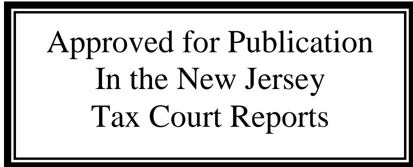
NOT FOR PUBLICATION WITHOUT THE APPROVAL OF THE TAX COURT COMMITTEE ON OPINIONS

JOHNSON & JOHNSON, Plaintiff, v. DIRECTOR, DIVISION OF TAXATION and COMMISSIONER, DEPARTMENT OF BANKING AND INSURANCE, Defendants.	TAX COURT OF NEW JERSEY DOCKET NO. 013502-2016



Decided: June 15, 2018

Michael A. Guariglia for plaintiff (McCarter & English, LLP, attorneys, Vlad Frants, on the brief).

William B. Puskas, Jr. for defendants (Gerber S. Grewal, Attorney General of New Jersey, attorney).

BRENNAN, J.T.C.

This constitutes the court's decision on plaintiff's motion for summary judgment and defendants' cross-motion for summary judgment. For the reasons explained more fully below, the court finds that as a matter of law, effective July 21, 2011, the insurance premium tax due by plaintiff is based on all premiums for risks located within the United States, and not solely on an allocation of risks within New Jersey. Accordingly, the court denies plaintiff's motion for summary judgment and grants defendants' cross-motion for summary judgment.

I. <u>Findings of Fact and Procedural History</u>

The court makes the following findings of fact based on the submissions of the parties pursuant to R. 1:7-4.

Johnson & Johnson ("J&J") is a New Jersey corporation engaged in a world-wide pharmaceutical, medical device, and consumer health care business. The global insurance requirements for J&J and its subsidiaries are substantial and include, but are not limited to, Worker Compensation, Automobile Liability, General Liability, Product Liability, Excess Product Liability, Executive Protection, Property, and Casualty coverages.

In 1970, J&J formed an insurance subsidiary named Middlesex Assurance Company Limited ("Middlesex Assurance"). J&J formed this subsidiary in order to decrease insurance costs, obtain broader coverage than may be otherwise available in the general insurance market, avoid brokerage fees or commissions, and expedite claims processing. In the insurance industry, Middlesex Assurance is known as a "single-parent" or "pure" captive insurance company,[1] meaning that it was established with the specific objective of only providing insurance coverage for J&J's risks in the United States ("U.S.").

Originally incorporated in Bermuda, Middlesex Assurance moved to Vermont in 1994, and is only authorized to conduct business within Vermont, its domiciliary state.[2] It is regulated by

---

[1] A captive insurance company is defined as a company that insures the liabilities of its owner. The insured is usually the sole shareholder and only customer of the captive insurer. Black's Law Dictionary 926 (10th ed. 2010).

Various types of captive structures have evolved over the years. The vast majority of captives insure only the risks of their parent (single parent or 'pure' captive). In addition to single-parent captives, there now exist group/association captives, rent-a-captive, risk retention groups, agency captives, branch captives, senior or diversified captives, protected cell captives, and producer owned reinsurance companies (PORCs). The list is not exhaustive; variations continue to flourish as companies create more sophisticated and innovative ways to use captives. See Captive Insurance Companies, http://www.naic.org/cipr_topics/topic_captives.htm (last visited May 10, 2018).

[2] In 1994 only a limited number of states authorized the formation of captive insurance companies. In February 2011, the New Jersey Legislature passed N.J.S.A. 17:47B-1 to -19, which allows for the formation of captive insurance companies in New Jersey. The tax rate associated with a captive insurance company admitted to do business in New Jersey is found at N.J.S.A. 17:47B-12, and is similar to the tax rate in Vermont.

the Insurance Division of the Vermont Department of Financial Regulation and is subject to an insurance premium tax ("IPT")[3] imposed by Vermont. While Middlesex Assurance only conducts business in Vermont, it can and does provide insurance coverage for J&J's risks in other jurisdictions.

All transactions involving the purchase of J&J's insurance coverage occur directly between Middlesex Assurance and J&J's corporate risk management group. J&J's corporate risk management group conducts its day-to-day activities at J&J's world headquarters in New Brunswick, New Jersey. The corporate risk management group is responsible for the placement and servicing of the various insurance programs that afford insurance coverage and protection to J&J, its subsidiaries, and affiliates nationally and globally including the purchase of its U.S. insurance coverage from Middlesex Assurance.

In New Jersey, IPT is imposed on the premiums paid by an insured (J&J) to its nonadmitted captive insurance company (Middlesex Assurance) under N.J.S.A. 17:22-6.64.[4] J&J's brief labels

---

[3] An IPT is a form of gross receipts or excise tax levied on direct premiums or on premium income, and not based on the profits or net income of an insurance company. See 2 Brian T. Casey and Dean Colin, New Appleman on Insurance Law Library Edition § 12.01 [3] (2018).

[4] Like most states, New Jersey imposes an IPT on the purchase of insurance products. The IPT tax rate is lower for insurance companies that are admitted to do business in the state, and higher for insurance companies that are nonadmitted.

Admitted insurers include both domestic and foreign insurance companies. A New Jersey insurer (domestic) must receive approval from the Commissioner, Department of Banking and Insurance ("DOBI"), authorizing the company to transact insurance in this state. See N.J.S.A. 17:17-1 to -20. Out of state insurance companies (foreign) seeking to transact insurance business in New Jersey must be admitted by the DOBI Commissioner to do so. See N.J.S.A. 17:32-1 to -22.

Nonadmitted insurers include foreign (out of state) insurance companies, alien (outside the U.S.) insurance companies, and also domestic surplus lines insurers as defined by N.J.S.A. 17:22-6.69b.

A captive insurance company can either be admitted or nonadmitted.

this statute and its related tax as "self-procured." Although there is no such label in the statute, for purposes of this opinion, the court will refer to this statute as "the self-procurement statute" and the related IPT as the "self-procurement tax."[5]

Since J&J purchases all of its insurance coverage through its corporate risk management office in New Jersey, other states cannot impose a self-procurement tax on J&J due to lack of

---

Generally, self-insured entities are not subject to IPTs because self-insurance is not considered to be insurance, as no risk shifts to an insurer and no insurance policy is issued, nor are insurance premiums paid. See 2 New Appleman § 12.09 [8].

[5] The lack of a formal designation for N.J.S.A. 17:22-6.64 or its related tax has contributed greatly to the confusion and misperceptions present in this case.

Sources such as New Appleman, refer to self-procured insurance as "direct" or "independently" procured insurance. The New Jersey Division of Banking and Insurance in correspondence to J&J has referred to the tax as a "procurement tax."

An important distinction is that the tax imposed under N.J.S.A. 17:22-6.64 is not referred to as a "premium receipts tax" or "surplus lines tax." The self-procurement statute is contained within N.J.S.A. 17:22-6.40 to -6.65, which is referred to as the Surplus Lines Law. However, its location within the Surplus Lines Law has led to the argument that self-procured insurance is a form of surplus lines coverage, and that the tax is a surplus lines tax.

