DEPARTMENT OF INSURANCE
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BEFORE THE INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of ALIN PARTY SUPPLY CO., Appellant, From a Decision of THE WORKERS' COMPENSATION INSURANCE RATING BUREAU OF CALIFORNIA, Respondent.	FILE NO. ALB-WCA-93-5 **PROPOSED DECISION**

INTRODUCTION

This is an appeal filed by Alin Party Supply Company from a Workers' Compensation Rating Bureau ("Bureau") decision that the experience modification factor ("ex mod") for Alin Party Supply for the policy years beginning December 28, 1991, and December 28, 1992, had been properly computed using the combined experience of Alin Party Supply and Abbey Party Rents, Inc. No hearing was conducted in this matter because the Appellant waived its right to a hearing, and the Bureau had no objections to the cancellation of the hearing that had been scheduled.

The Bureau was represented in this proceeding by Carol Joyce, Vice President - Legal for the Bureau and attorney Thomas McDonald of LeBoeuf, Lamb, Greene & MacRae, and the

Appellant was represented by attorney Arthur J. Levine from the Law Offices of Arthur J. Levine. For the reasons set forth below, the Bureau's decision is AFFIRMED.

FINDINGS OF FACT

Procedural Background

On July 22, 1993, the Appellant, Alin Party Supply Co., filed a timely appeal of a June 8, 1993, decision of Bureau's Classification and Rating Committee ("C&R Committee"). Scheduling of this matter for a hearing was delayed because of discovery efforts by the Appellant which were only recently concluded in the state courts. This matter was calendared for a hearing on May 6, 1997. After the pre-hearing briefs were filed by both parties, the Appellant's counsel indicated in a letter that there appeared to be no disputed facts and waived the Appellant's right to a hearing. The hearing was vacated after the Bureau indicated that it had no objections to the hearing being canceled.

The evidentiary record in this matter includes the Appellant's appeal filed with the Administrative Law Bureau on August 5, 1993, the Bureau's file in this matter received by the Administrative Law Bureau on September 24, 1993, and Joint Exhibits 1, 2 and 3 submitted by the parties on April 29, 1997.

This matter was submitted for decision following a telephone status conference conducted on May 14, 1997, during which the evidentiary record was stipulated to by the parties.

Jurisdiction

The Bureau is a licensed rating organization within the meaning of Insurance Code section 11750.1. It publishes and administers the regulations relating to workers' compensation insurance found in Title 10, California Code of Regulations, after they are adopted by the Insurance Commissioner, including section 2353, which is known as the Experience Rating Plan,

Workers' Compensation Insurance.[1] The Department has the authority under Insurance Code section 11753.1(a)[2] to consider the appeal.

Factual Background

The facts in this case are undisputed. From December 1988 through June 30, 1992, Alin Party Supply, a retail seller of party supplies, was a wholly-owned subsidiary of a holding company called Party Time, Inc. On June 24, 1989, Party Time bought Abbey Party Rents, a party supply rental company. On May 31, 1991, Party Time sold Abbey Party Rents' assets, along with its name, to Balser Investments, Inc., an unrelated corporation, and renamed Abbey Party Rents as APR Sales Corp. Abbey Party Rents underwent a material change in ownership on May 31, 1991. Party Time subsequently filed a petition for voluntary bankruptcy for APR Sales Corp. on October 8, 1991. On June 30, 1992, Party Time dissolved its corporate structure and merged with Alin Party Supply.

Alin Party Supply's workers' compensation policy period began on December 28. When the Bureau computed the ex mod for Alin Party Supply for the 1991-92 and 1992-93 policy years it used the combined claims experience of both Alin Party Supply and Abbey Party Rents to calculate the ex mod. The computation resulted in an ex mod of 154% for the policy year beginning December 28, 1991, and 198% for the policy year beginning December 28, 1992, for Alin Party Supply. Alin Party Supply objected to the inclusion of Abbey Party Rents' claim

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[1] Joint Exhibit 1 is a copy of the Experience Rating Plan which was effective January 1, 1990. The parties have stipulated that the provisions of the Rating Plan raised in this appeal did not change between January 1, 1990, and December 28, 1992, the time period involved in this appeal.

