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**BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF CALIFORNIA**

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| In the Matter of the Appeal of<br><br>PREFERRED MEAL SYSTEMS, INC.,<br><br>Appellant,<br><br>From a Decision of<br><br>THE WORKERS' COMPENSATION INSURANCE RATING BUREAU OF CALIFORNIA,<br><br>Respondent. | FILE NO. ALB-WCA-97-1 |

**PROPOSED DECISION**

Appellant Preferred Meal Systems, Inc. ("Preferred Meal"), an Illinois company, appeals the decision of the Classification and Rating Committee ("C&R Committee") of Respondent Workers'

Compensation Insurance Rating Bureau of California ("Bureau")[1]. The C&R Committee affirmed the decision of the Bureau to omit the payroll of six Illinois-based employees who worked temporarily in California when determining whether Preferred Meal met the requirements set forth in the California Experience Rating Plan[2], Section III, Rule 8 for avoiding the use of past experience in determining the workers' compensation insurance premiums for a California company acquired in 1993. The sole issue in dispute in this appeal is whether the Bureau and its C&R Committee properly interpreted Plan Section III, Rule 8(b)(2)(b).

This appeal to the Insurance Commissioner is authorized by

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[1]The Bureau is a licensed rating organization within the meaning of Insurance Code section 11750.1 and serves as the Insurance Commissioner's designated statistical agent under Insurance Code section 11751.5. The decision of the Classification and Rating Committee ("C&R Committee") appealed here can be found in the minutes of its December 10, 1996 meeting, in evidence as Exhibit 3, Record of Documents and Exhibits in Bureau File, at Bates-stamped pages 191-189. Hereafter, Exhibits will be cited as Exh.#, pp.xx-xx.

[2]The business of workers' compensation insurance is regulated generally by the provisions of Section 11630 *et seq.*, of the Insurance Code, and regulations codified in Title 10 of the California Code of Regulations. The Bureau separately publishes and administers some sections of Title 10, including section 2350 (Rules, Classifications and Basic Rates for Workers' Compensation Insurance) cited here as "Manual" and Section 2353 (California Workers' Compensation Experience Rating Plan) cited here as "Plan".

Insurance Code section 11753.1 and was timely filed on January 8, 1997. The matter was submitted without hearing to Administrative Law Judge Andrea L. Biren, at San Francisco, on September 30, 1997, after the parties stipulated to the Bureau's record as evidence and on briefs filed in June, July and August. Official Notice was taken of the records of the Department of Insurance, the provisions of the California Insurance Code and provisions of the California Code of Regulations applicable to the business of workers' compensation insurance in the 1993-94 time period, as well as the statutes, cases, and other legal material pertaining to workers' compensation in Illinois submitted with the briefs.

Appellant Preferred Meal was represented by Arthur J. Levine, Esq. of the Law Offices of Arthur J. Levine. Respondent Bureau was represented by E. Lynn Malchow, Esq., of the law firm of Frye, Alberts, & Malchow.

Based on the facts recited below and for the reasons stated, the decision of the C&R Committee is AFFIRMED.

BACKGROUND

In Dinwiddie Construction Co. v. Dept. of Insurance (N.D.Cal.1990) 745 F.Supp. 589, 592, the Court ably set out the Constitutional and statutory context of the experience

modification system. The Court stated:

> The California Constitution vests in the Legislature "plenary power, unlimited by any provision of this Constitution, to create, and enforce a complete system of workers' compensation . . .". (Cal.Const.Art. 14, section 4.) Among the express legislative powers of creating and enforcing this system are "full provision for regulating such insurance coverage in all its aspects, including the establishment and management of a State compensation insurance fund . . . and full provision for vesting power, authority and jurisdiction in an administrative body with all the requisite governmental functions . . .". (Id.)
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> Under this plenary power, the legislature has provided that the Commissioner of Insurance may classify risks and set rates using a "merit rating system," (Cal.Ins.Code section 11732) in which "experience of the particular insured is used as a factor in raising or lowering his rate." (Id. at section 11730.) If such a system is used, it must be uniformly applied to all insurers. (Id. at section 11732.) Pursuant to this authority, the Insurance Commissioner promulgated the California Experience Rating Plan ("CERP"), which is codified at Cal.Code Regs., Title 10, section 2353.
>
> CERP is implemented by a rating organization, as defined and licensed under Ins. Code sections 11750-11759, in this action named defendant The Workers' Compensation Insurance Rating Bureau ("Bureau"). Section III of CERP directs that "experience of a risk" shall be used to set and modify the rate for an individual policy for an "experience period" of three years. (CERP section III(2) - (3).) Premium reductions for loss experience, therefore, cannot be granted unless a three-year "experience period" has run.

