the job is an enormous mandatory insurance program. Employers subject to the Workers' Compensation Act are required by law to obtain insurance for their employees under stringent conditions. The insurance plans are regulated and standardized by statute: The Legislature has authorized the Insurance Commissioner and the Workers' Compensation Insurance Rating Bureau (WCIRB) to oversee the form and substance of all workers' compensation insurance plans, including everything from the scope of required coverage provided to employees, to the amount employers pay insurers for premiums**.**

In addition to the many statutory provisions enacted to protect the injured employees, the Legislature has created a comprehensive system to regulate the insurance companies providing the required insurance to employers. Relevant to this case, insurance companies providing workers compensation policies are required by law to disclose and seek pre-approval from the Insurance Commissioner and WCIRB of the insurance plan being purchased. (Ins. Code, § 11658.)[1]

In this case, Argonaut Insurance Company provided a workers' compensation plan to a large corporation, Ceradyne Inc. After several years, Ceradyne filed a lawsuit against Argonaut, having concluded the insurance company was liable for mismanaging the workers' compensation claims and finances. Argonaut made an appearance in the action and began the discovery process, during which it discovered the parties had entered into an Insurance Program Agreement (IPA) several months after the insurance policy took effect. The IPA, which had not been disclosed or pre-approved by the Insurance Commissioner or WCIRB, contained an arbitration clause and a forum selection clause (designating New York as having exclusive jurisdiction over any dispute relating to arbitration).

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[1] All further statutory references are to the Insurance Code, unless otherwise indicated.

This appeal arises from the trial court's refusal to stay or dismiss the case to permit a New York court to consider Argonaut's petition to compel arbitration. Alternatively, Argonaut challenges the trial court's refusal to compel arbitration based on its conclusion the entire IPA was void because it had not been disclosed or approved as required by section 11658. After considering all the arguments raised on appeal, we conclude the order must be affirmed in part, and reversed in part. Specifically, because Ceradyne did not request to strike the entire IPA agreement, we reverse that portion of the court's order. However, because the IPA contains a severability clause, we conclude the trial court had authority to sever the void arbitration clause, deny arbitration, and deny the stay/dismissal request. Its order denying the petition to compel arbitration and denial of the motion to stay or dismiss the case is affirmed.

I

Ceradyne is a Delaware corporation with operations worldwide, including the State of California. Ceradyne is "among other things, a fully integrated developer and manufacturer of advanced technical ceramic products and components for defense, industrial, automotive/diesel, electronic and medical markets with numerous facilities throughout California, the United States and the world."

As required by California law, Ceradyne had to purchase workers' compensation insurance. It contracted with Argonaut to provide four "large deductible" workers' compensation policies, none of which contained arbitration provisions, with policy periods starting in March 2003, and ending in May 2006. Under "large deductible" policies, that are typical in the industry, "amounts paid on claims under the deductible amount are paid by [the insurer], but reimbursed by [the insured] by way of a deposit account required by and maintained by [the insurer]." Consequently, the insured ultimately pays for any claims up to the deductible amount as well as the costs of adjusting claims, and it must provide adequate security for the deductible amounts paid by the insurer.

The four large deductible policies covered workers' compensation claims made against Ceradyne throughout the United States. The 2003 policy (March 2003 to March 2004) required Ceradyne to pay a deductible on claims made under the policy up to the first $250,000 for each person entitled to benefits, and a program aggregate limit of $2 million. The other three policies (covering March 2004 through May 2006) required a $350,000 deductible, with a program aggregate limit of $2 million. Large deductible policies "are potentially attractive to employers like Ceradyne because the premium paid to the insurer is substantially less than with more traditional forms of insurance (i.e., a guaranteed cost program) in which the insurer pays all claims."

Under the terms of the workers' compensation policies, it was specified "this policy, including all endorsements forming a part thereof, constitutes the entire contract of insurance. No condition, provision, agreement, or understanding not set forth in this policy or such endorsements shall affect such contract or any rights, duties, or privileges arising therefrom." Additionally, the policies stated, "This policy includes at its effective date the information page and all endorsements and schedules listed there. It is a contract of insurance between you . . . and us . . . . The only agreements relating to this insurance are stated in this policy. The terms of this policy may not be changed or waived except by endorsement issued by us to part of this policy."

In November 2003 (nine months after the March 2003 effective date of the first policy), Argonaut requested Ceradyne execute an IPA. This agreement stated in the introductory paragraph, "This . . . Agreement is between . . . Argonaut . . . and you, Ceradyne . . . the first insured named under policies of insurance issued by us as listed on Schedules for each policy period covered by this Agreement (the policies covered by this Agreement will be referred to as the Policies)."