The court also notes that the self-procurement statute, N.J.S.A. 17:22-6.64, has different headings in both Lexis Advance and the New Jersey Statutes Annotated. In Lexis Advance the statute bears the heading "Report of Insurance through Unauthorized Foreign, Alien insurer." In the New Jersey Statutes Annotated, the designated heading is "Report of Insurance procured, continued or renewed with unauthorized insurer other than insurance procured pursuant to surplus lines law; levy and payment of tax."

sufficient minimum contacts with those states.[6] As a result, J&J only pays self-procurement tax to New Jersey.[7]

J&J began remitting self-procurement tax to New Jersey in 2008.[8] The amount of tax due was calculated in conformance with N.J.S.A. 17:22-6.64, and was based only on that portion of the premium allocated to risks in New Jersey. In November 2011, this method of determining the tax due changed in response to Congress's enactment of the Nonadmitted and Reinsurance Reform

---

[6] In general, in order for a state to have authority to tax insurance premiums, the entity to be taxed needs to have sufficient nexus, or connections, with the state. Since the regulation and taxation of insurance is not considered to be interstate commerce governed by the Commerce Clause, any analysis of nexus is determined by application of the Due Process and Equal Protection Clauses of the Fourteenth Amendment.

The United States Supreme Court has held that merely insuring a risk in a state is not sufficient activity under the Due Process Clause to subject a company to a procurement tax. In *State Bd. of Ins. v. Todd Shipyards Corp.*, 370 U.S. 451 (1962), the insured was incorporated and domiciled in New York, but did business and owned real and personal property in Texas. It sued to recover taxes levied and collected by Texas on insurance covering its property in Texas. All transactions pertaining to such insurance took place outside of Texas. The insurers were domiciled in London, and were not licensed in Texas and did no business and had no office or agents in Texas. The insurance was bought and issued in New York, and the premiums thereon and claims thereunder were payable in New York. The Court held that in the light of the history and provisions of the McCarran-Ferguson Act, the Texas tax on these wholly out-of-state transactions was invalid. Id. at 452-458.

[7] As noted earlier, Middlesex Assurance is subject to a separate IPT imposed by Vermont.

[8] In 2008, J&J voluntarily reported that it was transacting business with Middlesex Assurance in a manner that would make it subject to the self-procurement statute. Through a negotiated agreement with DOBI in 2008, J&J began paying self-procurement tax for tax years beginning with 2005.

Act of 2010 ("NRRA"),[9] and related statutory amendments by the New Jersey Legislature.[10] Thereafter, as a precautionary measure, J&J began to calculate and remit self-procurement tax[11] based on its total U.S. premiums.

On November 2, 2015, J&J filed a claim with the Commissioner, Department of Banking and Insurance ("DOBI") and the Director, Division of Taxation ("Director") seeking a refund of self-procurement tax in the amount of $55,902,070.95, plus applicable interest.[12] J&J asserted that the NRRA and New Jersey's 2011 legislative changes in response to the NRRA did not alter the method of calculating self-procurement tax. In support of this position, J&J argued that the NRRA was intended only to apply to surplus lines insurance and reinsurance, and not to self-procured insurance. Additionally, J&J argued that the statutory changes to N.J.S.A. 17:22-6.64 made by the New Jersey Legislature in 2011 did not alter the calculation of self-procurement tax, because the amendment refers only to surplus lines policies, and the original statutory language allocating the tax to risks located in New Jersey remained untouched.

By letter dated January 19, 2016, DOBI informed J&J that it determined that J&J's refund claims were unwarranted and not supported by prevailing law. DOBI relied on the NRRA's use of the term "nonadmitted insurance," which by definition includes both self-procured insurance

---

[9] The Nonadmitted and Reinsurance Reform Act of 2010 consists of three parts: Part I – Nonadmitted Insurance (P.L. 111-2013, Title V, Subtitle B, §§ 521-527); Part II – Reinsurance (§§ 531-533); and Part III – Rule of Construction (§§ 541-542). Parts II and III are not relevant to this matter. Accordingly, when the term "NRRA" is used herein, it refers only to Part I (codified at 15 U.S.C. §§ 8201-8206).

[10] Specifically N.J.S.A. 17:22-6.64.

[11] To add to the disarray of language usage in this case, the NRRA refers to what the parties call a self-procurement tax as a "premium tax."

[12] In determining the amount of its refund claim, J&J used the same allocation methods it used prior to November 2011. The refund sought represents the amount of IPT paid from November 2011 through March 31, 2015 associated with risks located outside of New Jersey.

and surplus lines insurance. Regarding the 2011 legislative amendments, DOBI wrote the following:

> When the New Jersey Legislature amended its surplus lines and self-procured insurance premium tax statutes in 2011, it did so with the expressly stated purpose of bringing those statutes into compliance with NRRA. 2010 Legis. Bill Hist. S. 2930. Although the legislative history and the statutory amendments use the term "surplus lines," (see, P.L. 2011, c. 119), this is of no import. The definition of "surplus lines insurer" in N.J.S.A. 17:22-6.41 as any "unauthorized insurer in which an insurance coverage is placed or may be placed under this surplus lines law," makes clear that the Law is intended to establish procedures for the purchase and taxation of insurance from unauthorized insurers whether procured through a surplus lines broker pursuant to N.J.S.A. 17:22-6.42, or directly by an insured and therefore "self-procured" pursuant to N.J.S.A. 17:22-6.64. Also, P.L. 2011, c. 119 specifically amended both the self-procured insurance premium tax statute, N.J.S.A. 17:22-6.64, and the taxing provision for insurance procured through a surplus lines broker, N.J.S.A. 17:22-6.59, with identical language as follows: if a policy "covers risks or exposures in this State and other states, where this State is the home state . . . the tax payable pursuant to this section shall be based on the total United States premium for the applicable policy."

Relying on DOBI's analysis, the Director denied J&J's refund claim on August 9, 2016.

On October 24, 2016, J&J filed a Complaint with the Tax Court, alleging that DOBI and the Director's denial of the refund claim was incorrect. Specifically, J&J asserted the following:

> The Division's refund denial is contrary to the plain language of the Self Procurement Tax set forth at N.J.S.A. 17:22-6.64;
>
> After New Jersey's implementation of the NRRA, the plain language of the Self Procurement Tax in N.J.S.A. 17:22-6.64 still applies only to premiums paid "upon a subject of insurance resident, located or to be performed within [New Jersey]";
>
> The Refund Denial is contrary to the intent and legislative history of New Jersey's 2011 legislative changes to the Surplus Lines Law;
>
> The Refund Denial is contrary to the purpose and intent of the NRRA because the NRRA does not apply to premiums paid to a captive insurance company;

> There is no authority permitting DOBI or the Division to subject the entire premium paid by J&J to Middlesex Assurance to the Self-Procurement Tax, because under N.J.S.A. 17:22-6.64, New Jersey can tax only that portion of J&J's premiums allocable to insured risks located in New Jersey;
>
> The Surplus Lines Law expressly provides that it does not apply to insurance independently procured from a captive insurance company and taxed under N.J.S.A. 17:22-6.64; and
>
> The Surplus Lines Law expressly provides that a captive insurance company is not a "surplus lines insurer" as defined in the statute.

On February 21, 2017, DOBI and the Director filed an Answer to J&J's Complaint. J&J filed a motion for summary judgment on May 26, 2017, and DOBI and the Director filed a cross-motion for summary judgment on October 17, 2017. The court heard oral argument on February 26, 2018.