The Bureau measures an employer's previous claims or "loss experience" against the loss experience of other employers in the

same classification(s) to develop an experience modification factor. In 1993, this factor, set forth in percentage form, was then applied to the premium computed using Manual rates[3] for the classifications in the employer's business. An experience modification of less than 100% resulted in a discount of Manual rates, and one greater than 100% resulted in an addition to Manual rates. This experience modification was reset to 100% when a company "changed its status" - when it met all the criteria described in Section III, Rule 8 of the Plan. This rule provides in pertinent part as follows:

> Change in Status (Ownership, Operations and Employees). The following rules govern the use of past experience in future ratings whenever a change in ownership, management, control, operations or employees occurs. Experience of the past shall be used in future experience ratings unless a material change in ownership as specified in subrule (a) is accompanied by a material change in operations or employees as specified in subrule (b).
>
> (a) Change in Ownership
>
> ...
>
> (b) Change in Operations or Employees

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[3] Effective January 1, 1995, pursuant to the provisions of comprehensive workers' compensation insurance legislation, the Insurance Commissioner no longer sets minimum or Manual rates. The policies at issue in this matter incepted and are subject to the laws prior to January 1, 1995.

1. ...

2. Except as noted in 3 below, a change in employees is material only if:

a. a majority of the employees who conduct the operations during the first 90 days following the material change in ownership were not employed to conduct such operations during the 90 days immediately preceding the material change in ownership, and

b. a majority of the payroll earned by the employees who conduct the operations during the first 90 days following the material change in ownership was earned by employees who were not employed to conduct such operations during the 90 days immediately preceding the material change in ownership.

3. ...

## FINDINGS OF FACT

The facts in this case are, for the most part, undisputed. The Appellant is an Illinois corporation that had limited California operations in Mission Viejo prior to March 15, 1993, when, through a holding company, it acquired Feeding Systems, Inc., a California corporation based in Irvine. The parties agree that a material change in ownership occurred at that time, pursuant to Section III, rule 8(a) of the Plan, and the California company began operations under the name Preferred Meal Systems West, Inc. The parties also agree that a material change

in operations did not occur, pursuant to Section III, rule 8(b)(1)(a)&(b), because both the acquiring and the acquired company made meals for institutions, and the operations of the California company did not need to be reclassified for the purposes of determining the risk and appropriate basic premium rate for the company.

Therefore, the parties agree, in order for Preferred Meal to receive a 100% experience modification, there needed to be a change in employees. It is also undisputed, although some relevant payroll records were unavailable, that in the 90 days following March 15, 1993, a majority of employees who conducted the operations of the company had not been employed to conduct such operations during the 90 days preceding March 15, 1993. Thus, the parties agree that Preferred Meal meets the requirements of Section III, rule 8(b)(2)(a). What the parties do not agree upon is whether Preferred Meal meets the other prong of the test for a change in employees, that is, that a majority of the total payroll earned in the relevant 90 days was earned by new employees. (Plan section III, rule 8(b)(2)(b).)

Some payroll records for Preferred Meal Systems West were initially submitted to the Bureau by Preferred Meal on September 15, 1993, at which time it noted that some management employees

should be included in the employee count. (Exh.34,p.22.) However, the payroll records for the management employees were not submitted at that time. Records ultimately indicated that as of June 18, 1993, (90 days after March 15 change of ownership) out of the $156,012 total for the 90 days, $105,720 had been earned by 35 employees who had worked during the 90 days prior to March 15. (Exh.22, p.37.)

In December 1994, the Bureau first received copies of the records indicating that six Preferred Meal Illinois management employees had come to California during the 90 days following March 15, 1993. These records reflect that no single management employee was present in California more than 23 of those 90 days, and most spent much less time in California. (Exh. 20, p.105.) The records do not indicate how much of the time spent in California is attributable to work for Preferred Meal Systems West, Inc., (the Irvine company) or Preferred Meal Systems, Inc. (the Illinois company with a Mission Viejo office), but it is clear that at least some time was spent on Mission Viejo business. (See, e.g., Exh.20, p. 61.) The Mission Viejo office was in the process of closing during this period, and its employees moved to Irvine on May 30, 1993, but remained the employees of the Illinois company. (Exh. 34, p.19.) It is a

subject of official notice that Mission Viejo and Irvine are equally accessible to Orange County Airport, to which the Illinois management employees flew.

