DEPARTMENT OF INSURANCE
ADMINISTRATIVE HEARING BUREAU
45 Fremont Street, 22nd Floor
San Francisco, CA 94105
Telephone: (415) 538-4102
FAX No.: (415) 904-5854

BEFORE THE INSURANCE COMMISSIONER

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of **STAFF RESOURCES, INC.,** Appellant, From the Decision of **STATE COMPENSATION INSURANCE FUND,** Respondent.	)	FILE AHB-WCA-03-54

ORDER ADOPTING PROPOSED DECISION

This appeal was filed by Staff Resources, Inc. (SRI) on September 16, 2003. Following several status conferences, and various discovery and in limine motions, an evidentiary hearing was held.

During the course of the proceeding, on May 11, 2004, Gevity HR, Inc., a Florida-based professional employer organization doing business in California, sought permission to file an Amicus Curiae brief in support of appellant. The ALJ denied the request.

The record was closed on August 12, 2004 and submitted for decision.

The Administrative Law Judge issued her proposed decision on September 9, 2004. The proposed decision finds that State Compensation Insurance Fund's (SCIF) practice of issuing separate policies to Staff Resources Inc.'s (SRI) clients in their own names is contrary to the reporting rules of the California Workers' Compensation Insurance Rating Plan-1995 (the Plan).

On September 24, 2004, the Commissioner reopened the record and granted Gevity's request to file an Amicus brief. Other interested persons were invited to respond to Gevity's brief or to file their own Amicus by October 15, 2004.

SCIF filed a reply brief in opposition to Gevity's position, and the Workers' Compensation Insurance Rating Bureau (WCIRB) replied in support of Gevity. Administaff, a PEO doing business in California, and ADP TotalSource, a PEO which plans to begin business in California in the coming year, both filed letter Amicus briefs in support of SRI and the WCIRB.

Gevity's main argument is that SCIF's requirement that separate policies be issued to SRI's clients, rather than to SRI and its clients in SRI's name, is contrary to the plain language of the Plan. Further, if SCIF's position is upheld, Rule 4 would be destabilized with unknown consequences to the California PEO industry.

SCIF answers that its requirement does not violate Rule 4 and that direct writing enables SCIF to more accurately underwrite "client-employers." SCIF also asserts, inter alia, that its practice is more consistent with the goals of the Plan, that combining thousands of businesses and worksites does not promote accurate experience rating, and that master policies can lead to gaps in coverage.

SCIF's arguments raise issues of policy that need to be addressed. However, they should be addressed in a different forum. To that end, Judge Rasmussen's Order thoughtfully directs

the WCIRB to conduct a comprehensive analysis to determine whether the Plan rules should be revised.

At this time, however, I believe a more limited analysis should be pursued. Because of its unique role in California's workers' compensation system, I would like SCIF and the WCIRB to explore whether SCIF should be given a degree of flexibility in underwriting PEOs and therefore I direct them to work jointly on a proposal for a relevant rule change acceptable to both. The proposed rule shall be filed with me for review at the next pure premium rate hearing, in the spring of 2005. If SCIF and the WCIRB do not agree on a rule change, either SCIF or the WCIRB may propose its own rule change at the next pure premium rate hearing.

The attached proposed decision of Administrative Law Judge Marjorie Rasmussen is adopted as the Insurance Commissioner's decision in the above-entitled matter, but proposed ordering paragraph 4 is amended as follows:

4. SCIF and the WCIRB shall work together to determine whether a rule can be developed which is acceptable to both parties. The proposed rule should be filed for review at the next pure premium rate hearing in the spring of 2005. If SCIF and the WCIRB do not agree on a rule change, either SCIF or the WCIRB may propose a rule change at the next pure premium rate hearing. Other insurers or interested persons may comment on any proposed submission by SCIF or the WCIRB.

This order shall be effective December 1, 2004. Judicial review of the Insurance Commissioner's decision may be had pursuant to California Code of Regulations, title 10, section 2509.76. Persons authorized to accept service on behalf of the Insurance Commissioner are listed below.

Chief Counsel Gary Cohen
Deputy Chief Counsel Connie Perry
45 Fremont Street 23rd Floor
San Francisco CA 94105

Staff Counsel Darrel Woo
300 Capitol Mall 17th Floor
Sacramento CA 95814

In addition, any party seeking judicial review of the Insurance Commissioner's decision shall lodge copies of the writ of administrative mandamus and the final judicial decision and order on the writ of administrative mandamus with the Administrative Hearing Bureau of the California Department of Insurance.