II. Legal Authority

A. Summary Judgment

Summary judgment should be granted where "the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact challenged and that the moving party is entitled to a judgment or order as a matter of law." R. 4:46-2 (c). In *Brill v. Guardian Life Ins. Co. of Am.*, 142 N.J. 520, 523 (1995), our Supreme Court established the standard for summary judgment as follows:

> [W]hen deciding a motion for summary judgment under Rule 4:46-2, the determination whether there exists a genuine issue with respect to a material fact challenged requires the motion judge to consider whether the competent evidential materials presented, when viewed in the light most favorable to the non-moving party in consideration of the applicable evidentiary standard, are sufficient to permit a rational factfinder to resolve the alleged disputed issue in favor of the non-moving party.

"The express import of the Brill decision was to 'encourage trial courts not to refrain from granting summary judgment when the proper circumstances present themselves.'" Twp. of Howell v. Monmouth County Bd. of Taxation, 18 N.J. Tax 149, 153 (Tax 1999) (quoting Brill, 142 N.J. at 541).

There are no material facts in dispute between the parties relevant to the laws at issue. The court is asked to interpret the IPT statutes, and the calculation of self-procurement tax under N.J.S.A. 17:22-6.64. J&J contends that the NRRA and the 2011 legislative changes to the IPT statutes did not alter the calculation of self-procurement tax, which it asserts is based only on risks allocable to New Jersey. J&J also claims that it would be unconstitutional to impose self-procurement tax on its risks located outside of New Jersey.

DOBI and the Director take the contrary position and argue that the NRRA and the 2011 legislative changes to N.J.S.A. 17:22-6.64 altered the method by which J&J's self-procurement tax is calculated to include all U.S. premiums, and that such taxation is constitutionally permissible. As this is entirely a matter of legal interpretation, the court agrees that this matter is ripe for summary judgment.

B. Discussion of Applicable Laws

The insurance industry is complex, highly regulated, and ever evolving. In order to fully understand and analyze the legal arguments at hand, some history and background is required.

States have a legitimate interest in regulating insurance companies. Regulations safeguard the public by making sure that companies selling insurance are financially sound and have reliable management to meet future obligations to insureds. In order to effectuate the imposition of regulations, states require insurers to become "admitted" to conduct business in their state. Once admitted, an insurer submits itself to complex requirements and reporting procedures designed to

ensure solvency and the ability to pay claims. By becoming admitted, an insurer also subjects itself to taxation.

State taxation of insurance premiums predates the Civil War. Massachusetts first imposed an IPT in 1832. In most states, the initial purpose of the tax was not to raise revenue, but rather to cover the expenses of insurance regulation, provide funds for fire protection, encourage the formation of domestic insurance companies by imposing a discriminatory tax burden on foreign insurance companies, or to retaliate against other states that imposed discriminatory taxes based on an insurer's residency. See 2 Brian T. Casey and Dean Colin, New Appleman on Insurance Law Library Edition § 12.01 [1] (2018).

Citizens have a constitutional right to purchase insurance from the insurer of their choosing. Acknowledging the "vital distinction between acts done within and acts done beyond a State's jurisdiction," the Supreme Court recognized in 1897 that a state could not impinge on a citizen's Fourteenth Amendment Due Process right to purchase insurance outside its confines, even if that insurance covered property within the state. *See Allgeyer v. Louisiana*, 165 U.S. 578, 588 (1897). *See also St. Louis Cotton Compress Co. v. Arkansas*, 260 U.S. 346, 349 (1922) ("[T]he State may regulate the activities of foreign corporations within the State but it cannot regulate or interfere with what they do outside.").

From the 1860s through the 1940s, the United States Supreme Court consistently held that the business of insurance could be freely regulated by the states because insurance was not considered to be "interstate commerce." See Paul v. Virginia, 75 U.S. 168, 183 (1869) ("Issuing a policy of insurance is not a transaction of commerce."); Hooper v. California, 155 U.S. 648, 655 (1895) ("The business of insurance is not commerce."); New York Life Ins. Co. v. Deer Lodge County, 231 U.S. 495, 510 (1913) ("[C]ontracts of insurance are not commerce at all, neither state

nor interstate.”). Because the business of insurance was held not to be interstate commerce, states were not subject to any restriction under the Commerce Clause, and virtually all states adopted statutes imposing premium taxes on insurance companies. See 2 New Appleman § 12.01 [1].

As the insurance industry grew, so too did the challenges on the ability of states to tax insurance premiums. In Connecticut General Life Ins. Co. v. Johnson, 303 U.S. 77 (1938), the Supreme Court limited a state's ability to tax insurance premiums. "As a matter of convenience and certainty, and to secure a practically just operation of the constitutional prohibition, we look to the state power to control the objects of the tax as marking the boundaries of the power to lay it.” Id. at 80. Where an insurance company carries out insurance transactions within a state, the insurance may be taxed. However, "the due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere.” Ibid.

Determination as to when a state may properly impose IPTs focuses on the "objects of the tax," the business entities involved, and the transaction. Ibid. The Supreme Court held that a registered foreign corporation may not be taxed on the reinsurance of risk in a state, where the insurance does not run to the "original insured" within the state, and is transacted entirely outside the state, because no part of that transaction was "embraced in any privilege granted by that state.” Id. at 82.

In 1944, the Supreme Court reversed its long-standing position and held that an insurance company conducting its operations across state lines was engaged in interstate commerce and thus, was subject to Commerce Clause protection against state interference. United States v. South-Eastern Underwriters Ass’n., 322 U.S. 533 (1944). Congress reacted to the decision with the adoption of the McCarran-Ferguson Act (“Act”), which provides:

> The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the

> regulation or taxation of such business. . . . No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance . . . .
>
> [15 U.S.C. § 1012]

The Act explicitly preserves the regulation of insurance for the states unless a federal law specifically addresses the business of insurance. Congress's intent, as set forth in the legislative history, was to provide for the continued regulation and taxation of insurance by the states, subject to the limitations set out in the controlling decisions of the United States Supreme Court. Those decisions hold, among other things, that a state does not have power to tax contracts of insurance entered into outside its jurisdiction by individuals or corporations resident or domiciled therein covering risks within the state.[13]

---

[13] Justice Douglas wrote in the Todd Shipyards decision:

> We need not decide de novo whether the results (and the reasons given) in the Allgeyer, St. Louis Cotton Compress, and Connecticut General Life Insurance decisions are sound and acceptable. For we have in the history of the McCarran-Ferguson Act an explicit, unequivocal statement that the Act was so designed as not to displace those three decisions. The House Report stated:
>
> "It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the Southeastern Underwriters Association case. Briefly, your committee is of the opinion that we should provide for the continued regulation and taxation of insurance by the States, subject always, however, to the limitations set out in the controlling decisions of the United States Supreme Court, as, for instance, in Allgeyer v. Louisiana (165 U.S. 578), St. Louis Cotton Compress Co. v. Arkansas (260 U.S. 346), and Connecticut General Insurance Co. v. Johnson (303 U.S. 77), which hold, inter alia, that a State does not have power to tax contracts of insurance or reinsurance entered into

The Supreme Court, in Prudential Ins. Co. v. Benjamin, 328 U.S. 408 (1946), upheld the Act as a valid exercise of Congressional power. The Court reiterated that the purpose of the Act was to remove current congressional obstructions and promote the development of state regulations on insurance. Id. at 429-30.