Although executed by Ceradyne's CFO in November 2003, and by Argonaut's Underwriting Manager in December 2003, the agreement specified it was to be effective retroactively, March 1, 2003. The second paragraph of the IPA stated, "This

Agreement describes the Insurance Program that you and we agreed to enter into; the terms of your payments for premium and other amounts you owe for the Policies and related services; the security you agree to provide for those payments; and other obligations you agree to as part of the Insurance Program. This Agreement contains a Schedule for each Program Period that the Policies are in force. We will issue a Schedule that will become part of this Agreement, together with any prior Schedules, at each renewal. *The complete terms of the Insurance Program are in both this Agreement and the Policies. Our obligations to you are set forth in the Policies*. This Agreement does not change any of the terms or conditions of the Policies or of our obligations or duties spelled out in the Policies." (Italics added.)

The IPA contained articles discussing the payment of premiums, a security deposit, money for the "Lost Deposit Fund," and Argonaut's right to offsets. It defined what events qualified as a default and required Ceradyne to indemnify Argonaut for any liabilities, obligations, penalties, costs, expenses, including reasonable attorney fees, that Argonaut may have to pay relating the terms in the IPA or "arising out of a delay in the payment of benefits, claims or any other amounts due under Policies . . . ."

Finally, the IPA contained a section discussing arbitration. It stated the parties agreed to arbitrate "any dispute between over the interpretation, application, formation, enforcement or validity of this Agreement or any other agreement between you and us, or yours and our rights with respect to any transaction involved, whether such dispute arises before or after termination of this Agreement." Furthermore, the section on arbitration provided, "You and we agree that arbitration is the sole remedy for the resolution of disputes between us. The board of arbitration will have complete and exclusive jurisdiction over the entire matter in dispute, including any question as to its arbitrability, and shall only conduct the arbitration proceeding to resolve disputes between you and us, and not as a class action or in any other way involving other parties."

The agreement specified arbitration must be held in Connecticut, and the panel of arbitrators must "be a disinterested active or retired officer[s] of an insurance or reinsurance company, broker, agency, claims or claims adjuster or lawyer, with at least ten (10) years of experience within the insurance or reinsurance industry." The award could not include punitive damages. The parties agreed, "For the purposes of enforcing the terms of [the arbitration clause] and confirming any arbitra[tion] award, you and we consent to the exclusive jurisdiction of either the U.S. District Court for the Southern District of New York or the Supreme Court of the State of New York, County of New York."

In July 2007, Ceradyne filed a lawsuit against Argonaut alleging the insurance company "mishandled, overpaid, and over reserved claims made under [Ceradyne's workers' compensation] Policies in such a way as to artificially increase [the] premiums it paid to [Argonaut] . . . ." Specifically, it alleged Argonaut breached the terms of the policies by failing or refusing to: (1) "provide claims review in a timely manner"; (2) "accurately set reserves"; (3) "reasonably adjust reserves in a timely manner"; (4) "properly investigate claims"; (5) "properly settle claims"; (6) "properly defend claims"; (7) "properly manage claims"; (8) "make appropriate adjustments to the letter of credit"; (9) "properly communicate in a timely manner regarding initial reserve settings and subsequent reserve adjustments" (10) "communicate in a timely manner regarding lost time and questionable claims"; (11) "properly communicate in a timely manner regarding settlements"; and (12) "properly communicate in a timely manner regarding investigation of claims."

Ceradyne argued the above misconduct amounted to breach of contract, breach of the implied covenant of good faith and fair dealing, and violations of the Business and Professions Code section 17200 (unfair business practices). It sought declaratory relief, injunctive relief, and monetary damages.

A few months later, Argonaut demurred to all claims in the complaint, except breach of contract. It filed a motion to strike punitive damages. In October 2007, the court overruled the demurrer and denied the motion. The parties exchanged several discovery requests until Argonaut's lawyers claim they discovered "for the first time" that the dispute was subject to arbitration pursuant to the terms of the IPA. In November 2007, Argonaut moved to stay the litigation and compel arbitration. A few months later, in December 2007, Argonaut filed a petition in the Supreme Court of New York to compel arbitration. The same day, it amended its pending motion in the California Superior Court, requesting a stay or dismissal of the litigation to allow the New York court to resolve the dispute.

In January 2008, after considering argument from both parties, the court denied Argonaut's motion. It reasoned the motion to stay or dismiss based on the IPA's forum selection clause was denied because the witnesses, business offices, transactions, and parties were all in California. It determined the IPA was unenforceable and void because Argonaut did not comply with section 11658, requiring submission of insurance contracts and endorsements to the Department of Insurance. It also determined Argonaut had waived its right to compel arbitration by waiting too long after participating in pleading and discovery in the civil action in California. Argonaut appealed.

We granted the request for judicial notice of documents showing that after the appeal in California was filed, the Supreme Court in New York expressly deferred to the California trial court's ruling and denied Argonaut's petition to compel arbitration. It determined Argonaut's actions in the California Superior Court had evidenced "its willingness to assent to the jurisdiction of the California court." We have been informed Argonaut appealed the New York court's ruling.

This court accepted amicus curiae briefs from general counsel for HealthSmart Pacific, Inc., and counsel for Grove Lumber & Building Supply, Inc. These companies are involved in similar litigation/arbitration disputes with their workers'

compensation insurers regarding large deductible policies. Having similar claims and contracts, they have provided additional argument in support of Ceradyne's argument the arbitration clause included within the IPA executed months after the inception of the actual policy is void.

