BEFORE THE INSURANCE COMMISSIONER

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	
VIP DRIVERS, INC.,	)	
	)	
Appellant,	)	FILE AHB-WCA-08-02
	)	
From the Decision of the	)	
	)	
WORKERS' COMPENSATION INSURANCE RATING BUREAU,	)	
	)	
	)	
Respondent.	)	
	)	

ORDER ADOPTING PROPOSED DECISION

The attached proposed decision of Administrative Law Judge Kristin L. Rosi is adopted as the Insurance Commissioner's decision in the above entitled matter. This order shall be effective 20 days from the date of service. Reconsideration of the Commissioner's decision may be had pursuant to California Code of Regulations, title 10, section 2509.72, but it is not necessary to request reconsideration prior to initiating judicial review. Any party seeking reconsideration of the Insurance Commissioner's decision should serve the request for reconsideration on William Gausewitz, Counsel to the Commissioner at the address indicated below in sufficient time to ensure that the Commissioner can review the request and take appropriate action before the expiration of the 30 day limit for reconsideration.

William Gausewitz
Counsel to the Commissioner
California Department of Insurance
300 Capitol Mall, 17th Floor
Sacramento, California 95814

Judicial review of the Insurance Commissioner's decision may be had pursuant to California Code of Regulations, title 10, section 2509.76. The person authorized to accept service on behalf of the Insurance Commissioner is:

Staff Counsel Darrel Woo
California Department of Insurance
300 Capitol Mall, 17th Floor
Sacramento, California 95814

Any party seeking judicial review of the Insurance Commissioner's decision shall file the original writ of administrative mandamus with the court. Copies of the writ of administrative mandamus and the final judicial decision and order on the writ of administrative mandamus must be served on the Administrative Hearing Bureau of the California Department of Insurance.

Dated: NOVEMBER 20, 2008

STEVE POIZNER
Insurance Commissioner

By: Bill Gausewitz
WILLIAM GAUSEWITZ
Counsel to the Commissioner

DEPARTMENT OF INSURANCE
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PROPOSED DECISION

I. Introduction

This appeal is brought pursuant to California Insurance Code section 11753.1, and arises from a dispute between the Workers' Compensation Insurance Rating Bureau ("WCIRB" or "Bureau")[1] and Appellant VIP Drivers, Inc. ("Appellant" or "VIP Drivers") regarding a potential change in ownership between Corporate Driver Services, Inc. ("CDS") and VIP Drivers pursuant to the Experience Rating Plan, Section II, subsections 3(b) and 3(d).

[1] The WCIRB is a rating organization licensed by the Insurance Commissioner under Insurance Code section 11750 et seq., to assist the Commissioner in the development and administration of worker's compensation insurance classification and rating systems. The WCIRB serves as the Commissioner's designated statistical agent for the purpose of gathering and compiling experience data developed under California's workers compensation and employer's liability insurance policies. (Ins. Code § 11751.5.)

Appellant appeals the WCIRB's finding that a "change in ownership" occurred when CDS dissolved its operations simultaneously with the formation of VIP Drivers, pursuant to Experience Rating Plan, Section II, subsection 3(b).[2] Appellant also challenges the Bureau's determination that CDS sold, transferred or conveyed its tangible or intangible assets to VIP Drivers, pursuant to ERP Section II, subsection 3(d). Appellant concedes that if a change of ownership is found pursuant to the ERP, such a modification requires the experience modification of CDS be carried forward to VIP Drivers in accordance with ERP Section IV, Rule 1.

For the reasons set forth below, the WCIRB's decision is affirmed.

II. Statement of Issue

Did the WCIRB properly determine a change in ownership occurred between CDS and VIP Drivers, pursuant to ERP Section II, Rule 3(b) and 3(d)?

III. Procedural History

Appellant initiated these proceedings on January 9, 2008, by filing a written appeal to the Insurance Commissioner from the WCIRB's December 10, 2007, decision finding that a material change in ownership occurred pursuant to ERP Section II.

The Bureau first appeared by letter dated February 8, 2008 and participated in the proceedings thereafter. State Compensation Insurance Fund ("SCIF") appeared by letter dated February 19, 2008, in support of the WCIRB's decision.

Administrative Law Judge Kristin L. Rosi conducted a live evidentiary hearing in the Department of Insurance's Los Angeles hearing room on June 5 and June 6, 2008.