With the power to regulate insurance safely within the purview of state control, IPTs were crafted to respond to two insurance markets – admitted and nonadmitted insurance. In most states, the IPTs imposed on admitted insurers were lower than the IPT's levied on nonadmitted insurers, and were collected directly from the insurance company.

A nonadmitted insurer,[14] operates in two basic insurance markets, the surplus lines market and the self-procured market. The surplus lines market was created as a result of admitted insurers being unable or unwilling to provide insurance coverage to certain entities or ventures categorized as high risk. In New Jersey such risks might include shore properties, refineries, manufacturing plants, casinos, sports complexes, and large shopping malls. Simply put, surplus lines insurance companies provide coverage that is difficult or impossible to obtain from admitted insurers.

In New Jersey, the IPT imposed on surplus lines insurance is designated as a "premium receipts tax" under N.J.S.A. 17:22-6.59. It is also referred to in other sources as a "surplus lines

---

> outside its jurisdiction by individuals or corporations resident or domiciled therein covering risks within the State or to regulate such transactions in any way." H. R. Rep. No. 143, 79th Cong., 1st Sess., p.3.
>
> Senator McCarran, after reading the foregoing part of the House Report during the Senate debate, stated, ". . . we give to the States no more powers than those they previously had, and we take none from them." 91 Cong. Rec. 1442.
>
> [Todd Shipyard, 370 U.S. at 455-56.]

[14] Sometimes referred to as "unadmitted" insurers.

tax" or an "excess tax." For purpose of this opinion the court will use the Legislature's designation of "premium receipts tax."

A premium receipts tax is levied on insurance premiums paid to surplus lines insurers through the interaction with a surplus lines agent.[15] The premium receipts tax is paid by and is the responsibility of the surplus lines agent, who passes this cost on to the insured. The amount of the tax varies by state, along with the procedures for paying and reporting the tax. Some states have surplus lines stamping offices to assist in the processing and collecting of the tax. Historically, where all of the risk or liability from a particular surplus lines insurance policy resided in only one state, all premium receipts taxes would be remitted to that particular state. However, where a policy covered risks in multiple states, the tax was distributable to the various states. See 2 New Appleman § 12.10 [1].

The second nonadmitted insurance market is self-procured insurance. For a multitude of reasons (such as oppressive premium rates that may be related to high risk, or to reduce costs), an insured may choose to forego governmental protections and exercise its constitutional right to purchase insurance on its own from a nonadmitted insurer, without the involvement of an agent. In most states, self-procurement tax is collected directly from the insured or policyholder. Approximately three quarters of the states impose some type of self-procurement tax, with tax rates varying state-by-state. See 2 New Appleman § 12.11 [1]. Each state has its own forms and disclosures that must be filed along with the self-procurement tax. See 2 New Appleman § 12.10 [5].

[15] An insurance agent represents a specific insurance company. An insurance broker represents the insured and is not contractually bound to any one insurance company. The NRRA and DOBI use the term "broker" while the Surplus Lines Law defines and uses the term "agent." For purposes of this opinion, the two terms are interchangeable and the court will use the term "agent."

Over the years, various forms of self-procured insurance have gained popularity. One particular segment of the self-procured insurance market that has experienced both popularity and growth in the last fifty years is captive insurance. In the insurance industry, the origin of the term "captive" dates back to 1953, when the Steel Insurance Company of America was founded for the benefit of its parent, an Ohio steel company. The term was borrowed from "captive mines," which produce ore that is used entirely by the same company's mills.[16] Captive insurance companies operate similar to commercial insurers in that they issue policies, collect premiums, and pay claims, but they do not offer insurance to the general public and they are regulated differently than commercial insurers.[17]

In the 1950s and 1960s, most captive insurers were alien insurers, meaning that they were domiciled in foreign countries. In the 1970s, the first U.S. special law to encourage captive insurance formation was passed in Colorado, followed by Tennessee, then Vermont. Over recent decades, an increasing number of states have passed captive insurance legislation or modified existing legislation to gain a foothold as a domicile for captive insurers. Today, more than half of

---

[16] See Hugh Rosenbaum, The Early Days of Captives (through 1984), https://www.captive.com/resources/captive-insurance-history/before-1985 (last visited May 9, 2018).

[17] The captive insurance concept has been around for a long time. In the early 1500's, ship owners met in the London coffeehouses where they retained, shared and transferred the risk associated with their ships, akin to today's captives. During the 1700's and 1800's, there were instances of mutual insurance companies being formed by members of a particular industry to provide insurance coverage. The term "captive" was coined in the 1950's by Frederic M. Reiss, a property engineer turned insurance broker in Youngtown, Ohio. Reiss, known as the father of captive insurance, used the term "captive" to describe an insurance company he helped form to provide insurance coverage solely to its parent. In 1958, Reiss incorporated American Risk Management and began to assist corporations in setting up captives. During this time, U.S. regulations made it prohibitively expensive to form and operate captives in the U.S., leading Reiss to seek out other jurisdictions to allow his captive idea to flourish. See Shanique Hall, Recent Developments in the Captive Insurance Industry, comment to The Center for Insurance Policy and Research Newsletter January 2012, https://www.naic.org/cipr_newsletter_archive/vol2.htm (last visited May 9, 2018).

U.S. jurisdictions, including New Jersey, have captive insurance licensing laws. See Shanique Hall, Recent Developments in the Captive Insurance Industry, comment to The Center for Insurance Policy and Research Newsletter January 2012, https://www.naic.org/cipr_newsletter_archive/vol2.htm (last visited May 9, 2018).

As the insurance industry evolved, the multi-state regulation of nonadmitted IPTs became complex and inconsistent, especially as it related to surplus lines insurance. These complexities manifested themselves in different rates being applied and multiple taxes being imposed. Congress attempted to streamline and simplify these complexities as part of the Federal Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) ("Dodd-Frank"). Enacted in 2010, Dodd-Frank implemented expansive financial reforms, including the NRRA, which enumerated rules for the reporting, payment, and allocation of premium taxes for nonadmitted insurance.

The NRRA sought to clarify and simplify the process for collecting nonadmitted premium taxes by creating a uniform system of premium taxation for nonadmitted insurance covering multistate risks. To accomplish this, the NRRA provided that "no state other than the home state of an insured may require any premium tax payment for nonadmitted insurance" ("Home State Rule"). 15 U.S.C. §8201 (a).

The NRRA does not require taxation, nor does it specify that a home state has the authority to tax 100 percent of U.S. premiums. However, the Home State Rule gives the home state the authority to tax all nonadmitted insurance premiums in the U.S. There is no evidence to support the position that the NRRA was intended to limit a home state's ability to impose nonadmitted premium tax only to risks allocated to that state. Nor is there evidence to support the argument

that the Home State Rule was only intended to apply to premiums that were taxed prior to the NRRA's enactment.