II

A. Worker' compensation insurance law is highly regulated.

"[T]he California Constitution authorizes the Legislature to enact laws that fully provide and regulate insurance coverage against liability to pay or furnish compensation. The Constitution also vests the Legislature with the power to establish a State Compensation Insurance Fund . . ., and to provide for other means of securing the payment of compensation. [Cal. Const. art. XIV, § 4.] The Legislature exercised this power by enacting the Workers' Compensation Act. The Act requires all employers (except the state) to secure the payment of compensation by: (1) being insured by an authorized carrier; or (2) securing a certificate of consent from the Director of Industrial Relations to become a self-insurer. [Lab. Code, § 3700.] An employer subject to the Act who fails to secure the payment of compensation is guilty of a misdemeanor punishable by imprisonment in the county jail for up to one year, or by a fine of up to $10,000 or by both if the employer knew or should have known of that obligation. [Lab. Code, §§ 3700.5, 3710.2]." (Eskenazi et al., Cal. Civil Practice Workers' Compensation (2008) § 1:5, p. 1-16.)

An employer may fulfill its legal obligation under the workers' compensation scheme by obtaining coverage from either the State Compensation Insurance Fund or from a private compensation insurer. Workers' compensation insurers may not issue a policy unless it has been approved in "form and substance" by the insurance commissioner and the California Workers' Compensation Insurance Rating Bureau (WCIRB). (§ 11658, subd. (a).)" (Eskenazi et al., Cal. Civil Practice Workers' Compensation, supra, § 1:10, p. 1-22.) Compensation policies are required and presumed

by statute to contain several provisions delineated in sections 11651 through 11664. (§ 11650.) To name just a few, every policy is required to contain a clause providing that: the insurer is directly and primarily liable for payment of any compensation for which the employer is liable, subject to the terms of the policy. (§ 11651.) A compensation policy does not relieve the insurer from payment "if the employer becomes insolvent or is discharged in bankruptcy" during the period "the policy is in operation or the compensation remains owing." (§ 11655.) The insurer will "be bound by and subject to the orders, findings, decisions[, and] awards rendered against the employer subject to the terms of the policy. (§ 11654.) This last provision also specifies, "The insurance contract shall govern as between the employer and the insurer as to payments by either in discharge of the employer's liability for compensation." (*Ibid.*) In sum, the workers' compensation plans are highly regulated and designed primarily to protect the worker and ensure prompt payment of claims.

There are several provisions describing the procedures an insurer must follow. Relevant to this case, section 11658 requires insurers to seek review of the "workers' compensation insurance policy or endorsement" by both the insurance commissioner and the WCIRB. It specifies the "form or endorsement" must be preapproved before it can be used. (§ 11658.)

The California Code of Regulations, title 10, section 2218, elaborates further on the process that must be followed: "(a) *All workers' compensation insurance forms* must be submitted in duplicate to the [WCIRB] of California for preliminary inspection. The Bureau shall review such forms and submit them to the Commissioner for final action. [¶] (b) Workers' compensation rates shall be filed as provided in [section] 2509.30, et seq., of this Chapter." (Italics added.)

The reasons for requiring full disclosure, review, and approval by not just one, but two regulatory agencies, are not specified in the statute. However, we can infer several purposes from the statutory scheme and wide-ranging regulatory powers granted

to the Insurance Commissioner and WCIRB. The insurance commissioner's job description includes the regulation and oversight of the rates and practices of all insurance companies. (See <http://www.insurance.ca.gov.>) Not surprisingly the Legislature has enacted ample statutory authority to provide the insurance commissioner unfettered access to workers' compensation insurance information, and has granted the commissioner broad authority to regulate, accept, and reject workers' compensation insurance plans. The WCIRB, as explained in the Insurance Code, has several purposes, including: (1) "To provide reliable statistics and rating information with respect to workers' compensation insurance and employer's liability insurance incidental thereto and written in connection therewith;" and (2) "To examine policies, daily reports, endorsements or other evidences of insurance for the purpose of ascertaining whether they comply with the provisions of law and to make reasonable rules governing their submission." (§ 11750.3.)

Certainly, to effectively, review, regulate, examine, and provide reliable statistics and rating information, the insurance commissioner and WCIRB require full disclosure of the various workers' compensation plans being offered to employers. They are charged with regulating and overseeing financial aspects as well as the liability terms of the workers compensation plans. Requiring the disclosure and pre-approval of "[a]ll workers' compensation insurance forms" (Cal. Code Regs., tit. 10, § 2218), serves as an effective safeguard of the goals of this unique kind of insurance. Both employers and employees benefit from the government's regulation of the entire workers' compensation scheme, its oversight to ensure accurate rates, its work towards the prevention of insurance monopolies, and creation of industry wide standards.

B. How should we classify the IPA?

As discussed in the prior section, the Legislature has determined it is necessary for the WCIRB and the insurance commissioner to review all workers'

compensation plans. Argonaut argues the IPA does not look like an "insurance policy," and therefore, the insurance commissioner did not need to review or approve it. It asserts the purely financial document should not be classified as an insurance policy because it does not address its indemnity obligations for loss or liability, and it expressly does not affect any provision of the insurance policies. (Citing § 22 [generally defining insurance as "a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event"].) We disagree with this narrow interpretation of the disclosure requirements for purposes of section 11658.