All six employees were paid by the Illinois office for the days in California, and that payroll was part of the data reported in Illinois for the purposes of calculating premium for an Illinois workers' compensation insurance policy covering those employees. The payroll was not reported in California for any purpose until the Appellant proposed it be used in this case.

It appears from the briefs that the parties may disagree about whether the six management employees were covered by an extant California workers' compensation insurance policy despite the fact that their payroll was not used as part of the statistical basis for its premium calculation and experience modification. The policy itself was not submitted as evidence; therefore, no finding can be made on this issue.

## CONTENTIONS OF THE PARTIES

In this appeal, the Appellant argues first that including the pay of the six managers would be in keeping with the purpose of the Change of Status rule, that is, to revert to a unity experience modification when management changes. Appellant believes that the Bureau is reading a qualification into the

language of Plan Section III, Rule 8(b)(2)(b) that is not there - to wit, that the payroll must be from California-based employees and be that reported as the basis of the next year's experience modification. Rather, Appellant asserts, the payroll must merely be the pay developed for working in California while conducting the acquired operations during the relevant 90 day period.

Alternatively, the Appellant argues that if indeed the payroll referred to in Plan Section III, Rule 8(b)(2)(b) is the same as the payroll reported for the purposes of the next year's experience modification, then the Bureau should order the payroll of the six managers reported, for in fact they would have been covered under the California policy for any California injury - they were part of the employer's experience.

The Bureau's position is that these employees are not part of the California experience of the risk for any purpose. The pay garnered by the six for their work in California was pay to Illinois-based employees hired in Illinois who were doing extraterritorial work for their Illinois company. Their pay was never part of the statistical basis for California workers' compensation insurance premiums, or for California experience modifications. Therefore, it should not be included for a change of status analysis. Moreover, the Bureau contends, a reading of

Plan Section III, Rule 8(b)(2)(b) that includes these employees' pay would be administratively unworkable because the pay is unreported in California. Also, if consistent definitions of "payroll" are used for all Bureau rules, such a reading would require unreported out-of-state payroll to be used in the calculation of experience modifications and premium calculation too. Rather, the Bureau argues, Rule 8(b)(2)(b) read in the context of the rules as a whole requires the omission of the pay in question. The Bureau disputes the relevance of whether the California Workers Compensation Appeals Board would have jurisdiction over any injury to the managers while in California, but nevertheless insists that such jurisdiction would be improper.

## DISCUSSION

In 1993, the Insurance Commissioner was responsible for approving a classification of risks and premium rates, as well as a uniform system of merit rating. In the context of this uniform system, the question presented here is: "What is the meaning of the word 'payroll' in the California Experience Rating Plan, Section III Rule 8(b)(2)(b)?

"Administrative regulations are subject to the same rules of construction and interpretation that apply to statutes." (Inter

Valley Health Plan v. Blue Cross (1993) 16 Cal.App.4th 60, 68, 19 Cal.Rptr. 782, 788, quoting Organization of Deputy Sheriffs v. County of San Mateo (1975) 48 Cal.App.3d 331, 341, 122 Cal.Rptr. 210.) The language at issue here, found in the Plan, is a regulation under Title 10, California Code of Regulations, section 2350. The well-known rules of construction follow:

> Words used in a statute or constitutional provision should be given the meaning they bear in ordinary use. *(In re Rojas* (1979) 23 Cal.3d 152, 155, 151 Cal.Rptr. 649, 588 P.2d 789; *Great Lakes Properties, Inc. V. City of El Segundo* (1977) 19 Cal.3d 152, 155, 137 Cal.Rptr. 154, 561 P.2d 244.) If the language is clear and unambiguous there is no need for construction, nor is it necessary to resort to indicia of the intent of Legislature (in the case of a statute) or of the voters (in the case of a provision adopted by the voters). *(In re Lance W.* (1985) 37 Cal.3d 873, 886, 210 Cal.Rptr. 631, 694 P.2d 744; *State Board of Education v. Levit* (1959) 52 Cal.2d 441, 462, 343 P.2d 8.) But the "plain meaning" rule does not prohibit a court from determining whether the literal meaning of a statute comports with its purpose or whether such a construction of one provision is consistent with other provisions of the statute. The meaning of a statute may not be determined from a single word or sentence; the words must be construed in context, and provisions relating to the same subject matter must be harmonized to the extent possible. *(Dyna-Med, Inc. V. Fair Employment & Housing Com.* (1987) 43 Cal.3d 1379, 1386-1387, 241 Cal.Rptr. 67, 743 P.2d 1323.) Literal construction should not prevail if it is contrary to the legislative intent apparent in the statute. The intent prevails over the letter, and the letter will, if possible, be so read as to conform to the spirit of the act. *(People v. Belton* (1979) 23 Cal.3d 516, 526, 153 Cal.Rptr. 195, 591 P.2d 485; *Amador Valley Joint Union High Sch. Dist. V. State Bd. Of Equalization*