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[2] Change of ownership designations must be made in accordance with the California Workers' Compensation Experience Rating Plan – 1995 ("ERP"). The provisions of the ERP constitute duly promulgated regulations of the California Insurance Commissioner (Cal. Code Regs., tit. 10, § 2353) and have the same force and effect as a statute. The 2005 version of the ERP applies to the issues raised by this appeal, as the alleged change of ownership took place in 2005.

Arthur J. Levine, Esq. represented Appellant. John N. Frye, Esq. of the Law Offices of John N. Frye represented Respondent WCIRB. Isabel Lallana, Esq. represented Respondent SCIF.

The parties filed opening briefs, introduced documentary evidence, and elicited testimonial evidence at the hearing. The documentary evidence in this case includes all exhibits admitted into evidence, identified more specifically in the parties' Exhibit Lists.

Each party called witnesses to testify on its behalf. Linda and Warren Williams, owners of CDS, testified on behalf of the Appellant. Additionally, Appellant called VIP Drivers' owner Floyd Carter. SCIF called Special Risk Underwriting Supervisor Racquel Tabizon and the WCIRB called Vice President of Operations Warren Clark.

Following the evidentiary hearing, the parties filed post-hearing briefs, and the record was closed on September 30, 2008.

IV. Contentions of the Parties

Appellant contends a change in ownership did not occur between CDS and VIP Drivers. Appellant insists that as the two businesses are wholly separate and VIP Drivers was formed without the assistance of CDS, a change of ownership should not be found.

The WCIRB and SCIF contend a change in ownership occurred pursuant to ERP Section II, Rule 3(b) because CDS dissolved and VIP Drivers formed contemporaneously. The WCIRB and SCIF further contend that a change in ownership occurred pursuant to ERP Section II, Rule 3(d) as CDS transferred or conveyed its client list to VIP Drivers.

V. Findings of Fact[3]

Appellant contends the closure of CDS and the formation of VIP Drivers were not simultaneous and that the formation of VIP Drivers was done without the knowledge of CDS' owners Linda and Warren Williams. A great deal of the testimony discussed the involvement (or lack thereof) of the Williams' in the creation of VIP Drivers, in an effort to distinguish these two operations. Additionally, much was made of Mr. Carter's contradictory testimony with regard to the formation, location and operation of VIP Drivers. While most of the testimony by Appellant's witnesses was inconsistent with the documentary evidence and unbiased testimony of Ms. Tabizon, such conflicts are largely irrelevant to the ultimate issue in this matter; whether the facts demonstrate a change of ownership between CDS and VIP Drivers pursuant to ERP rules. As such, only those relevant facts are enumerated below.

A. ERP Background and Policy

A determination of the relevant facts herein requires an understanding of the policy reasons behind the change in ownership provisions and their impact on a business' experience modification. An experience modification factor is a percentage that reflects how an insured's workers compensation premium rate may vary from the standard or "normal" rate for the insured's industry, based on the loss history of the particular employer insured.[4] If the employer has better than normal loss experience (i.e. fewer or less serious worker injuries than prevail in the industry), the experience modification may be less than the standard (100%), which means that the premium for that business would be less than 100% of the standard rate for similar businesses. Conversely, if the loss experience of a business is worse than the norm for businesses in that industry, the premium rate would be higher than the standard 100%.

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[3] References to the transcript of the hearing held on June 5 and June 6, 2008 are "Tr." followed by the page number(s) and, where line references are used, a ":" followed by the line numbers(s). Thus, for example, a reference to Tr. 35:14-18 is to page 35, lines 14-18 of the transcript. Exhibits are referred to by the numbers assigned to them in the Exhibit Lists filed by the parties.

[4] ERP, Section II.

Mr. Clark testified that prior to 1990, an entity's previous experience rating would not follow the entity if a material change in ownership occurred.[5] This rule operated regardless of whether the entity had earned a 64% experience modification or a 165% experience modification.[6] The rationale behind that rule was based upon the premise that management and ownership of the operation controlled the risk of the entity. Thus, if majority ownership changed, so should the experience modification.