The approval process contemplated by the Insurance Code and regulations includes more than just a review of the indemnity/liability portion of the insurance contract. Section 11658 refers to preapproval of the "policy," "endorsements" and "forms." The California Code of Regulations, title 10, section 2218, requires submission of "All workers' compensation insurance forms[.]" The WCIRB's task is "to examine policies, daily reports, endorsements or other evidences of insurance for the purpose of ascertaining whether they comply with the provisions of law" and to "collect[] and tabulat[e] rating information[.]" (§§ 11750, 11750.3.) As noted above, workers' compensation plans are highly regulated. The statutory language calls for the disclosure and review of more than just the indemnity and liability portions of the plans. Indeed, the breadth of information customarily disclosed is evidenced by the contents of the workers' compensation plan Argonaut submitted to WCIRB and insurance commissioner before offering it to Ceradyne.

Argonaut's approved insurance policy contained much more information than its indemnity obligations for loss or liability. On the very first page, Argonaut's policy described the estimated annual premium amount, limits of liability, and notified the insured about the schedule for Ceradyne's premium payments. The next five pages contained a schedule relating to financial information, describing the premium basis and estimated annual premium for each classification of employees. The first endorsement

stated it "modifie[d] [the] insurance provided" by requiring Ceradyne to pay a deductible for each bodily injury by accident or disease. This deductible endorsement contained definitions, conditions, and a list of the "schedule of deductibles."

The policy contained other endorsements relating solely to funding, administrative matters, and money allocation. For example, the policy contained a "limits of liability endorsement" ($1 million for each accident/disease), and an "endorsement premium offset" (stating Argonaut may offset any owed return premium against additional premium owed by Ceradyne). The policy also included an "installment billing endorsement" stating the deposit premiums must be paid according the schedule provided on the same page, and deposits begin on or before the start of the policy period. The schedule showed the first payment of $60,269 was due on March 1, 2003, and additional payments were due the beginning of the next nine months. We need not take the time to describe all the endorsements, suffice it to say, many of them concerned matters unrelated to the description of Argonaut's indemnity and insurance obligations.

The IPA *repeats* much of this same information. For example, Article I, "YOUR PAYMENTS" simply states Ceradyne must pay the premium, taxes, surcharges, and assessments "on the dates and the amounts in the [s]chedule[.]" The attached schedule, like the schedule in the policy, showed when the premium payments are due. And although the IPA was not executed until the end of 2003, the schedule mirrors the policy and provides the first payment of $60,277 was due on March 10, 2003. Another example of repetitive clauses is Article III describing Argonaut's right to offset. It is essentially identical to the policy's endorsement regarding offsets. The IPA repeatedly refers to and incorporates by reference the obligations under the insurance policy.

Section 11654 plainly states: "The insurance contract shall govern as between the employer and insurer as to payments by either in discharge of the employer's liability for compensation." So there would be no doubt as to its purpose, the IPA expressly states, "*The complete terms of the Insurance Program are in both this*

Agreement and the Policies." The IPA defined itself as part of the insurance contract, not a separate side financial agreement, as urged by Argonaut.

We recognize the IPA contained several new items regarding how payments are to be made and maintained for the policy to continue in effect. Argonaut requested a security, such as a letter of credit, to serve as collateral for Ceradyne's obligation. The $500,000 collateral was due at the beginning of each program period. The IPA also required Ceradyne to set up a "Loss Deposit Fund" "in an amount [determined by Argonaut] to pre-fund the payment of Paid Losses and [Allocated Loss Adjustment Expenses.]" i.e., the amounts paid as benefits for claims and costs incurred in connection with processing the claims. The initial funding of $31,000 for the Loss Deposit Fund was due immediately, and in addition Argonaut reserved the right to seek immediate reimbursement for any payment towards a loss of $31,000 (a "Large Loss Payment") "even if there are enough funds in the Loss Deposit Fund to pay the loss." The contract also contained an indemnification provision, and article devoted to describing events of default, and most relevant to this case, a forum selection and an arbitration clause.

The IPA was presented to Ceradyne several months after the workers' compensation policy took effect. The IPA stated all its terms were retroactive to the policy start date. Argonaut offers no explanation for the delay or why the "complete terms" of its insurance plan were not included in the original policy. The IPA contains what we would consider to be significant details regarding the terms of insurance, yet there is no indication they were disclosed to Ceradyne when the insurance contract was being negotiated. Rather than address why Ceradyne, the insurance commissioner, and WCIRB did not require disclosure of the "complete terms" of the workers' compensation policy before it went into effect, Argonaut provides the following meritless arguments as to why the IPA is technically not an "insurance policy" and should be viewed as simply a "side agreement" between the parties.

(i) Argonaut's argument statutory authority implicitly allows the IPA to be excluded from the policy terms and from the review/approval process lacks merit.