The NRRA provides several key definitions:

> Home State: either (i) the state in which an insured maintains its principal place of business or, in the case of an individual, the individual's principal residence; or (ii) if 100 percent of the insured risk is located out of the state referred to in clause (i), the state to which the greatest percentage of the insured's taxable premium for that insurance contract is allocated (15 U.S.C. § 8206(6)(A)).
>
> Nonadmitted insurance: any property and casualty insurance permitted to be placed directly or through a surplus lines broker with a nonadmitted insurer eligible to accept such insurance (15 U.S.C. §8206 (9)).
>
> Nonadmitted insurer: with respect to a state, an insurer not licensed to engage in the business of insurance in such state (15 U.S.C. §8206 (11)(A)).
>
> Independently Procured Insurance: insurance procured directly by an insured from a nonadmitted insurer (15 U.S.C. §8206 (7)).
>
> Premium tax**:** The term "premium tax" means, with respect to surplus lines or independently procured insurance coverage, any tax, fee, assessment, or other charge imposed by a government entity directly or indirectly based on any payment made as consideration for an insurance contract for such insurance, including premium deposits, assessments, registration fees, and any other compensation given in consideration for a contract of insurance. (15 U.S.C. §8206 (12)).

Once Congress established the Home State Rule, in order for states to avail themselves of this authority, and to offset the loss of tax revenue, they had to amend their nonadmitted IPT statutes. To afford states an adequate opportunity to amend their statutes to comply with NRRA, the law did not become effective until July 21, 2011.[18]

[18] 15 U.S.C. §8201 (b)(2).

1. New Jersey's Nonadmitted IPT prior to NRRA.

In 1945, New Jersey began implementing IPT with the passage of N.J.S.A. 54:18A-1 to -21. As enacted, admitted insurers were subject to an IPT of two percent on the net premiums on insurance contracts covering property and risks located within the state.[19] The admitted insurer must file a return with both the DOBI Commissioner and with the Director, and the admitted insurer is responsible for remitting the tax to the Director.[20] Admitted insurers provide the standard and primary insurance market in the state.

In 1960, New Jersey began to regulate the nonadmitted insurance market with the enactment of N.J.S.A. 17:22-6.40 to -6.69. The legislative history of N.J.S.A. 17:22-6.40 to -6.69 suggests that the primary purpose of the legislation was to protect the public from fiscally irresponsible surplus lines insurers and unlicensed or dishonest insurance agents.[21] The law was enacted after a 1959 scandal in Newark involving embezzled premiums and bankrupt or fake foreign insurance companies.[22] The new law provided the public with access to financially solvent nonadmitted insurers through qualified, licensed, and supervised agents for the purchase of insurance coverages not procurable from admitted insurers, and protected admitted insurers from unwarranted competition by nonadmitted insurers. Designated as surplus lines coverages, they may be procured under certain conditions as regulated by DOBI. One of the conditions is that the

---

[19] With the exception of life insurance companies and marine insurance. N.J.S.A. 54:18A-2.

[20] N.J.S.A. 54:18A-1(a).

[21] See Alexander Milch, Warns Insurance Men on Unlicensed Firms, Newark News, September 6, 1957.

[22] See John O. Davies Jr., High Risk Insurance Now Closely Regulated in N.J., Camden Courier-Post, August 7, 1962.

insurance must be "eligible for export," with a nonadmitted insurer.[23] See N.J.S.A. 17:22-6.41 (c), -6.42 (a), -6.43 (b).

When enacting N.J.S.A. 17:22-6.40 through 17:22-6.65, the Legislature specified in N.J.S.A. 17:22-6.40 that those statutes constitute and may be referred to as the "Surplus Lines Law." The Surplus Lines Law includes a multitude of rules and regulations for both surplus lines insurers, and the surplus lines agents who sell surplus lines insurance. It provides for a premium receipts tax on all net premiums charged by a surplus lines insurer and procured by a surplus lines agent. It is the responsibility of the surplus lines agent to collect and remit the premium receipts tax to the DOBI Commissioner. See N.J.S.A. 17:22-6.59.

Although not specifically mentioned in the history of the legislation, within the four corners of N.J.S.A. 17:22-6.40 to 6.65, our Legislature enacted N.J.S.A. 17:22-6.64, which applies to insureds that self-procure insurance from a nonadmitted insurer without the services or involvement of surplus lines agents. The self-procured insurance statute is a catch-all for nonadmitted insurers not regulated by the Surplus Lines Law. Captive insurance, which was in its infancy in 1960 when the statute was enacted, is a part of the self-procured insurance market.

Despite being contained within the four corners of N.J.S.A. 17:22-6.40 to 6.65, the New Jersey Legislature specifically and unambiguously determined that the self-procurement statute was not subject to the Surplus Lines Law.

---

[23] The DOBI Commissioner declares certain classes of insurance eligible for export when he finds that "there is no reasonable or adequate market among 'authorized insurers' for those classes of insurance." N.J.S.A. 17:22-6.43. The Commissioner then issues a list of those generally exportable insurance classes. N.J.A.C. 11: 1-34.1 to – 34.6. That list is known as the Exportable List. N.J.A.C. 11:1-34.6. Other conditions under the Surplus Lines Law are that the insurer must be an "eligible surplus lines insurer" as defined by N.J.S.A. 17:22-6.42(b), -6.43, -6.45 and the insurance must be placed through a licensed New Jersey surplus lines agent. N.J.S.A. 17:22-6.42(c).

N.J.S.A. 17:22-6.40 states:

> Short Title; Application of act [Surplus Lines Law]
> Sections 6 through 31 of this act (C. 17:22-6.40 through 17:22-6.65) constitute and may be referred to as "the surplus lines law." This act does not apply to life insurance companies writing life insurance, accident and health insurance and annuities, nor to risks insured under exceptions (e) and (f) of section 3 of this act (C. 17:22-6.37), nor to insurance coverages which are independently procured as provided in section 30 (C. 17:22-6.64) of this act.
>
> (emphasis added)

Consequently, self-procured insurance coverages are exempt from the provisions of the Surplus Lines Law, and have their own prescribed tax, albeit at the same rate as the premium receipts tax.

When originally enacted, New Jersey's self-procurement statute contained the following provisions:

> Every insured who in this State procures or causes to be procured or continues or renews insurance with an unauthorized foreign or alien insurer, or any insured or self-insurer who so procures or continues excess loss, catastrophe or other insurance, upon a subject of insurance resident, located or to be performed within this State, other than insurance procured through a surplus lines agent pursuant to the surplus lines law of this State or exempted from tax under section 25 of this act, shall within 30 days after the date such insurance was so procured, continued, or renewed, file a report of the same with the commissioner in writing and upon forms designated by the commissioner and furnished to such an insured upon request. The report shall show the name and address of the insured or insureds, name and address of the insurer, the subject of the insurance, a general description of the coverage, the amount of premium currently charged therefor, and such additional pertinent information as is reasonably requested by the commissioner.
>
> Any insurance in an unauthorized insurer procured through negotiations or an application, in whole or in part occurring or made within or from within this State, or for which premiums in whole or in part are remitted directly or indirectly from within this State, shall be deemed to be insurance procured, or continued or renewed in this State within the intent of this section.

> There is hereby levied upon the obligation, chose in action, or right represented by the premium charged for such insurance, a tax at the rate of 3% of the gross amount of such premium less any return premiums charged for such insurance.
>
> [N.J.S.A. 17:22-6.64 (1960).]

Unlike with admitted insurance or surplus lines insurance, it is the insured, not the insurer or agent, which is responsible for all reporting obligations, and payment of the self-procurement tax to the DOBI Commissioner. N.J.S.A. 17:22-6.64.