(1978) 22 Cal.3d 208, 245, 149 Cal.Rptr. 239, 583 P.2d 1281.) . . . . [E]ach sentence must be read not in isolation but in the light of the statutory scheme *(In re Catalano* (1981) 29 Cal.3d 1, 10-11, 171 Cal.Rptr. 667, 623 P.2d 228); and if a statute is amenable to two alternative interpretations, the one that leads to the more reasonable result will be followed *(Metropolitan Water Dis. V. Adams* (1948) 32 Cal.2d 620, 630-631, 197 P.2d 543).

Lungren v. Deukmejian (Robertí) (1988) 45 Cal.3d 727, 735, 248 Cal.Rptr. 115, 120.(Emphasis added.)

A reasonable result includes consideration of the practicality of a construction. A tribunal construing wording must be mindful of "the consequences that will flow from a particular interpretation" (Dyna-Med, Inc. v. Fair Employment and Housing Com. (1987) 43 Cal.3d 1379, 1387) and look for a "sensibl[e]" and "practical" construction of the law (Fireman's Fund Ins. Companies v. Quackenbush (1997) 52 Cal.App.4th 599, 607). (See also, Fields v. Fong Eu (1976) 18 Cal.3d 322,328, 134 Cal.Rptr. 367, 371.)

Looking at the plain language of Plan Section III Rule 8 (b)(2)(b), "payroll" appears to mean that remuneration earned by the employees who conduct the operations of the acquired company. It does not explicitly say those employees must be in California.

Payroll is not separately defined in the Plan, as it is in another part of the Commissioner's regulations. In the

California Manual of Rules, Classifications and Basic Rates for Workers' Compensation Insurance, Section II, paragraph 14, payroll (and remuneration) is defined, for the purposes of the Manual, as "the monetary value at which service is recompensed. . . . Remuneration shall not include those amounts which are expressly excluded from the basis of premium or premium computation by other rules of this Manual." Thus, Plan Section III rule 8 does not make it as clear that "payroll" means only that remuneration that is the basis of premium.

The word is therefore somewhat ambiguous, and a meaning must be imputed that comports with the statutory and regulatory scheme of which rule 8 is a part. The various parts of an enactment must be harmonized by considering a section in the context of the framework as a whole. (Select Base Materials v. Board of Equal. (1959) 51 Cal.2d 795, 799.)

As previously recited, the uniform basis of both the California premium assessment and merit rating system is the payroll and experience reported to the Bureau. "...[T]he rate structure and the determination of experience modifications are based upon the data reported in accordance with this Plan. . . ." (Introduction to the Unit Statistical Plan, at paragraph 7.) The Unit Statistical Plan, also a part of the Commissioner's

regulations, prescribe exactly how an employer must report experience of claims and payroll by classification.

In Section I(A) of the 1993 Unit Statistical Plan, it states: "Reports of experience for every Workers' Compensation Policy extending coverage under the California Workers' Compensation Laws, including California coverage by endorsement on a policy primarily covering another state, must be filed in accordance with the instructions contained in this Plan." Significantly, in 1993, the Insurance Code prohibited the use of experience arising under policies written solely under other states' laws.

> No classification of risks and premium rates or system of merit rating shall permit a determination or modification of the premium or premium rate of a particular insured by reason of the combination of his or her California workers' compensation insurance premium or experience with his or her premiums or experience arising out of workers' compensation insurance written under the laws of any other jurisdiction. (former Ins. Code section 11732.3, repealed by Stats.1993, c.228 (S.B.30), section 1, operative Jan.1, 1995.)

Thus, the Plan and Insurance Code indicate that experience and payroll from another jurisdiction, to be used in California, must be both from an endorsed out of state policy and reported through the Unit Statistical Report. In other words, while the payroll need not be generated by a California-based employee, the

payroll must be reported in California to be used in the regulatory scheme. No exceptions, such as for the change-of-status rule, are mentioned.