[2] Section 11753.1(a) provides that a person aggrieved by a decision by a rating organization may file a written complaint and request a hearing with the Insurance Commissioner if the rating organization rejects or fails to act on a request for reconsideration of the offending decision, action or omission to act.

history in computing its ex mod.

Alin Party Supply appealed the ex mod determination to the C&R Committee. The C&R Committee affirmed the Bureau staff's ex mod computation at its June 8, 1993, meeting. This appeal followed.

Applicable Workers Compensation Law

An employer's workers' compensation insurance premium is determined in part by the provisions of the Workers' Compensation Insurance Experience Rating Plan ("Rating Plan"). Under the Rating Plan, an employer's previous workers' compensation loss experience during a 3-year experience period[3] is used to develop an experience modification factor, or ex mod, which is applied to the employer's manual[4] rates to determine the employer's actual insurance premium. The ex mod is used as an indicator of the likelihood of future claims. Employers with an average claim rate for the particular industry have an ex mod of 100%. Employers with a higher than average claim rate have a debit ex mod over 100%, which results in workers' compensation premiums that are higher than the manual rate, while employers with a lower than average claims history have a credit ex mod under 100%, and lower premiums. The ex mod is affected by material changes in ownership and common ownership of multiple entities.

The general rule governing the experience rating following a change in ownership is found in Section III, rule (3) of the Rating Plan ("Rule 3") which provides, in part, that:

> "... if the owners of a risk sell, transfer, convey, discontinue, self-insure or otherwise dispose of all or part of the operations of a risk, all experience incurred prior to such

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[3] The experience period for the policy starting December 28, 1991, was March 28, 1987, to March 28, 1990, and the experience period for the December 28, 1992, policy period was March 28, 1988, to March 28, 1991.

[4] The manual rate is computed from the job classification codes assigned to the employer's employees and the insurance rate associated with those codes.

action shall be used in determining experience modifications which shall be applied to any remaining operations and to any new operations in which the owners of the risk own a one-half or greater interest."

The Rating Plan includes provisions for computing the ex mod in situations where multiple entities share a common owner. The applicable rule, also known as the "Combination of Entities Rule", is found at Section III, rule (9) of the Rating Plan ("Rule 9"). During 1991 and 1992, Rule 9 included paragraphs that addressed different situations that might arise and affect the experience rating for multiple entities with a common owner.

The first paragraph of Rule 9 states the basic concept that "[s]eparate entities shall be combined for experience rating purposes when the same person or persons own a majority interest in each of the entities." Paragraph 2 of Rule 9, which will be referred to here as the "Bankruptcy Provision," addresses the situation when one of the combined entities goes into bankruptcy. It provides that:

> "A risk in bankruptcy or receivership shall not be combined with any other entity for experience rating purposes unless (a) the other entity is a part of the same bankruptcy or receivership proceeding and under the same trustee or receiver or (b) the risk is being operated by the Debtor in Possession and the other entity is combinable with the debtor."

The fifth paragraph of Rule 9, which will be referred to as the "Change in Ownership Provision," provides the criteria for determining the experience rating if the multiple entities are no longer combinable as a result of a nominal or material change in ownership, differentiating between the two. It provides that:

> "If two or more entities are no longer combinable as a result of a change in ownership which is not material, the entire experience developed by the combined entities prior to the change and during the experience period shall be used in developing experience modifications for each of the entities after the change. If two or more entities no longer are combinable as a result of a change in ownership which is material, the experience incurred prior to the change and during the experience period shall be used in developing the experience modification for each of the entities which has not undergone a material change."