Thus, while N.J.S.A. 17:22-6.40 to -6.65 never uses the term "nonadmitted," it covers all nonadmitted insurance and insurers. That being said, the Surplus Lines Law and the self-procurement statute are separate and distinct from each other. One involves the participation of surplus lines agents and the other does not. For reasons not explained in the legislative history, the New Jersey Legislature chose to enact both laws at the same time, and as part of the same legislative act. L. 1960, c. 32, §25 and 30. The court concludes that our Legislature did so with the design to have both statutes work together as a means to close any gaps in the imposition of IPT on nonadmitted insurance coverage procured by New Jersey insureds.[24]

From 1960 until 2011, the premium receipts tax and the self-procurement tax were calculated based on an allocation of the insured's risks within the state. If an insured had risks outside of New Jersey, the tax only applied to that portion of the premium allocable to the risks in New Jersey. Other states with nexus to the insured were also able to impose and collect nonadmitted IPT from the insured.

---

[24] There is an IPT exemption under both N.J.S.A. 17:22-6.59 and N.J.S.A. 17:22-6.64, relating to fire insurance coverage covering certain properties in New Jersey. That exemption does not pertain to the present matter.

2. New Jersey's Nonadmitted IPT after NRRA

After enactment of the NRRA, states had to amend their own nonadmitted IPT statutes to avail themselves of the NRRA provisions. On June 6, 2011, the New Jersey Senate introduced Senate Bill No. S. 2930 ("S. 2930"). The Statement to S. 2930 states that the bill "revises the method for the regulation and collection of surplus lines insurance premium taxes" and further states that the proposed revisions are "intended to bring 'the surplus lines law,' P.L. 1960, c. 32 (C.17:22-6.40 et seq.), into compliance with the federal 'Nonadmitted and Reinsurance Reform Act of 2010' (NRRA). Statement to S. 2930, 7 (June 6, 2011).

S. 2930 amended New Jersey's nonadmitted IPT statutes in the following manner:

(1) by amending N.J.S.A 17:22-6.41 to update the definition of "surplus lines agent" and to add paragraph (g) to include the same definition of "Home State" that is contained in the NRRA as set forth at 15 U.S.C. §8206 (6);

(2) by amending N.J.S.A. 17:22-6.45 (b) to add additional language regarding domestic surplus lines insurers;

(3) by amending N.J.S.A. 17:22-6.59 to replace the language regarding a surplus lines policy that covers risks or exposures in additional other states, with language that enabled premium receipts tax to be based on the total U.S. premium when New Jersey is the insured's home state as authorized by 15 U.S.C. §8201;

(4) by amending N.J.S.A. 17:22-6.64 to include the following additional language: "[I]f a surplus lines policy covers risks or exposures in this State and other states, where this State is the home state, as defined in section 7 of P.L. 1960, c. 32 (C. 17:22-6.41), the tax payable pursuant to this section shall be based on the total United States premium for the applicable policy"; and

(5) By adding N.J.S.A. 17:22-6.69 (a)-(g) entitled "Reinsurance and Surplus Lines Stimulus and Enhancement Act, which provides among other things, the authority to the Commissioner to enter into multi-state compacts or agreements concerning the reporting, payment, collection and allocation of premium taxes on multi-state risks," as contemplated by 15 U.S.C. §8201(b).

The Senate and the Assembly unanimously passed S. 2930 on June 29, 2011. It was enacted into law on August 19, 2011 with a retroactive effective date of July 21, 2011.

As a result of the 2011 statutory amendments, both N.J.S.A. 17:22-6.59 and 17:22-6.64 now include the following identical paragraph:

> If a surplus lines policy covers risks or exposures in this State and other states, where this State is the home state, as defined in section 7 of P.L.1960, c.32 (C.17:22-6.41), the tax payable pursuant to this section shall be based on the total United States premium for the applicable policy.
>
> [Ibid. (emphasis added)]

C. Analysis of Applicable Laws

1. NRRA

The court is asked to determine whether the NRRA was intended to apply to captive insurance companies, and if so, whether New Jersey's statutory amendments adopting the NRRA's Home State Rule, and imposing taxes on risks located outside of New Jersey is unconstitutional.

J&J references a number of statements made by congressional leaders in support of its position that the NRRA was not intended to apply to captive insurance. Specifically it refers to the following:

- On September 9, 2009, a predecessor to the version of the NRRA adopted in the Dodd-Frank Act was discussed on the House floor by three of its sponsors, Rep. Scott Garrett (R-NJ), Rep. Dennis Moore (D-KS), and Rep. Spencer Bachus (R-AL). All three described the bill as a resolution to improve surplus lines insurance laws.[25]
- On July 22, 2010, Congressman Moore spoke on the House floor "to make one important clarification of intent. . . Section 521 (a) [the operative tax provision] is intended to require the broker to pay

[25] 155 Cong. Rec. H9362 (2009).

or remit all tax in a surplus lines transaction to the 'Home State' of the insured . . . ." (emphasis added).[26]

- In January 2013, Rep. Judy Biggert (R-IL), the out-going Chair of the Subcommittee on Insurance of the Committee on Financial Services stated that the NRRA was never intended to apply to captive insurers.[27]

- In a February 6, 2013 Statement for the record, Congressman Garrett stated that "[T]he NRRA was drafted with the specific intention of addressing burdensome and often conflicting regulatory and tax compliance issues facing only two industries – the surplus lines and reinsurance" (emphasis added).[28]

- On June 11, 2015, Senators Patrick Leahy (D-VT) and Lindsey Graham (R-SC) reintroduced NRRA bill S. 1561, which was intended to make clear that the NRRA was never intended to apply to captive insurers.

Moreover, J&J argues that because (i) the Act expressly establishes the primacy of the states to regulate and tax the business of insurance and (ii) Congress must act specifically to preempt state regulation and taxation of insurance in order for federal law to prevail in this area, the failure to specifically include captive insurance coupled with the statements of intent from members of Congress indicates that the NRRA was not intended to apply to captive insurance.

This court leaves to the federal courts the interpretation and constitutionality of the NRRA and its inclusive Home State Rule. The New Jersey Legislature's 2011 statutory amendments resulted from Congress' directive in the NRRA for states to adopt nationwide uniform

---

[26] 156 Cong. Rec. E1407 (2010).

[27] Letter from Judy Biggert, Outgoing Chairman of the Subcomm. on Ins. of Comm. on Fin. Servs. in the House of Representatives, to Jeb Hensarling, Chairman-elect, Comm. on Fin. Servs., and Maxine Waters, Ranking Member-elect, Comm. on Fin. Servs. (Dec. 18, 2012).

[28] February 6, 2013, Statement for the record by Rep. Scott Garrett (R-NJ).

requirements, forms, and procedures, such as an interstate compact, that provide for the reporting, payment, collection, and allocation of premium taxes for nonadmitted insurance.

The NRRA's definition of "nonadmitted insurance" is "any property and casualty insurance permitted to be placed directly or through a surplus lines broker with a nonadmitted insurer eligible to accept such insurance." 15 U.S.C. §8206(9)(A) (emphasis added). Additionally, the NRRA specifically defines self-procured insurance (NRRA uses the term "independently procured insurance") as insurance procured directly by an insured from a nonadmitted insurer (15 U.S.C. §8206(7)). Also, as referenced by DOBI and the Director, Congress did acknowledge that certain groups, i.e. risk retention groups, were explicitly excluded from the NRRA.[29] The NRRA does not explicitly exclude captive insurers and, to date, Congress has not amended the NRRA to exclude captive insurers. Additionally, no federal court has ruled the Home State Rule unconstitutional as applied to captive insurance.