Argonaut maintains there is one code provision applicable to policies with deductibles that "implicitly require side agreements" regarding payments of the deductibles unrelated to the policy. To analyze the argument, we take a moment to describe how the workers' compensation statutory scheme is organized in the Insurance Code. The section devoted to workers' compensation is divided into several chapters. Chapter 1 contains the "general regulations." Chapter 2, titled "workers' compensation policies," contains definitions and *the mandatory* policy provisions, including section 11658 [review/approval by the insurance commissioner]. Chapter 3 concerns the regulation of the "business of workers' compensation." This chapter contains more definitions and rules regulating the deposits and rates charged by the insurance industry. Article 2 of this chapter provides rules relating to "state rate supervision." These rules provide the insurance commissioner with "authority to disapprove rates charged by workers' compensation insurers that are inadequate to cover their losses and expenses. This is to prevent insurers from 'low balling' rates in order to build market share and monopolize the market." (Croskey et al., Cal. Practice Guide: Insurance Litigation (The Rutter Group 2008) ¶ 14.155, p. 14-26; §§ 11732–11733.)

Argonaut asserts that within Chapter 3's provisions concerning the regulation of the insurance rates, there is a one special statute (§ 11735, subd. (e)(3)) that sets out the "key provisions to be used in policies with deductibles" and implies deductible provisions "can be accomplished only by side agreements." It reads too much into the statute. Section 11735, subdivision (e)(3), reads: "The endorsement shall provide that notwithstanding the deductible, the insurer shall pay all of the obligations of the employer for workers' compensation benefits for injuries occurring during the policy period. Payment by the insurer of any amounts within the deductible shall be treated as

an advancement of funds by the insurer to the employer and shall create a legal obligation for reimbursements, and may be secured by appropriate security."

Argonaut argues that to "effect" such a large deductible program, it was required to create a "side agreement" that was not part of the workers' compensation policies. Section 11735 says no such thing. There is no mention of whether the endorsement should not, or could not, disclose a schedule for reimbursement of the deductibles and include an estimated amount of the security. To the contrary, the first sentence of subdivision (e) of section 11735 (which Argonaut omits from its discussion) states, "Notwithstanding [s]ections 11657 to 11660, inclusive, supplementary rate information filed with the commissioner for purposes of offering deductibles to policyholders for all or part of benefits payable under the policy shall be deemed complete if the filing contains all of the following: . . ." By this language, the Legislature intended the deductible-related provisions contained in section 11735, to be in addition to the mandatory policy provisions contained in chapter 2 of the Insurance code (including section 11658 requiring full disclosure of all insurance program forms to the Insurance Commissioner).

Moreover, the first paragraph of section 11735, subdivision (a), requires disclosure of financial information: "Every insurer shall file with the commissioner all rates and supplementary rate information that are to be used in this state. The rates and supplementary rate information shall be filed not later than 30 days prior to the effective date. Upon application by the filer, the commissioner may authorize an earlier effective date. To the extent possible, rates and supplementary rate information shall be based upon supporting information derived from the experience or data of the insurer, rating organization, advisory organization, or other insurers." We find nothing in section 11735 which would explain the need for a separate non-disclosed insurance program agreement regarding premiums, reimbursement obligations, security, and mandatory arbitration.

(ii) Argonaut's discussion of case authority construing insurance contracts narrowly does not help its argument.

Argonaut cites one tax law case to support its theory the IPA contract was not an insurance policy requiring review by the Insurance Commissioner. (*Title Ins. Co. v. State Bd. of Equalization* (1992) 4 Cal.4th 715 (*Title Ins. Co.*).) The case hurts, not helps, its argument. In *Title Ins. Co.*, the Supreme Court evaluated an underwriting agreement between a title company and a title insurance company and the court concluded it was not a contract of insurance for state tax purposes. (*Id*. at pp. 726-727.) The court noted the contract did not look like an insurance contract because it did not "appear to distribute the risk of liability for claims among similarly situated persons." (*Id.* at p. 726.) Although the underwritten title company agreed to indemnify the insurer for a portion of its liability, the underwriting agreements did not distribute the risk among similarly situated title insurers. The court focused on the main function of the agreement, which was to require the title company to perform a title search and examination properly, not to provide insurance to either the title insurer or the insured. (*Id.* at p. 727.)

Argonaut asserts there is nothing in the IPA distributing the risk of liability and its primary function is to ensure repayment of the money advanced for deductibles. It classifies the agreement as separate and secondary to the insurance policy. This argument directly conflicts with Argonaut's contention Ceradyne's suit for breaching the "policy" necessarily invokes the IPA's arbitration clause. In any case, the argument is meritless because unlike the *Title Ins. Co.* agreement, in this case the IPA looks very much like part of an insurance contract. Its primary function is related to Argonaut's ability and obligation to provide insurance. Unlike a title company, Argonaut is undeniably an insurer in the business of writing insurance policies, collecting premiums, and paying claims. To accept Argonaut's claim the IPA is purely a secondary financial document would require us to ignore the actual terms of the agreement. It expressly states the IPA describes the "complete insurance program." IPA stands for "Insurance

Program Agreement." The schedules for payment of premiums and deductibles are nearly identical to the "endorsements" regarding these same terms contained in the policy.