DISCUSSION

Appellant's Position

The Appellant argues that because Abbey Party Rents went into bankruptcy, the Bureau erred in combining it with Alin Party Supply for experience rating purposes because the Bankruptcy Provision of Rule 9 specifically says that a risk in bankruptcy shall not be combined with any other entity for experience rating purposes unless certain conditions, which are not present in this case, are met.

Alternatively, the Appellant argues that the language in the Change in Ownership Provision of Rule 9 should be interpreted to mean that the prior combined experience history can no longer be used for the entities after a material change in ownership and the separate claim history of the entity that did not undergo the material change should be used to determine its ex mod. Rule 9 provides that if the change in ownership is nominal the "entire experience developed by the combined entities" before the change and during the experience period is to be used for each of the entities after the change. However, if there is a material change, Rule 9 merely states that the "experience" incurred before the change and during the experience period is to be used for the entity that did not undergo a material change in ownership. There is no reference to the experience "developed by the combined entities." The Appellant argues that this omission means that the intent is to separate the experience of the entities that had been combined and to treat them as separate entities for ex mod purposes when there is a material change in ownership.

Bureau's Position

The Bureau argues under Rule 9, if there is a material change in ownership and two entities are no longer combinable, then the entity that did not undergo the material change in

ownership retains the entire combined experience until the ownership change for ex mod purposes. That entity's separate experience after the change in ownership is used for the rest of the experience period.

The Bureau also argues that its interpretation is consistent with Rule 3 which requires that in this situation, the combined experience of Abbey Party Rents and Alin Party Supply up until Abbey Party Rents was sold must continue to be used in computing the ex mod for Alin Party Supply which did not change ownership.

The Bureau rejects the Appellant's argument that the Bankruptcy Provision of Rule 9 requires the segregation of the experience of the bankrupt entity from any other entities it may have been combined with and argues that the language in it merely means that the entity's experience after the bankruptcy must be segregated. The Bureau further argues that the Bankruptcy Provision does not apply in this situation since the Bankruptcy Provision refers to the "risk" in bankruptcy, and Abbey Party Rents was not a "risk" covered by Rule 9 after the sale because it was merely a corporate shell and did not operate as a business.

Analysis

I find no merit to the Appellant's argument that the prior claim history of Abbey Party Rents and Alin Party Supply must be segregated when Alin Party Supply's ex mod is computed for the December 28, 1991, and December 28, 1992, policy periods. Workers' compensation insurance premiums are computed using a method which attempts to predict the likelihood that future claims will be filed and paid. One of the factors that affects the likelihood of a claim being filed is the work environment which is generally under the control of the owner of the business. The Rating Plan recognizes this by assigning a new ex mod only if there is a material change in ownership, defined as a change in the majority ownership of a company, and a material change in

the operations or personnel of the business. Even the Bankruptcy Provision recognizes and adopts this concept. An entity in bankruptcy that had been combined with another entity before the bankruptcy will continue to be combined with the other entity despite the bankruptcy if all entities are in the same bankruptcy and controlled by the same trustee or the bankrupt entity is being operated by the debtor and the other entity can be combined with the debtor. This is certainly the concept underlying both Rule 3 and the general rule for combination of entities.

The Bureau is correct when it argues that the Bankruptcy Provision does not apply to this situation. Party Time sold Abbey Party Rents on May 31, 1991, and no longer operated Abbey Party Rents. As of the date of sale, Abbey Party Rents was no longer part of the "risk" that Party Time had insured, and Abbey Party Rents was no longer combinable with Alin Party Supply. Because of the sale and material change in ownership, the Change in Ownership Provision of Rule 9 governs, not the Bankruptcy Provision. Where there is a material change in ownership, Rule 9 requires that the "experience incurred prior to the change and during the experience period shall be used in developing the experience modification" for the entity that did not undergo a material change, namely Alin Party Supply. There is a dispute over how the words "experience prior to the change and during the experience period" is to be interpreted. The Appellant and the Bureau have taken this language and interpreted these words differently.