J&J alternately argues that if the NRRA includes captive insurance companies, New Jersey's statutory amendments adopting the Home State Rule are unconstitutional and in violation of the Due Process Clause of the Fourteenth Amendment. J&J argues that it is unconstitutional to apply the Home State Rule to premiums allocable to risks located outside of New Jersey.

In support of this, J&J cites Todd Shipyards, 370 U.S. 451, (1962), in which the Supreme Court held that a Texas tax on premiums paid by an insured to an out-of-state insurer without a place of business in Texas was invalid under the Due Process Clause because the only substantive connection between Texas and the insurance transaction was that the property covered by the policy was located in Texas. Id. at 453-55.

[29] 15 U.S.C. §8206 (11)(B).

J&J argues that under the Due Process Clause, a state cannot tax income which is "in no just sense attributable to transactions" within the state and an apportionment formula that acts "unreasonable and arbitrarily" must be invalidated because the resulting tax is beyond the state's authority. Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123, 134-136 (1931). The relevant inquiry is whether the income attributed to the state is "rationally related to 'values connected with the taxing State.'" Moorman Mfg. Co. v. Bair, 437 U.S. 267, 273 (1978) (quoting Norfolk & W. Ry. Co. v. Missouri State Tax Comm'n, 390 U.S. 317, 325 (1968)). An apportionment methodology will be invalidated if the state's "tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State." Oklahoma Tax Comm'n v. Jefferson Lines, 514 U.S. 175, 185 (1995)). J&J posits that subjecting 100 percent of the premiums paid to Middlesex Assurance to the self-procurement tax would impose on J&J an unconstitutional tax out of all appropriate proportion to its insured risks in New Jersey.

IPT however is not an income tax or an ad valorem tax as was true in the cases cited above. IPT is an excise tax based on the amount of premium paid. In the present case, the transactions for all U.S. policies are connected in some way to J&J's corporate management group in New Jersey, either through negotiation, placement, issuance of premium payment, or receipt of claims payments. Thus, while the risks may not all be in New Jersey, all of J&J's purchase of U.S. insurance products from Middlesex Assurance are connected to New Jersey.

The court finds that the Legislature's statutory amendments adopting the NRRA Home State Rule to self-procured insurance, including captive insurance, is not unconstitutional. The NRRA modified the manner in which states regulate and tax nonadmitted insurance. The NRRA itself does not impose IPT on nonadmitted insurers, nor does it require states to impose such a tax. The NRRA created the Home State Rule, which provides that only the home state of an insured is

permitted to collect premium tax on a "nonadmitted" insurance transaction. The decision to adopt the Home State Rule, and whether to enter into multi-state compacts is left to the individual states.

The Act gives the states the police power to regulate and tax the business of insurance, including insurance activities and transactions occurring within its borders. The New Jersey Legislature's decision to exercise our state's right to regulate and tax insurance as authorized under the NRRA, and in particular its Home State Rule, is part of that prescribed police power. The Legislature was neither unreasonable, nor arbitrary in enacting the amendments.

The Legislature's reasons for adopting provisions of the NRRA are evident in the legislative history of the amended IPT statutes. Since the NRRA limited and changed the way nonadmitted IPTs were collected, the failure of the Legislature to adopt the NRRA provisions would have resulted in the loss of revenue for the state. Under the NRRA, New Jersey would no longer be able to impose IPT on premiums paid to nonadmitted insurers by insureds with risks in New Jersey, but whose home state was not here. Offsetting the loss of that pre-NRRA tax revenue is a legitimate state purpose. The court finds that the New Jersey Legislature's adoption of the Home State Rule is constitutionally permissible and valid.

2. 2011 Statutory Amendment to N.J.S.A. 17:22-6.64 Self-Procurement Statute

The court's analysis is guided by the familiar principle that the Director's interpretation of tax statutes is entitled to a presumption of validity. "Courts have recognized the Director's expertise in the highly specialized and technical area of taxation." Aetna Burglar & Fire Alarm Co. v. Dir., Div. of Taxation, 16 N.J. Tax 584, 589 (Tax 1997) (citing Metromedia, Inc. v. Dir., Div. of Taxation, 97 N.J. 313, 327 (1984)). The scope of judicial review of Taxation's decision with respect to the imposition of a tax "is limited." Quest Diagnostics, Inc. v. Dir., Div. of Taxation, 387 N.J. Super. 104, 109 (App. Div.), certif. denied, 188 N.J. 577 (2006). "The Supreme

Court has directed the courts to accord 'great respect' to Taxation's application of tax statutes, 'so long as it is not plainly unreasonable.'" PPL Elec. Utilities Corp. v. Dir., Div. of Taxation, 28 N.J. Tax 128, 137 (Tax 2014) (citing Metromedia, 97 N.J. at 327); see also GE Solid State, Inc. v. Dir., Div. of Taxation, 132 N.J. 298, 306 (1993) ("Generally, courts accord substantial deference to the interpretation an agency gives to a statute that the agency is charged with enforcing."). "However, judicial deference is not absolute. An administrative agency's interpretation that is plainly at odds with a statute will not be upheld." Advo, Inc. v. Dir., Div. of Taxation, 25 N.J. Tax 504, 511 (Tax 2010); see Oberhand v. Dir., Div. of Taxation, 193 N.J. 558, 568 (2008) (citing GE Solid State, 132 N.J. at 306).

As referenced by our Supreme Court in *Fedders Fin. Corp. v. Dir., Div. of Taxation*, 96 N.J. 376 (1984), there are two principles of statutory interpretation relevant to the analysis of taxing statutes. In that opinion, Justice Schreiber wrote:

> First, the court should follow the clear import of statutory language. In re Jamesburg High School Closing, 83 N.J. 540, 547 (1980). Second, when interpretation of a taxing provision is in doubt, and there is no legislative history that dispels that doubt, the court should construe the statute in favor of the taxpayer. We applied those guidelines in Kingsley v. Hawthorne Fabrics, 41 N.J. 521 (1964), when interpreting two of the same provisions that are under consideration here, N.J.S.A. 54:10A-4(d) and -4(e). In Kingsley, 41 N.J. at 528-29, we quoted approvingly the following language from Gould v. Gould, 245 U.S. 151, 153 (1917):
>
> > In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the government, and in favor of the citizen.
>
> . . . We continue to adhere to the view that our task is to ascertain the legislative intent. When the statutory language is unclear and the legislative history is wanting, the doubt referred to in Gould

> exists and its principle is applicable. This situation is to be distinguished from the one in which the taxpayer seeks an exemption from a taxing statute. Then the probable legislative intent is one of inclusion and exemptions are to be construed narrowly. Boy's Club of Clifton v. Twp. of Jefferson, 72 N.J. 389, 398 (1977).
>
> [Fedders, 96 N.J. at 385-86.]

With these guiding principles in mind, the court examines the 2011 statutory amendments to the self-procurement statute.

The court finds that nonadmitted insurance consists of both the surplus lines insurance market and the self-procured insurance market. They are separate and distinct from one another, both statutorily and in the general insurance context. However, this conclusion raises the specter that the 2011 legislative amendments to the self-procurement statute are problematic in two ways.