However, this rule led a number of schemes fashioned to avoid application of a high (debit) experience modification.[7] For example, an employer faced with a hefty experience modification because of poor safety practices could simply create a "new" corporation to carry on the business of the "old" corporation and, because of the rule's language, avoid application of the previous experience modification.[8] The company's past experience modification would simply be disregarded despite the fact that the entity's operations, personnel and poor safety practices would all remain the same.[9]

This same rule also penalized those operations that worked diligently for a low (credit) experience modification. For instance, an entity with a 45% experience modification which undergoes a material change in ownership but retains the same operations and same personnel would lose its credit modification and revert back to the manual 100% experience rating.[10]

Given these inequities, in 1990 the Insurance Commissioner modified the rule to its present form. It is these new rules regarding "change of ownership" that apply to the facts in this case.

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[5] Tr. 380:9-23.
[6] Tr. 380-381:24-2. An experience rating of 100% is considered average for the entity's classification.
[7] Tr. 382-383:18-1.
[8] *In the Matter of the Appeal of Dav-El Los Angeles, Inc.* (1996) ALB-WCA-95-10, p. 14.
[9] Tr. 382:18-23.
[10] Tr. 383:6-11; See, *Dinwiddie Const. v. Dept. of Ins., State of Cal.* (N.D. Cal., 1990) 745 F.Supp. 589.

B. Nature of Business at Issue

Both CDS and VIP Drivers provide temporary or regular truck drivers for contracting businesses (or clients).[11] The drivers operate equipment owned by the client and thus CDS and VIP Drivers have no vehicles of their own.[12]

Appellant's business is cyclical in nature, with business peaking during the summer and holiday season and slowing down from January through April.[13] Moreover, given the volume of business, employee leasing companies do not possess exclusive contracts with most clients.[14] Clients generally have multiple contracts for temporary drivers, as one temporary staffing company may not be able to provide the number of temporary drivers needed.

C. CDS' Operations

In 1993, Linda and Warren Williams formed CDS after previously working for another employee leasing company owned by Mr. Williams' family.[15] At all times relevant herein, CDS operated out of an office at 375 Main Street, Suite 233 in Pomona, California.[16]

CDS employed approximately 71 drivers and administrative personnel[17] including Floyd Carter and Thomas Niedenthal. Mr. Carter began his employment with CDS in 1997 and was promoted over the years to become one of CDS' most valuable employees.[18] Mr. Carter negotiated rates and contracts with clients, hired and dispatched drivers, handled CDS' preliminary payroll accounting, and performed other administrative duties.[19] As much of Mr. Carter's work concerned client relations, CDS permitted Mr. Carter to access CDS' client list as

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[11] Tr. 77:11-13.
[12] Tr. 77-78:16-4.
[13] Tr. 31:12-19; Tr. 113:20-25.
[14] Tr. 71:9-25; Tr. 133:17-19.
[15] Tr. 78:5-7; Tr. 80:6-10; Tr. 164:8-19.
[16] Tr. 241:2-4.
[17] Exh. 227-5.
[18] Tr. 24:2-3.
[19] Tr. 142-144:16-10; Tr. 91:17-20.

well as its rate-making formula.[20] Because of his involvement in rate-setting, Mr. Carter was also aware of CDS' experience modification rating as assigned by the WCIRB and understood the rating's effect on CDS' ability to compete with other staffing businesses.[21] Mr. Carter was also in charge of soliciting new business and as such routinely signed the SCIF-required Temporary Staffing Letters which informed the insurer of new CDS clients.[22] Mr. Carter continued to work for CDS until its closure on September 30, 2005, and received his final CDS paycheck after September 30, 2005.[23]

Mr. Niedenthal and Mr. Williams have been friends for over 27 years, and Mr. Niedenthal became a CDS employee when the company formed in 1993.[24] During CDS' thirteen years in business, Mr. Niedenthal held a number of positions including operations manager, dispatcher, payroll clerk, and personnel manager and was a key CDS employee.[25]

D. CDS' Closure

The parties agree that on September 30, 2005, CDS closed its operations and shut its doors.[26] At the time of its closure, CDS has an experience rating of 208%.[27] Although the parties presented much testimony regarding the circumstances leading to the closure of CDS' operations, such facts are ultimately irrelevant to whether a change of ownership occurred under the provisions of the ERP.[28]