(iii) Argonaut's contention the complaint proves the IPA was not an insurance policy is meritless.

Next we address Argonaut's argument the nature of Ceradyne's claims prove the IPA is not a workers' compensation policy within the meaning of section 11658. Without offering any legal analysis or citations, Argonaut argues the claims do not relate to a failure to pay benefits to claimants, but rather concern allegations Argonaut mishandled Ceradyne's money pursuant to the terms of the IPA. They have misconstrued the crux of the lawsuit. Ceradyne sued Argonaut for mismanagement of the workers' compensation claims, and costing Ceradyne more money than necessary. Ceradyne purchased an insurance policy, not a financial agreement. Its lawsuit relates to both the policy and the IPA. As noted above, Argonaut expressly defined the scope of the insurance plan in the IPA: "The complete terms of the Insurance Program are in both this [IPA] and the Policies."

(iv) We reject Argonaut assertions it can be inferred the Insurance Department approved the arbitration clause during a routine audit and this court must ignore Ceradyne's evidence the Insurance Department would never have approved the arbitration clause.

Larry White, a former employee of the Department of Insurance, offered his opinion about whether the Insurance Commissioner would have approved an arbitration agreement in a workers' compensation program. He declared he had never seen such a provision in an approved program, he did not believe the Insurance Department has ever approved such a provision, and he personally would not have approved an insurance program requiring arbitration. Argonaut argues this lay opinion does not answer the legal question of whether section 11658 requires review or

submission of the arbitration clause. We agree. However, for this same reason we reject Argonaut's claim the trial court should have inferred from Marilyn Brands' deposition testimony the Insurance Department implicitly approved the arbitration clause in question. Brands testified the Insurance Department audited Argonaut's files every few years and it made no negative findings. She recalled the Department's examiner opined the IPA was well written and a "good document." As aptly stated by Ceradyne, the purpose of a market conduct audit is to evaluate an insurance carrier's general operating procedures. (Cal. Code of Regs., title 10, § 2591.) The audit does not require the review and approval of agreement terms, such as an arbitration clause. All the workers' compensation forms and policies were purportedly prescreened and approved by the WCIRB and the Insurance Commissioner before they were issued in the first instance. One examiner's lay opinion does not answer the legal question of whether section 11658 requires disclosure and pre-approval of the arbitration clause.

(v) We conclude the dispute resolution provision falls within the broad scope of insurance forms that must be disclosed and pre-approved.

None of the arguments raised by Argonaut leads us to the conclusion the terms of the "Insurance Program Agreement" are not subject to disclosure and regulation by the Insurance Commissioner and the WCIRB. By its own terms, the IPA was part and parcel of the complete insurance plan offered to Ceradyne. As evidenced by Argonaut's own policy, a standard workers' compensation policy includes more than just a statement of the indemnity obligations. To adequately and efficiently regulate and monitor rates and insurance companies, the Commissioner and the WCIRB must review more than indemnity and liability terms. Under California law employers have no choice but to secure workers' compensation insurance (Lab. Code, § 3700) and, consequently, the entire system is highly regulated. If dispute resolution by arbitration was intended to be part of the "insurance program" with Ceradyne, we conclude the provision required review and approval by the Insurance Commissioner and the WCIRB.

C. The arbitration clause is void.

Based on the statutory language of section 11658, subdivision (a), noncompliance with the mandatory review and pre-approval process renders the arbitration provision in the IPA unenforceable. In addition to the mandatory preapproval language in the Insurance Code, the California Code of Regulations, title 10, section 2218, subdivision (a), unequivocally states all workers' compensation forms must be formally approved. The Legislative intent could not be more clear. Workers' compensation insurance programs are to be closely scrutinized and are highly regulated.

"'[G]enerally speaking, "a contract made in violation of a regulatory statute is void," . . . [however,] "'the rule is not an inflexible one to be applied in its fullest rigor under any and all circumstances.'"' [Citations.] 'In compelling cases, illegal contracts will be enforced in order to "avoid unjust enrichment to a defendant and a disproportionately harsh penalty upon the plaintiff." [Citation.]' [Citation.] '"'In each case, the extent of enforceability and the kind of remedy granted depend upon a variety of factors, including the policy of the transgressed law, the kind of illegality and the particular facts.'" [Citation.]' [Citation.]" (*Malek v. Blue Cross of California* (2004) 121 Cal.App.4th 44, 70 [arbitration provision that did not comply with disclosure requirements of Health and Safety Code section 1363.1 deemed void].)

In this case, analysis of the above factors supports the conclusion the arbitration clause should not be enforced. As discussed above, the review and pre-approval safeguards were created to protect both employers and employees. It would defeat the statutory purpose to allow an insurance company to bypass the governmental review process by simply waiting nine months after the policy has gone into effect to introduce additional or modified terms to its insurance program. It cannot be overlooked that workers' compensation coverage is not optional for the employer. (Labor Code § 3700.) Although Ceradyne is a large company, it had committed to Argonaut's policy and was in need of the statute's oversight protection. Argonaut knew or should have

known of the review and pre-approval process of their insurance program. It followed the procedures for the first policy, but deliberately did not for the IPA.