The first sentence of the Change in Ownership Provision specifies that "the entire experience developed by the combined entities prior to the change and during the experience period" is to be used to develop the ex mod for each of the entities after a nominal change. The second sentence, which addresses the ex mod after a material change, does not mention using the experience of the combined entities. The Appellant argues the failure to specify that the entire combined experience should also be used when there is a material change in ownership means

that each entity's ex mod should be computed on the basis of its own experience. I do not find the Appellant's argument persuasive. Such an interpretation yields a result which would be contrary to the more general rule articulated in Rule 3. Since both sentences appear in the same paragraph, the word "experience" in the second sentence should be interpreted to incorporate the full description of experience that appeared in the first sentence for situations with a nominal change in ownership.

In analyzing and comparing the two sentences, the more significant language is the inclusion of the words "experience incurred prior to the change" in both sentences, not the exclusion of "experience developed by the combined entities" from the second sentence. If the Combination of Entities provision had been intended to eliminate the use of the combined experience for multiple entities sharing a common owner after one of them undergoes a material change in ownership, then there would have been no need to differentiate between the experience before and after the change. The language "experience incurred prior to the change" is irrelevant in the second sentence if the remaining entity's separate experience is to be used after a material change in ownership because the only cutoff for the claims experience would be the end of the experience period, not when the ownership of the other entity changed.

Rule 3 specifically provides that the experience rating developed by an owner of a "risk" prior to a sale of all or part of the operations of the "risk" must be applied to any operations that the owner continues to own or acquires after the sale. As the Appellant pointed out, "the regulatory definition of [r]isk is a sweeping one encompassing 'all insured operations,' including 'all operations' when two or more entities are combinable." [Appellant's Opening Brief, page 6.] Applied to this case, the risk that Party Time owned included both Abbey Party Rents and Alin Party Supply. Until May 31, 1991, Party Time developed an experience on that risk which was

the combined experience of both Abbey Party Rents and Alin Party Supply. After Party Time sold Abbey Party Rents, Rule 3 requires that the combined experience be applied to Alin Party Supply which Party Time still owned.

The Appellant's interpretation of the provisions of the Combination of Entities rule would yield a result that is inconsistent with the basic Rule 3 concept that the combined experience of all entities owned by an owner during the experience period should be used to compute the ex mod for all businesses owned by the owner. Under the Appellant's interpretation, the sale of Abbey Party Rents would result in Alin Party Supply's ex mod being based solely on its own experience, in direct contravention of the requirements of Rule 3. As discussed above, Rule 3 mandates that all the experience Party Time acquired during the experience period as the owner of both Abbey Party Rents and Alin Party Supply continue to be used for all businesses that Party Time continued to own after it sold Abbey Party Rents, or, more specifically, Alin Party Supply.

The individual rules of the workers' compensation regulations cannot be read and interpreted in isolation. They must be read and interpreted in conjunction with the entire body of regulations to ensure that they are consistent with each other. A common thread that runs through the rules governing the computation of the experience rating is that an owner should be bound by the ex mod attributed to that party's ownership and management of a business. Rule 9 is essentially the application of the more general Rule 3 to a specific situation. The Bureau's interpretation of Rule 9 is consistent with the concept that underlies Rule 3, and, as demonstrated above, it is consistent with the application of Rule 3 to this situation.

The Appellant has also mistakenly argued that "experience" in Rule 3 concerns the continued use of "an entity's" experience when the entity is sold, conveyed or discontinued while Rule 9 is about the combinability of separate entities' experience. [Appellant's Opening Brief, p.

15.] Rule 3 does not refer to an "entity", but rather to the "risk." Contrary to the Appellant's argument, Rule 3 specifically requires the continued use of all of a risk's past experience if part of that risk is disposed of, as in this case.