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[20] Tr. 144-145:22-2.
[21] Tr. 320:10-20.
[22] Exh. 413-4 to 413-14.
[23] Tr. 86:6-18; Tr. 146:14-23. Details regarding CDS' payroll report for September 2005 were not provided. As such, the ALJ relied upon the testimony of Appellant's witnesses. Mr. Carter testified that he was employed at CDS through August 2005. (Tr. 177:6-10.)
[24] Tr. 166-167:17-12.
[25] Tr. 167:17-25.
[26] Tr. 75:9-12; 104:15-18; 154:9-11.
[27] Exh. 19.
[28] The parties presented evidence regarding the Williams' voice mail message, Mr. Williams' conversation with Ms. Tabizon, Mr. Williams letter to SCIF, and the Williams' reaction to the formation of VIP Drivers. While such evidence was considered, it was found to be immaterial.

E. VIP Drivers' Formation

On June 10, 2005, Mr. Carter filed Articles of Incorporation with the State of California incorporating VIP Drivers.[29]

On June 19, 2005, Mr. Carter entered into a lease agreement with his personal friend and colleague Bryant Moore, President of Crystal Mountain Investments, for office space located at 802 N. Euclid Street, Suite E, in Ontario, California.[30] The two-year lease agreement commenced on June 19, 2005, and required a monthly payment by Mr. Carter of $1,100. There is no evidence that Mr. Carter ever paid Mr. Moore rent pursuant to this lease.

On June 25, 2005, Mr. Carter signed a second lease for office space with Mr. Moore for office space located at 802 N. Euclid Street, Suite E., the same address listed in the first lease.[31] This one-year lease agreement commenced on July 1, 2005 and required monthly payments of $475.00. Mr. Carter indicated the first lease was "cancelled" and the second lease was for a smaller space.[32] As noted, the lease agreements both listed Suite E as Mr. Carter's suite. Mr. Carter testified he merely moved the letter "E" off one door and put it on his new door.[33] There is no evidence Mr. Carter ever paid rent to Mr. Moore pursuant to this lease.

In late June 2005, Mr. Moore contacted CDS' insurance broker Judy Busam to obtain worker's compensation insurance for VIP Drivers.[34] At that time, Ms. Busam warned Mr. Carter to make sure he was "separate" from CDS and not to employ more than 50% of CDS' employees at one given time.[35]

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[29] Tr. 302:10-12; Exh. 1-1. While Mr. Carter admittedly falsified VIP Drivers' corporate meeting minutes, such a fact is irrelevant to the actual operating date of VIP Drivers.
[30] Exh. 205-1; Tr. 307:23-25.
[31] Exh. 4.
[32] Tr. 255:4-11.
[33] Tr. 331:9-22.
[34] Tr. 220:10-15.
[35] Tr. 182-183:15-8.

On July 13, 2008, Mr. Carter signed yet another lease, this time for office space at 375 South Main Street, Suite 231.[36] This office was located in the same building and presumably in the immediate proximity of CDS' office which was located in Suite 233.[37] This new lease commenced on August 1, 2005 and indicated Mr. Carter would pay $715.00 per month in rent. There is no evidence Mr. Carter ever paid rent pursuant to this lease. Appellant did provide a copy of a rent and deposit check dated September 13, 2005, for the amount of $175.00.[38]

1. VIP Drivers Operations

In July 2005, Mr. Carter began soliciting clients for VIP Drivers.[39] Mr. Carter admitted that many of the clients he solicited were current clients of CDS and that Mr. Carter solicited such clients while he was employed by CDS.[40]

On August 2, 2005, Mr. Carter wrote a letter to Ms. Busam, which was forwarded to SCIF, indicating he resigned his employment with CDS in July 2005.[41] On August 11, 2005, Mr. Carter wrote a letter to SCIF Underwriter Darlene Holloway again stating he resigned his employment with CDS in July 2005.[42] These letters are in direct contrast to the Williams' testimony and the payroll report which notes that Mr. Carter was paid $912.00 a week by CDS through the end of August 2005.[43] Mr. Carter later admitted during cross-examination that the resignation dates in both his letters to SCIF were incorrect and that he ceased working for CDS in September 2005.[44]

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[36] Exh. 6.
[37] Tr. 266:5-14. Mr. Carter testified that Suite 231 and Suite 233 were located in different buildings and that the numbering system of the building had "no rhyme or reason." Tr. 241:14-20. Without corroborating evidence demonstrating the unique numbering system, the ALJ finds this testimony not credible.
[38] Exh. 7.
[39] Tr. 326:4-8.
[40] Exh. 426.
[41] Exh. 206-1.
[42] Exh. 207-1; Tr. 316:12-23.
[43] Exh. 236-13.
[44] Tr. 267-268:18-7; Tr. 270:5-13.