The Bureau alleges, without dispute, that its consistent interpretation of "payroll" has been that payroll reported pursuant to the Unit Statistical Reporting Guidelines and subject to audit. The Bureau is entitled to rely on the data furnished by California employers in the reports. Such a uniform system of general applicability, approved by the Commissioner, is a step "necessary to reduce the job to manageable size." (Calfarm Ins. Co. v. Deukmejian (1989) 48 Cal.3d 805, 824, 258 Cal.Rptr. 161, 172.) If payroll reported in other states and not reported in California could form the basis of California experience rating, including change-of-status determinations, the Bureau's administrative burden would be tremendously increased, if not made impossible. The ability to audit the records in a meaningful fashion goes beyond mere administrative convenience.

Considering the statutory and regulatory scheme as a whole, and giving due deference to the interpretation of the Bureau in its effort to effect a uniform system of experience rating for the Commissioner that is practical to administer, the meaning of "payroll" in Plan Section III rule 8(b)(2)(b) must be that

payroll reported pursuant to the Unit Statistical Reporting Guidelines and subject to audit.

Looking at the change-of-status rule in isolation rather than looking at the regulatory scheme as a whole, Appellant asserts that including the unreported pay of the six managers is in keeping with the purpose of the change-of-status rule. We disagree with both the method of analysis and the assertion. As noted above, Plan Section III rule 8 must be construed in the context of the regulatory scheme. Moreover, the point of the change-in-status rule is to allow a reversion to a unitary experience modification when so many aspects of a company have changed that it is unlikely to have the same loss experience in the ensuing years as its predecessor company would have had. Visiting management employees, who appear for 23 days out of 90 at the most, are unlikely to have an appreciable ongoing effect on loss experience.

Here, while many aspects of the company did change, the operations have not substantially changed and most of the higher paid permanent workforce is the same. Not only were the stays of the six short, but there is no definitive evidence of how much of their California sojourn was spent "conducting the operations of the acquired company." There is simply not a rational basis for

concluding that the work of the six visiting employees while in California indicates an ongoing change in the likely loss experience of the acquired company.

Thus, Appellant had an affirmative duty to report in California the payroll and experience of its six managers if it wished that payroll to be included in the basis for its premiums and experience ratings. Indeed, if these employees have a continuing impact on the management of the company, it can perhaps be argued that their Illinois experience should be reported to California under an endorsed Illinois policy. Having chosen not to do so, Appellant cannot now reasonably claim that the unreported payroll of the six is relevant to experience rating in the context of a change of status only.

Alternatively, the Appellant asks that the Unit Statistical Report for 1993 be revised to include the payroll generated from the California sojourns of these six employees. The six employees at issue here had their payroll and experience reported in Illinois, not in California. Reporting experience solely from another jurisdiction would offend Insurance Code section 11732.3 and allowing the employer to now report in California the experience and payroll already reported in Illinois would sanction employer manipulation of the experience reporting

process. Appellant's suggestion is rejected.

Both parties agree that it should be possible to decide this case without considering whether the six were covered by California workers' compensation insurance law. They are correct. As shown above, the word "payroll" in Plan section III Rule 8(b)(2)(b) can be construed without resort to Labor Code section 3600.5 and the teachings of the cases from Illinois. Accordingly, there is no need to address the other arguments of the parties.

## DETERMINATION OF ISSUES

The rules of construction teach that the word "payroll" used in the California Experience Rating Plan, Section III, Rule 8(b)(2)(b) should be construed so as to lead to a reasonable result in the context of the regulatory scheme. Accordingly, it is held that the word "payroll" used in the California Experience Rating Plan, Section III, Rule 8(b)(2)(b) means that remuneration paid, recorded as paid, and timely reported to the Bureau as required under the Unit Statistical Plan, for conducting the operations of a California covered entity within 90 days of a change in status. Therefore, the pay generated by the six management employees from Illinois is not included because it has not been shown how much of it was for conducting the operations

of a California covered entity within 90 days of its acquisition, nor was the pay reported as required for the purposes of experience rating the acquired entity.

The contentions of the parties with regard to Labor Code section 3600.5 are not addressed.

## ORDER

Upon the basis of the Findings, Discussion and Determinations of Issues hereinabove set forth, the decision of the Workers' Compensation Insurance Rating Bureau is **AFFIRMED.**

DATED: September 30, 1997.

**ANDREA L. BIREN**
Administrative Law Judge
California Department of Insurance