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BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF CALIFORNIA

FILED

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ADMINISTRATIVE LAW BUREAU

In the Matter of the Appeal of DAV-EL LOS ANGELES, INC., Appellant, From a Decision of THE WORKERS' COMPENSATION INSURANCE RATING BUREAU OF CALIFORNIA, Respondent.	FILE NO. ALB-WCA-95-10

PROPOSED DECISION

This case concerns the determination of the proper experience modification to be assigned to Appellant, Dav-El Los Angeles, Inc. (hereafter "appellant" or "Dav-El L.A.") for 1990, 1991, and 1992, pursuant to the California Experience Rating Plan (hereafter "Plan").[1]

Dav-El L.A. appeals the decision of the Classification and Rating Committee of Respondent Workers' Compensation Insurance Rating Bureau of California.[2] This appeal to the

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[1] The Plan was approved by the Insurance Commissioner (Cal. Code Regs., tit. 10, §2353) and constitutes part of the Commissioner's regulations, the relevant law in this case.

[2] 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

Further, a "provision must be given a reasonable and common sense interpretation consistent with the apparent purpose and intention of the lawmakers, practical rather than technical in nature, which upon application will result in wise policy rather than mischief or absurdity. [Citations.]" In addition, "the various parts of a statutory enactment must be harmonized by considering the particular clause or section in the context of the statutory framework as a whole. [Citations.]" DeYoung v. City of San Diego (1983) 147 Cal.App.3d 11, 18. See also, Granberry v. Islay Investments (1984) 161 Cal.App.3d 382, 388, wherein the Court states:

> "One of the cardinal rules of construction requires that words be given such interpretation as will promote rather than defeat the *general purpose and policy* of the law. A statute should be interpreted so as to produce a result that is reasonable. [Citations.] The words of a statute will not be literally construed if this would cause an absurd result, or if it would fail to give effect to the manifest purpose of the statute in light of its legislative history." (*emphasis in original*)

Appellant contends that Dav-El West's prior loss experience cannot be applied to Dav-El L.A. to determine an experience modification because Rule 8(c)(1)(a) does not apply. Appellant argues that this rule only applies where the former corporation is "dissolved or non-operative," and Dav-El West neither dissolved nor ceased operations. On the contrary, Dav-El West continued to operate in California, albeit in a changed manner, and retained its status as a California corporation in good standing. The Bureau, on the other hand, contends that, since Dav-El West did not have employees after August 26, 1988, and was not subject to the California workers' compensation laws, it became "non-operative" for California workers' compensation

purposes. Because it was "non-operative," and because Mr. Solombrino and Mr. Caruso owned more than 50% of the issued voting stock in both Dav-El West and Dav-El L.A., the change of ownership was "nominal" for purposes of Rule (8)(c)(1)(a), requiring that the loss experience developed by Dav-El West be applied to Dav-El L.A.

"Non-operative" is not defined in the Plan, the Manual, or the enabling statutes. Thus, we must construe it in a common sense manner, harmonizing it within the context of the statutory framework. We find that the interpretation given the Bureau to the word "non-operative" is reasonable and consistent with the overall goals, policy, and purpose of the Plan and the enabling statutes. Further, we hold that to construct the term "non-operative" in any other manner would defeat the overall purpose and policy of the Plan. In reaching this decision, we also accord the Bureau some consideration in interpreting the regulations because of its long experience in administering them on behalf of the Commissioner. (See, in other contexts, Thor v. Superior Court (1993) 5 Cal.4th 725, 745; Public Emp. Relations Bd. v. Superior Court (1993) 13 Cal.App.4th 1816, 1831; DeYoung v. City of San Diego (1983) 147 Cal.App.3d 11, 18.)

The purpose of experience rating is to reduce work-related accidents by rewarding employers who have lower losses and by penalizing employers who have greater losses. Management is considered vested in ownership; owners are considered to have control over business practices and are solely and ultimately responsible for worker safety. The Plan requires that the "risk" be insured; the risk then follows the owner—the person or persons who are in the position to affect loss prevention. It is axiomatic that the risk can only follow the owner if the risk continues to exist. Thus, if the business ceases to engage in operations that are subject to California's workers' compensation laws, there is no risk to insure. This is recognized in the

definition of "risk" as "mean[ing] and includ[ing] all *insured operations* of any entity within the State . . . ." (Section II, Rule (1)) *(Emphasis added.)* Thus, a business must be deemed "non-operative," when it is not subject to workers' compensation insurance, even if it continues to legally exist, i.e., pursuant to the corporation laws.

The Plan's provisions further support this construction. The Plan provisions demonstrate that only *risks* subject to *California Workers' Compensation Insurance* are rated under the Plan:

> Section I, Rule (1) of the Plan: "The rules of this Plan shall govern the experience rating procedure to be followed in connection with *California Workers' Compensation Insurance*." (*Emphasis added.*)
>
> Section III, Rule (1): "A *risk* shall qualify for rating its *California Workers' Compensation Insurance* premium under this Plan . . . ." (*Emphasis added.*)
>
> Section III, Rule (3): **Experience to be Used for Rating *California Workers' Compensation Insurance Risks.*** The entire California Workers' Compensation Insurance experience of a risk (except as hereinafter provided) developed under any policy which provides coverage for all or a part of the risk's operations. . . ." (*Emphasis added*).