In mid-September 2005, VIP Drivers listed Tom Niendenthal as an employee and was paying Mr. Niedenthal the same full-time salary that he received when employed by CDS.[45]

On October 8, 2005, VIP Drivers sent SCIF its first monthly payroll report for the time period September 1, 2005 through October 1, 2005.[46] This report was prepared and signed by Ms. Williams based on information provided by Mr. Carter's wife.[47] For the month of September 2005, VIP Drivers reported $59,482 in payroll, a marked increase from the $9,502 reported for August 2005.[48] VIP Drivers' payroll jumped to $81,633 in October 2005 and to $128,635 in November 2005.[49]

Payroll reports examined by SCIF and the WCIRB for the period of August 19, 2005 through November 11, 2005, show that VIP Drivers employed 58 workers during that time period.[50] Appellant does not dispute the WCIRB's calculations regarding the number of employees and the amount of payroll generated during that time period.[51] Thus, it is undisputed that of those 58 employees, 29 (or 50%) of those employees previously worked for CDS.[52] Additionally, VIP Drivers' total payroll during that same time period was $212,641, of which the 29 former CDS employees earned $152,856 (or 72%).[53]

2. CDS' Customer Information and Client List

Examination of CDS' client list at the end of September 2005 and VIP Drivers' client list for October 2005 shows that at least 27 of CDS' clients became clients of VIP Drivers.[54] Additionally, the client list for VIP Drivers' used the identical customer codes as the CDS list. When questioned about this fact, Mr. Carter stated that he had printed out a copy of CDS'

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[45] Exh. 233-29; Exh. 236-14.
[46] Exh. 209-1.
[47] Tr. 51:7-15.
[48] Exh. 233-30.
[49] *Ibid.*
[50] For WCIRB purposes, this time period constitutes the first 90 days of payroll after VIP's formation.
[51] Tr. 225:12-18.
[52] Exh. 423-2.
[53] Exh. 423-3.
[54] Exh. 426-23 to 426-30; Exh. 426-31 to 426-36.

customer list and brought that list with him to VIP Drivers.[55] He further testified that he took the list without the knowledge of the Williams' but did not intend to use the list to solicit clients.[56] The Williams' took no action to enjoin Mr. Carter's use of the list.

VI. Applicable Law

A. The Regulatory Scheme

The legislative goals of the ERP are to provide adequate incentives for loss prevention and sufficient premium differentials so as to encourage safety.[57] As such, the rules concerning ownership and experience rating have been crafted to ensure that an employer's experience modification accurately reflects an employer's history as a business owner and the history of any business an employer may acquire.

In most cases, an employer's experience modification is based upon the payroll and loss history of a single entity, or a combination of multiple commonly-owned businesses.[58] However, an employer's experience modification may be based upon the loss experience of an acquired operation. In such cases, the owner of a newly-acquired entity will inherit the business' previous loss experience rating, regardless of the change in ownership.

B. Change of Ownership Rule

In 1990, the Insurance Commissioner adopted changes to the ERP demonstrating a new attitude towards changes in ownership. The new philosophy recognizes that the employees' knowledge of the operations has a significant impact on losses and the knowledge does not diminish when there is a material change in ownership. The employees' knowledge of the operations is affected when there is a substantial change in operations being performed or a substantial change in the employees themselves. Therefore, ERP Section IV, Rule 1 now

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[55] Tr. 236-237:15-14.
[56] Tr. 301-302:20-1.
[57] Ins. Code § 11736.
[58] ERP Sections VI and VII.

provides that the experience of the past operation shall be used in future experience ratings unless a material change of ownership is accompanied by a material change in operations or employees.

Under ERP Section II, Rule 3, a "change in ownership" is defined as follows:

> a. All or a portion of the ownership in an entity is sold, transferred or conveyed from on person to another,
>
> b. An entity is dissolved or non-operative and a new entity is formed,
>
> c. Two or more corporations undergo a statutory merger or consolidation,
>
> d. All or most of the tangible or intangible assets of an entity are sold, transferred or conveyed to another entity,
>
> e. A trusteeship or receivership is set up, either voluntarily or at the direction of the courts, to operate a business.