First, the Legislature did not remove the portion of the original statutory language in N.J.S.A. 17:22-6.64 that applied the tax to premiums paid "upon a subject of insurance resident, located or to be performed within this State."[30] This statutory language is the basis for the self-procurement tax being allocated to the risks located within New Jersey. Second, the insertion of the paragraph beginning with "[I]f a surplus lines policy covers risks or exposures . . ." is on its face contrary, and irrelevant to the separate and distinct subject matter of the self-procurement statute. Id.

DOBI and the Director argue that when the Legislature uses the term "surplus lines policy" under N.J.S.A. 17:22-6.59 and -6.64, the Legislature is referring to all nonadmitted insurance. In support, they proffer Assembly Bill A. 1280 introduced on January 9, 2018, which states "This bill decreases the premium receipts tax for surplus lines coverage, whether procured directly by

---

[30] Similar language appears in N.J.S.A. 17:22-6.42.

the insured or through a surplus lines agent, from 5% to 3%. This decrease represents a reduction in this tax to the same level at which it existed prior to the enactment of P.L. 2009, c. 75." Statement to A. 1280 4 (January 9, 2018).

The problem is that N.J.S.A. 17:22-6.42 provides a definition of "surplus lines coverage" that does not include insurance coverage procured directly by the insured, but rather requires that the insurance be placed through a New Jersey licensed surplus lines agent, to wit:

> If certain insurance coverages of subjects resident, located, or to be performed in this State cannot be procured from authorized insurers, such coverages, hereinafter designated "surplus lines," may be procured from unauthorized insurers, subject to the following conditions:
>
> (a) The insurance must be eligible for export under section 9 of P.L. 1960, c. 32 (C. 17:22-6.43);
>
> (b) The insurer must be an eligible surplus lines insurer under section 11 of P.L. 1960, c. 32 (C. 17:22-6.45);
>
> (c) The insurance must be so placed through a licensed New Jersey surplus lines agent; and
>
> (d) Other applicable provisions of this surplus lines law must be complied with.
>
> (e) No surplus lines agent shall exercise binding authority in this State on behalf of any insurer unless the agent has first filed with the commissioner for informational purposes and not for the purpose of approval or disapproval the written agreement between the agent and the insurer setting forth the terms, conditions and limitations governing the exercise of the binding authority by the agent. A copy of any amendments to the agreement and of any notice of cancellation or termination of the agreement shall be filed by the agent with the commissioner no later than 10 days after adoption thereof.
>
> [N.J.S.A. 17:22-6.64 (1960) (emphasis added).]

DOBI and the Director's attempt to convince the court that the term "surplus lines policy" is applicable to both types of insurance is contrary to the NRRA, contrary to the Surplus Lines Law, and not meaningfully defensible.

The failure of the 2011 amendment to adequately and accurately change N.J.S.A. 17:22-6.64 to conform to the NRRA is J&J's strongest argument. The argument is buttressed by the Legislature's explicit statement that the proposed revisions are "intended to bring 'the surplus lines law,' P.L. 1960, c. 32 (C.17:22-6.40 et seq.), into compliance with the" NRRA, which by virtue of N.J.S.A. 17:22-6.40, statutorily excludes N.J.S.A. 17:22-6.64.

Although never mentioned in the 1960 legislative history, the self-procurement statute was enacted simultaneously with the Surplus Lines Law. The Legislature's inclusion of the self-procured insurance market in 1960 was deliberate and purposeful, and can only be interpreted as intending to close any gaps in the imposition of IPT on nonadmitted insurance products.[31]

---

[31] The confusion caused by N.J.S.A. 17:22-6.40 and its exclusion of N.J.S.A. 17:22-6.64 is further demonstrated under N.J.S.A. 17:22-6.65 which relates to the enforcement of statutorily imposed recordkeeping provisions. That statute reads:

> Every person by or as to whom insurance is procured or placed in an unauthorized insurer, upon the commissioner's order shall produce for his examination all policies and other documents evidencing the insurance, and shall disclose to the commissioner the amount of gross premiums paid or agreed to be paid for the insurance. In case of a failure of any person to comply with the commissioner's order, the Superior Court, on application of the commissioner, may issue an order requiring the production of the records and information sought by the commissioner. Any person failing to obey the court's order may be punished by the court as for a contempt.
>
> This section does not apply to life insurance or disability insurance.
>
> [N.J.S.A. 17:22-6.65.]

In 2009, both N.J.S.A. 17:22-6.59 and N.J.S.A. 17:22-6.64 were amended simultaneously to raise the tax rate from 3% to 5%, once again demonstrating the Legislature's consistency in treating all nonadmitted IPTs the same.

In 2011, our Legislature was prompted to take action by the NRRA, which focused on inequities and inconsistencies in the imposition of IPT in the multi-state nonadmitted insurance market. Just as was true in 1960, the 2011 amendments to the self-procurement statute are not discussed in the bill's legislative history. The motivation, focus, and discussion of the Legislature involved conformance to the NRRA, and discussions related to the Surplus Lines Law. Nonetheless, as it did in 1960 and again in 2009, our Legislature enacted amendments covering IPT provisions for <u>all</u> nonadmitted insurance, at the same time, within the same act, and at the same rate. The Legislature's intent is evident in the totality and inclusiveness of the IPT statutory structure.

The court will not speculate on how or why the term "surplus lines policy" was used when amending N.J.S.A. 17:22-6.64 to conform to the NRRA. The court is convinced that the New Jersey Legislature intended to include self-procured insurance in the adoption of the Home State Rule because it intended to include all nonadmitted insurers, and not to limit it to only surplus lines insurance. There is no other reason to have amended N.J.S.A. 17:22-6.64 in 2011.

The court is left with the difficult decision of balancing the weight and importance of the precise language of N.J.S.A. 17:22-6.64 against its true legislative intent. In <u>Caputo v. Best Foods</u>, 17 N.J. 259, 264 (1955), New Jersey's Supreme Court emphasized that statutory construction

---

Taken on its face, this enforcement provision only would apply to the Surplus Lines Law and would have no application to the records required to be filed with the DOBI Commissioner by insureds with self-procured insurance under N.J.S.A. 17:22-6.64.

"emerges from the spirit and policy of the statute rather than the literal sense of particular terms." Justice Handler wrote in Unemployed-Employed Council of N.J., Inc. v. Horn, 85 N.J. 646, 655 (1981) that "statutory language must be read perceptively and sensibly with a view toward fulfilling the legislative intent." Id. at 655.

While reasonable minds may disagree, this court finds the legislative intent to be more persuasive than the precise language of N.J.S.A. 17:22-6.64. Furthermore, the court has hope that, beginning with this decision, any confusion and inconsistencies will be addressed and remedied.

III. Conclusion

The court finds that the New Jersey Legislature intended to incorporate the authority afforded it under the NRRA through the enactment of amendments to both the Surplus Lines Law and the self-procurement statute. Those amendments apply the Home State Rule to all nonadmitted insurance including self-procured captive insurance. Understandably, the addition of a paragraph in the self-procurement statute relating to surplus lines policies is problematic, as is the failure to remove the original language allocating the IPT to the location of the risk. Nonetheless the Legislature's intent is clear and purposeful. By amending both N.J.S.A. 17:22-6.59 and -6.64, the Legislature kept consistent its equal treatment of nonadmitted insurers, and maximized its nonadmitted IPT revenue stream under the NRRA. Summary Judgment is granted in favor of DOBI and Director, and denied as to J&J.