Finally, this is not a case where equitable factors support upholding the arbitration clause. When this litigation started, neither party was aware there was an arbitration clause and both parties participated in the normal course of litigation for over six months until one of Argonaut's lawyers stumbled upon the apparently well hidden arbitration clause during the course of discovery.

We conclude that as a workers' compensation insurance provider, Argonaut should have been aware of its duty to seek review and approval of its arbitration clause. The clause is void. We deem this penalty for bypassing the statutory safeguards, in violation of both section 11658 and the California Code of Regulations, title 10, section 2218, "is not disproportionately harsh in relation to the gravity of the violation." (See *Malek v. Blue Cross of California, supra*, 121 Cal.App.4th at pp. 71-72.)

D. Does the trial court or arbitrator decide whether to invalidate the arbitration agreement?

In the trial court, Ceradyne argued the arbitration clause was void because Argonaut failed to have it reviewed and approved pursuant to section 11658. However, the trial court took the argument one step further and rejected Argonaut's request for arbitration on the basis *the entire* IPA contract was void because it had not be reviewed by the insurance commissioner.

Argonaut contends that under the Federal Arbitration Act (FAA), questions concerning the validity of the entire agreement must be decided by the panel of arbitrators, not the court. We need not address this issue because the record plainly shows Ceradyne did not seek to void the entire agreement. Its opposition to the petition to compel arbitration raised challenges to the validity of the arbitration clause only. It never sought to set aside or deem void the other provisions relating to and incorporating

the policy. This would serve no valid purpose as many of the acceptable policy terms were duplicated in the IPA.

We note the IPA provided: "Severability:–If any provision of this Agreement is at any time be deemed invalid and unenforceable then, to the fullest extent permitted by law, the other provisions of this Agreement shall remain in full force and effect and are to be construed to carry out your and our intentions as nearly as may be possible." A severability clause acknowledges the trial court's legal power to sever any unenforceable portions, and recognizes the possibility that enforceability issues will be decided, not by the arbitrator, but by the court. (*Armendariz v. Foundation Health Psychcare Services, Inc*. (2000) 24 Cal.4th 83, 96.)

Because the IPA contained a severability clause, the trial court had authority to sever and deem the arbitration clause void and unenforceable. The court's decision to deem void the entire agreement must be reversed, but we affirm its determination the arbitration clause was unenforceable.

E. The trial court correctly refused to dismiss or stay the case to permit a New York court to consider the validity of the arbitration clause.

The IPA contained a mandatory forum selection clause selecting New York for disputes concerning enforcement of the arbitration clause. Argonaut argues the trial court erred in refusing to enforce the forum selection clause to permit New York to consider the arbitration motion. We disagree.

There exists a disagreement among the appellate courts whether the abuse of discretion or substantial evidence standard of review applies when reviewing a trial court's decision whether to enforce a forum selection clause. The majority of courts have applied the abuse of discretion standard. For example, a different panel of this court stated, "We . . . consider whether the superior court abused its discretion in denying

Furda's motion to stay or dismiss . . . on the ground of forum non conveniens and the forum selection clause." (*Furda v. Superior Court* (1984) 161 Cal.App.3d 418, 424.) Division Two of the First District Court of Appeal also explicitly approved this approach in *America Online, Inc. v. Superior Court* (2001) 90 Cal.App.4th 1, 8, where the court went through a thorough analysis of the cases on this matter and decided there was clear language and sound reasoning supporting the abuse of discretion standard. Moreover, our Supreme Court has implied in *Smith, Valentino & Smith, Inc. v. Superior Court* (1976) 17 Cal.3d 491, 496 (*Smith*), the abuse of discretion standard applies when it denied a petition for mandate, finding that the trial court had acted within its discretion in upholding a contractual forum selection clause when there was no showing enforcement would be unreasonable.

A few appellate courts have applied the substantial evidence standard of review. The Third District Court of Appeal in *Cal-State Business Products & Services, Inc. v. Ricoh* (1993) 12 Cal.App.4th 1666, 1681, reasoned that when a forum selection clause is involved, "the trial court must determine if there is sufficient evidence to satisfy the requirements for invalidating a binding contract. If the trial court finds there are facts present which satisfy these criteria, it *must* act in a particular way; there is no discretion involved. The reviewing court is thus involved in determining the quantum of evidence adduced, not the manner in which factors were applied." (Relying on its prior decision in *Lifeco Services Corp. v. Superior Court* (1990) 222 Cal.App.3d 331.)

We conclude the abuse of discretion standard should be applied given the existing guidance on this question from our Supreme Court, the persuasive line of Court of Appeal decisions also applying the abuse of discretion standard, and this court's prior opinion on the issue. Applying this standard we have determined the trial court did not abuse its discretion in this case.