These definitions are specifically designed to limit those above described schemes used to avoid debit experience modification.[59] If no change in ownership occurs, then the analysis ends and the prior experience modification is not inherited by the new operation.

If a change in ownership occurs, the WCIRB will then determine whether the change in ownership was "material." A change is material only if the owner or owners prior to the change in ownership own less than a one-half interest after the change in ownership.[60]

If a material change in ownership exists, the regulations require the WCIRB to determine whether the change in ownership is accompanied by a material change in operations or employees. A material change of operations requires the business to substantially change the process of the business in the first 90 days of operation, such that reclassification by the WCIRB is necessary.[61] A material change in employees is found if a majority of employees of the

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[59] Tr. 385-386:22-7.
[60] ERP Section IV, Rule 1(a).
[61] ERP Section IV, Rule 1(b)(1).

affected entity differ before and after the first 90 days of the ownership change and a majority of the payroll for the affected entity before and after the first 90 days of the change in ownership is earned by different employees.

In short, an entity's previous experience modification will be used in future experience ratings unless a material change in ownership is accompanied by a material change in operations or employees.

VII. Discussion

The parties agree that should the Commissioner find that a change of ownership occurred, the change of ownership was material and was not accompanied by a material change in operations or employees.[62] Thus, the only issue on appeal is whether a change of ownership occurred between CDS and VIP Drivers pursuant to ERP Section II, Rule 3(b) or 3(d).

A. Rule 3(b)

ERP Section II, Rule 3(b) states a change of ownership occurs when an entity is dissolved or non-operative and a new entity is formed. The application of this provision does not require a finding of intent to avoid application of a deficit experience modification, and as such it is not necessary to find that circumvention of the ERP was Mr. Carter's objective.[63]

Appellant contends the Bureau erred in finding a change of ownership under Rule 3(b) as the Williams' did not know of the formation of VIP Drivers and because the WCIRB failed to demonstrate a connection between the open and closed businesses.[64] However, Appellant's analysis misinterprets the rule.

Rule 3(b) requires only that an entity become non-operative and that another entity form. The rule does not require collusion by the parties nor does it require specific intent. With regard to the dissolution of CDS, the testimony is clear and consistent. CDS became non-operative on

[62] Order Following Telephonic Status Conference dated March 21, 2008.
[63] *In the Matter of the Appeal of Dav-El Los Angeles, supra* at p. 17, n. 18.
[64] App. Post-Hearing Brief, p. 2.

September 30, 2005 and cancelled its workers compensation insurance as of October 1, 2005. While VIP Drivers was incorporated in June 2005 and began soliciting clients as early as July 2005, VIP Drivers did not become operative until mid-September, 2005, concurrent with the closure of CDS. This fact is supported by CDS' payroll report which demonstrates Mr. Carter's employment with CDS through August 2005, and by VIP Drivers' own payroll report for September 2005. Indeed, it was such synchronized closure and formation that alerted SCIF auditors to the change of ownership concerns. Such simultaneous dissolution and formation is exactly the kind of action the rule is meant to identify and the exact kind of action that will trigger application of ERP Section IV, Rule 1.

Ignoring evidence of the concurrent dissolution and formation, Appellant instead contends the WCIRB's interpretation of the ERP is flawed as there is no bright line drawn regarding the duration of time between dissolution of one entity and the formation of another. Appellant's argument is not persuasive. The specific facts in this case establish that CDS became non-operative on September 30, 2005 and VIP Drivers became operative in mid-September, 2005. Application of Rule 3(b) to this contemporaneous dissolution and formation is both consistent with prior case law and consistent with the ERP's purpose of preventing schemes aimed at avoiding deficit experience modifications.

As the dissolution of CDS and the formation of VIP Drivers was concomitant, the ALJ finds that a change in ownership occurred pursuant to Rule 3(b).

B. Rule 3(d)

ERP Section II, Rule 3(d) states a change of ownership occurs when all or most of the tangible or intangible assets of an entity are sold, transferred or conveyed to another entity.