Section III, Rule (9) also explicitly recognizes that a business must be both *operating and insured* in California in order for their experience rating to be combined:

> "(9) **Combination of Entities.** Separate entities shall be combined for experience rating purposes when the same person or persons own a majority interest in each of the entities." * * *
>
> "*Rule (9) applies only where the entities are, or have been, operating and insured concurrently in California.* It does not apply where concurrent operations are for a short period of time, not exceeding one year, provided the operation of the original entity, during the period both entities were operating, was restricted to the completion of contracts entered into prior to the new entity commencing operations. *Rule (8) applies in all*

situations where Rule (9) is not applicable."[15] *(Emphasis added.)*

Thus, under the scheme of the Plan, if the same "owners" operate more than one business subject to workers' compensation insurance laws, Plan Rule (9) applies; if such "owners" only operate one business subject to California workers' compensation insurance laws, Plan Rule (8) applies.[16]

Further, a contrary interpretation of the rule would license employers to play a corporate shell game. 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, under Appellant's interpretation of the rule, avoid the application of such an experience modification if it simply retained the shell of the first corporation. Such an interpretation is antithetic to the very purpose of the Plan and cannot be countenanced.

In view of the above, we hold that for purposes of applying Plan Section III, Rule (8)(c)(1)(a), the term "non-operative" must be read to mean "not operating a business subject to California workers' compensation insurance laws."

Applying our construction of Section III, Rule 8(c)(1)(a) to this case, we hold that since Dav-El West was no longer subject to California workers' compensation laws as of August 26, 1988, it was considered "non-operative" for workers' compensation insurance rating purposes.

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[15] Rule (9) does not apply in this case because Dav-El West , while operating concurrently with Dav-El L.A., has not been *insured*, as required by the express language of the Rule.

[16] Or if the owners of two or more corporations merge or consolidate, the prior experience is combined and used to determine the experience rating for the consolidated or surviving corporation. (Section III, Rule (8)(c)(4).)

Further, since Dav-El West and Dav-El L.A. shared 100% common ownership, and since Dav-El L.A. engaged in the same business that was formerly engaged in by Dav-El West,[17] the loss experience developed by Dav-El West must be applied when calculating the experience modification rating of Dav-El L.A.

Appellant also contends that Dav-El West's experience modification cannot be applied to Dav-El L.A. because Section III, Rule (8) only applies to entities that undergo a "change of ownership." Since Dav-El West and Dav-El L.A. have the same owners, it argues, there can be no "change of ownership." We reject this contention as inimical to the explicit language contained in the rule and to the policy upon which the rule is based. Contrary to Appellant's contention, the "change of ownership" rules do not only apply to an existing corporation that undergoes a change in ownership. The rules also apply to cases where the form of the entity has changed. Appellant focuses only on the words "change of ownership" in the title to Rule (8). However, the words "change of ownership" cannot be isolated from the rest of the rule; the rule must be read as a whole. Thus, in the sub-rules for corporations, Rule 8(c)(1)(a) provides that a

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[17] At the hearing, the Bureau also contended that Section III, Rule (8)(c)(1)(a) would require that the loss experience of Dav-El West be used to calculate the experience modification for Dav-El L.A. *regardless of* Dav-El L.A's business activities. We are not persuaded that Section III, Rule (8) would apply under those circumstances. Experience modification rates are based upon the average experience of employers *within a classification*; thus, it does not follow that an experience modification developed on losses from one business, with one type of classifications, should be applied to a new distinct business, with totally different classifications. For example, if Appellant had opened up a yoghurt stand, it does not follow that it should be given an experience modification rating based on losses developed in its limousine business. We note that Section 11730(c) of the Insurance Code supports our analysis. It defines "experience rating" as " . . . measuring the policyholder's loss experience against the loss experience of policyholders *in the same classification . . . .*" *(Emphasis added.)* While this section only became effective January 1, 1995, it appears to simply restate existing policy and not to create new policy.

"change of ownership" is denominated "material" where the "[o]ld corporation [is] dissolved or non-operative . . ." and a "new corporation [is] formed." The exception to Rule 8(c)(1)(a) further provides that such a "change" is "nominal" where the "stockholders common to both the dissolved or non-operative corporation and the newly formed corporation own or owned one-half or more of the issued voting stock in the old corporation and . . . the newly formed corporation. . . ." This language clearly contemplates separate and distinct entities—an "old" corporation and a "newly formed" corporation. Further, ownership changes due to a mere stock transfer or sale of one entity is also covered by another rule—Rule (8)(c)(2), which similarly distinguishes "material" and "nominal" ownership changes in accordance with the amount of stock transferred and the identity of the transferors and transferees. Finally, under the rule as applied, it is clear that a "change of ownership" denominated "nominal" is, in effect, a determination that there is *no* "change of ownership."

Our conclusion is further buttressed by the overriding policy behind the Experience Rating Plan rules. As aforestated, the purpose of experience rating is to reduce work-related accidents by rewarding employers—defined by their ownership—who have lower losses, and by penalizing employers—again defined by ownership—who have greater losses. The pertinent issue in this case, thus, is not whether there is a change in the operating entity, but whether the *owners* of a particular business continue to operate that same business, regardless of the *form* of entity. Under the rules, the *form* of the entity, i.e., a corporation, is irrelevant. The insurance "risk" follows the owners.

In view of the above, we find that the policy underlying the rules is to ensure that an

"owner" of a risk carries the same experience rating regardless of the legal form of the business entity. It makes no sense to have elaborate rules designed to make sure that owners are responsible for the safety of their employees, and then to allow them to avoid that responsibility—and its prior loss experience—by simply changing the legal form of its operation, i.e., by creating a new corporate entity.[18] To interpret this language as Appellant contends would certainly result in "mischief or absurdity."

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[18] We do not suggest that intent to avoid application of an experience modification rating is required under this rule. On the contrary, as noted by the Bureau, these rules also apply in situations where the experience modification rating *reduces* an employer's rates because of a lower than average loss experience.