The general rules regarding enforcement of forum selection clauses are as follows: "While it is true that the parties may not *deprive* courts of their jurisdiction over causes by private agreement [citation], it is readily apparent that courts possess discretion to *decline* to exercise jurisdiction in recognition of the parties' free and voluntary choice of a different forum." (*Smith, supra*, 17 Cal.3d at p. 495.) "[F]orum selection clauses are valid and may be given effect, in the court's discretion and in the absence of a showing that enforcement of such a clause would be unreasonable." (*Id.* at p. 496.) "'Mere inconvenience or additional expense is not the test of unreasonableness since it may be assumed that the plaintiff received under the contract consideration for these things.' [Citation.]" (*Ibid.*)

However, as with any contract provision, the forum selection clause can be breached and/or waived. By filing its action in California, Ceradyne obviously breached the forum selection clause. We conclude Argonaut then waived its right to enforce the provision by its subsequent conduct. First, it ignored the forum selection clause by making an appearance in the action and initiating discovery. Soon after receiving unfavorable rulings in October 2007 on its demurrer, motion for judicial notice, and motion to strike punitive damages, Argonaut moved for an "order compelling arbitration and staying this action." Still it did not try to compel compliance with the forum selection clause. When Ceradyne attempted to continue the hearing to conduct additional depositions, Argonaut filed a written opposition. Only after again receiving an unfavorable ruling did Argonaut attempt to invoke the forum selection clause by amending its motion and requesting a stay or dismissal for forum non conveniens. This amended motion was filed at the end of December 2007, six months after the action was initiated (July 2007).

At oral argument, we permitted the parties to brief the issue of whether Argonaut waived its right to enforce the forum selection clause based on its appearance and submission to the jurisdiction of the California courts for six months. (See Code Civ. Proc., § 418.10, subd. (e)(3).) We agree with Argonaut that Code of Civil Procedure section 418.10 subdivision (e)(3) does not preclude a party who has made a general appearance from filing a motion to stay or dismiss based on a forum selection clause. (See Code Civ. Proc., § 410.30, subd. (b) ["The provisions of [Code Civ. Proc., §] 418.10 do not apply to a motion to stay or dismiss the action by a defendant who has made a general appearance"].)

However, Argonaut's failure to timely invoke the forum selection clause, and the resulting time and judicial resources spent by the California courts on the case, is reason to deem the provision waived. Like the cases concerning waiver of arbitration provisions, there is no single test to determine if a particular contract provision is waived. (*Sobremonte v. Superior Court* (1998) 61 Cal.App.4th 980, 992 (*Sobremonte*).) We find instructive the list of factors used in arbitration clause waiver cases. As identified in *Sobremonte* a court in those cases may consider "'(1) whether the party's actions are inconsistent with the right to arbitrate; (2) whether "the litigation machinery has been substantially invoked" and the parties "were well into preparation of a lawsuit" before the party notified the opposing party of an intent to arbitrate; (3) whether a party either requested arbitration enforcement close to the trial date or delayed for a long period before seeking a stay; (4) whether a defendant seeking arbitration filed a counterclaim without asking for a stay of the proceedings; (5) "whether important intervening steps [e.g., taking advantage of judicial discovery procedures not available in arbitration] had taken place"; and (6) whether the delay "affected, misled, or prejudiced" the opposing party. [Citations.]'" (*Ibid.*)

The factors apply in this case, but must be slightly adjusted as the waiver question relates to a forum selection clause specifically requiring New York courts to enforce the arbitration provision. Argonaut filed the petition to compel arbitration first in California, a choice inherently inconsistent with its right to have the issue decided in New York. Moreover, because six months had passed since the action was filed, the litigation machinery had been substantially invoked. Both parties had submitted briefing and supporting declarations in support of, and opposing, the petition to compel arbitration. They were well into litigating the issue of arbitration. If the trial court had not granted Ceradyne's request for a continuance to conduct more discovery, Argonaut would not have had the opportunity to amend its motion and seek a dismissal based on the forum selection clause. Due to the time and resources expended by the court and the party opposing the petition to compel arbitration, it would be unreasonable, costly, and unfair to allow Argonaut to invoke the forum selection clause and start over by moving the hearing to a different state.

In its supplemental brief, Argonaut argues it cannot be deemed to have waived its forum selection argument because it was unaware of the clause when it demurred. We disagree. Argonaut initially chose California as the state to file its petition to compel arbitration, and was necessarily aware of the forum selection clause at that time. Both clauses were contained in the IPA. And, we note the argument "I didn't know about it" runs contrary to the policy for upholding a party's negotiated and allegedly voluntary forum selection clause. Argonaut's original need for New York to enforce its arbitration contracts was somehow forgotten and it sought enforcement from the California courts. Consequently, the inconvenient forum issue was waived.

IV

We reverse the portion of the court's order striking the entire IPA agreement. We affirm the portion of the court's order denying the petition to compel

arbitration and denying the motion to stay or dismiss the case. Respondent shall recover its costs on appeal.

O'LEARY, J.

WE CONCUR:

BEDSWORTH, ACTING P. J.

FYBEL, J.