Appellant contends that because Mr. Carter purportedly stole the client list from the Williams', such action cannot constitute a "conventional" transfer or conveyance.[65]

With regard to CDS' tangible assets, testimony demonstrated that the Williams' did not maintain their own fleet of vehicles and ran the business out a small office with only three 30-year old desks.[66] Thus, the tangible assets of CDS constituted only office equipment of negligible value.

CDS' only real item of any value was its client list, which noted the names and contact information of CDS' customers. California case law makes it clear that client lists, such as the one used by Mr. Carter to set up VIP Drivers, are intangible assets of a business as they are often a businesses sole economic asset.[67] Moreover, California's Uniform Trade Secret Act (UTSA)[68] considers client lists to be "trade secrets," the misappropriation of which results in serious financial consequences.[69] Given such statutory and case law, it is clear CDS' client list is an intangible asset under Rule 3(d).[70] The question thus becomes whether CDS transferred or conveyed this list to Mr. Carter.

The ERP does not define the term "transfer." Thus, it is necessary to research the plain meaning of that term in order to apply it to the facts herein. Webster's Dictionary defines "transfer" as "to carry, remove or shift from one person to another.[71] Black's Law Dictionary provides an even more comprehensive description of this term. Therein, transfer is defined as "the sale and every other method, direct or indirect, of disposing of or parting with property or with an interest therein, or with possession thereof . . . voluntarily or involuntarily, by or without

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[65] App. Post-Hearing Brief, p. 4-5.
[66] Tr. 77:16-23; Tr. 162:1-5.
[67] *Shubat v. Sutter County Asses. App. Bd.* (1993) 13 Cal.App.4th 794, 802-804.
[68] Civ. Code § 3426.1(d).
[69] Civ. Code § 3426.1(b); *MAI Sys. Corp. v. Peak Computer Inc.* (9th Cir. 1993) 991 F.2d 511, 521.
[70] The Williams' failure to seek restitution for Mr. Carter's alleged misappropriation of CDS' client list, a protected trade secret, casts doubt upon their testimony that they were "surprised" by the formation of VIP Drivers or that such formation was done without their knowledge and/or blessing.
[71] Webster's II New College Dictionary (2005) p. 1198.

judicial proceedings, as a conveyance, sale, payment, pledge, mortgage, lien, encumbrance, gift, security or otherwise."[72] These definitions make clear that any direct or indirect method of exchanging possession of some item is considered a "transfer."

The ALJ finds that the Williams', either directly or indirectly, exchanged possession of the client list when they permitted Mr. Carter to take the list with him to VIP Drivers. This conclusion is further supported by the fact that the Williams' did not use the client list again after "transferring" it to Mr. Carter. Given the transfer of CDS' only true asset, the ALJ finds that a change in ownership occurred pursuant to Rule 3(d).

C. Burden of Proof

In an apparent attempt to pre-empt any discussion of witness credibility, Appellant argues the Court need not address the credibility of its witnesses, as the WCIRB fails to demonstrate the sale, transfer or conveyance of CDS' assets.[73] Appellant's argument is misguided and misstates the burden of proof in this matter.

California Code of Regulations, title 10, section 2509.61 provides that each party has the burden of proof as to each fact the existence or nonexistence of which is essential to the claim for relief. In other words, Appellant independently has the burden to prove that the facts in this case do not meet the standard set forth in Rule 3(b) and 3(d). Failure by the WCIRB to prove otherwise, does not relieve Appellant of its burden.

With regard to credibility determinations, Appellant's argument is simply erroneous. Assessment of the credibility of witness testimony is at the heart of judicial decision making. California Evidence Code section 780 specifically permits the trier of fact to consider any matter that has any tendency to prove or disprove the truthfulness of a witness's testimony at the hearing, including a witness's interest in the proceedings, prior inconsistent statements, attitude

[72] Black's Law Dict. (5th ed. 1979) p. 1342, col. 1.
[73] App. Post-Hearing Brief, p. 4.

towards the proceedings and even witness demeanor.[74] Moreover, Government Code section 11425.50(b) states that with regard to credibility determinations, the judge must identify any evidence of the observed demeanor, manner or attitude of the witness that supports the overall judicial determination.

While the inconsistencies in Mr. Carter's testimony raise doubts about his credibility, such discrepancies are not material to the underlying decision, as there was little dispute regarding the central facts in this matter. However, had this matter turned on witness credibility, the ALJ would be charged with assessing the veracity of each witness and be further required to detail the rationale behind such findings.

D. Due Process Concerns

Appellant further contends the WCIRB's rules regarding a change in ownership are vague and ambiguous and fail to provide concerned parties with sufficient notice on how such rules will be interpreted.[75] This apparent substantive due process argument is misplaced and discredited by Appellant's own behavior.

The constitutional guaranty of substantive due process protects against arbitrary legislative actions. As such, it requires legislation not be "unreasonable, arbitrary or capricious" but to have a "real and substantial relation to the object sought to be attained.[76] "Once it is established that the general provisions further the legislative goal, the Legislature has wide discretion in determining what limits will be set on the prohibition."[77] As long as the statute

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[74] Evid. Code § 780; 2 Jefferson, Cal. Evidence Benchbook (Cont.Ed.Bar 3d ed. 1997) Credibility of Witnesses, § 28.3, p. 533.
[75] App. Post-Hearing Brief, p. 2.
[76] *Coleman v. Dept. of Personnel Administration* (1991) 52 Cal.3d 1102, 1125. See also, *People v. Santos* (2007) 147 Cal.App.4th 965, 978.
[77] *People v. Mitchell* (1994) 30 Cal.App.4th 783, 789.

rationally serves its purpose, it is not made arbitrary or capricious simply because it might have been drawn more narrowly.[78]

Section V, subsection A of this decision summarizes the rationale for the criteria set forth in ERP for discarding or carrying over the experience of a prior owner. As Mr. Clark noted, the changes to ERP Sections II and IV resulted from concern that a significant number of employers with poor safety practices were manipulating the ownership provisions in order to avoid their debit modifications.[79] Moreover, in some instances an employer would lose a credit modification because of a material change in ownership, even though there was not a change in management, employees and operations.[80] Additionally, such rules were adopted after extensive discussion and a public hearing.

Given the above stated motivation, Section II, Rule 3(b) and 3(d) are neither unreasonable, nor arbitrary or capricious. The new philosophy recognizes that the employees' knowledge of the operations has a significant impact on losses and the knowledge does not diminish when there is a material change in ownership. Moreover, it prevents exploitation of the ownership rules to avoid debit modifications. As such, Rules 3(b) and 3(d) are substantially related to their stated purpose and do not violate Appellant's due process rights.

Appellant's due process arguments are further discredited by Mr. Carter's testimony and actions, which demonstrate Mr. Carter was aware of the ERP's prohibitions. Mr. Carter's testimony indicates his insurance agent, Ms. Busam, specifically informed him of the technicalities of Section IV and admonished him not to hire more than 50% of CDS' employees.[81] Despite this admonition, Mr. Carter's payroll records from August 19, 2005 to November 11, 2005 show that VIP Drivers employed 58 workers, 29 (50%) of which had

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[78] *People v. Hodges* (1999) 70 Cal.App.4th 1348, 1356.
[79] Tr. 382-383:18-1.
[80] See, *Dinwiddie Const., supra* 745 F. Supp. 589.
[81] Tr. 182-183:15-18.

worked for CDS in the 90 days prior to VIP Drivers formation. Moreover, the 29 employees generated 72% of VIP Drivers total payroll during its first 90 days of operation.[82] Had Mr. Carter simply followed Ms. Busam's advice and made a material change in employees, WCIRB intervention would have been avoided.

VIII. Conclusion

Pursuant to California Code of Regulations, title 10, section 2509.61, subdivision (a), a "party has the burden of proof as to each fact the existence or nonexistence of which is essential to the claim for relief or defense that he or she is asserting."

Based on the evidence submitted by the parties, the record on appeal and the foregoing analysis of the facts and law at issue, Appellant has not met its burden of proof to show the WCIRB's determination that a change in ownership occurred between CDS and VIP Drivers, pursuant to ERP Section II, Rule 3(b) and 3(d) was improper.

ORDER

1. The decision of the Workers Compensation Insurance Rating Bureau that a change of ownership occurred between CDS and VIP Drivers is affirmed.

I submit this proposed decision based on the evidentiary hearing, records and files in this matter and recommend its adoption as the decision of the Insurance Commissioner of the State of California.

Dated: October 27, 2008

KRISTIN L. ROSI
Administrative Law Judge
Administrative Hearing Bureau
California Department of Insurance

[82] Exh. 423-2 and 423-3; Exh. 228-6.