Date: November 1, 2004

John Garamendi
Insurance Commissioner

By: _____
JANICE E. KERR
Special Counsel

DEPARTMENT OF INSURANCE
ADMINISTRATIVE HEARING BUREAU
45 Fremont Street, 22nd Floor
San Francisco, CA 94105
Telephone: (415) 538-4102
FAX: (415) 904-5854

BEFORE THE INSURANCE COMMISSIONER

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	
STAFF RESOURCES, INC.,	)	
	)	
Appellant,	)	FILE AHB-WCA-03-54
	)	
From the Decision of	)	
	)	
STATE COMPENSATION INSURANCE FUND,	)	
	)	
	)	
Respondent.	)	
	)	

PROPOSED DECISION

Introduction

Appellant, Staff Resources, Inc. ("SRI") is a California corporation engaged in business as a Professional Employer Organization ("PEO").[1] Pursuant to Insurance Code section 11737(f), SRI appeals a decision by State Compensation Insurance Fund (SCIF) to directly issue

[1] In June 2002, the National Association of Insurance Commissioners ("NAIC") released its report on Employee Leasing and Professional Employer Organizations ("NAIC White Paper".) The NAIC White Paper defined a PEO as a type of employment services outsourcing arrangement that provides various long-term employee services to an employer ("client") pursuant to a contract under which the PEO and client enter into a co-employment relationship. (Exhibit 83, p. 0472.) The National Association of Professional Employer Organizations' ("NAPEO") website defines a PEO as "a company which contractually assumes and manages critical human resource and personnel responsibilities and employer risks for its small to mid-sized businesses by establishing and maintaining an employer relationship with worksite employees." (Exhibit 93, p. 0665.)

workers' compensation policies for the 2003 policy period to SRI's clients instead of issuing a policy to cover SRI and its clients in SRI's name. The Workers' Compensation Insurance Rating Bureau of California ("WCIRB")[2] joins in the appeal because it pertains to how data is reported to the WCIRB pursuant to the California Workers' Compensation Experience Rating Plan – 1995 ("ERP").[3]

As explained more fully below, SCIF's decision to issue separate policies only in the name of SRI's clients for the 2003 policy year is contrary to current law; therefore SRI's appeal is well-taken. The Administrative Law Judge recommends, however, that the WCIRB conduct a comprehensive analysis of California's employee outsourcing businesses that includes input from SCIF and the insurance industry, employers and the general public.

Parties' Contentions

SRI and the WCIRB contend that SCIF's decision in this case is contrary to various provisions of the ERP and precedential decisions of the Insurance Commissioner that regulate how loss experience is to be reported under policies covering employee leasing arrangements. SRI and the WCIRB contend that SRI is a labor contractor involved in an employee leasing operation and as such, SRI is the employer of its own administrative staff and of the employees it leases to its clients. As a general rule, SRI and the WCIRB claim the ERP requires that the workers' compensation policy covering SRI's employees at its own and at its client's worksites be issued in the name of SRI so that the WCIRB can consider the experience of all of SRI's

---

[2] 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 workers' compensation insurance classification and experience rating systems.

[3] The provisions of the ERP constitute duly adopted regulations promulgated by the California Insurance Commissioner (Cal. Code of Regs., title 10, §2353). The ERP's rules have the same force and effect as statutes. (*Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 10; *Agricultural Labor Relations Bd. v. Superior Court* (1976) 16 Cal. 3d 392, 401.) The 2003 edition of the ERP is applicable to this appeal because the policies at issue incepted in 2003 and all references, unless otherwise stated, are to the 2003 edition of the ERP.

employees in developing SRI's experience modification. SRI and the WCIRB note that Section V, Rule 4 of the ERP creates an exception to this general rule and mandates that SRI's experience-rated clients, who come within this exception, be provided workers' compensation insurance under separate policies so that these clients retain their own experience modification, but, these separate policies still must name SRI as the insured. (SRI's Post Hearing Reply Brief, pp. 5-6; WCIRB Post-Hearing Reply Brief, pp. 2-4.)

SCIF contends that SRI is not involved in an employee leasing arrangement with its clients but rather is an administrative co-employer without control of the employees' work. According to SCIF, an employee leasing arrangement should be narrowly defined to encompass only those situations in which the client terminates its workers' employment, transfers them to a labor contractor who becomes the workers' sole employer and who then leases the workers back to the client for a fee. This interpretation, SCIF asserts, is in keeping with the definition of "employee leasing" found in Section V, Rule 4 of the ERP.

In essence, SCIF argues that the employee outsourcing industry has evolved since the ERP rules governing labor lease contractors were created in the mid 1980's such that many in the industry, like SRI, are not engaged in employee leasing at all. SCIF claims that the WCIRB's and SRI's overly expansive view of employee leasing is contrary to the statutory purposes of experience rating as it: (1) allows the combination of experience from multiple worksites to form one experience modification; (2) permits certain employers from ever developing their own experience modification; (3) allows clients to avoid an experience modification by switching PEOs; and (4) permits an entity to obtain a potentially favorable experience modification the moment it signs on with a PEO even though it never terminates its employees or changes its worksite conditions. (SCIF's Post Hearing Memorandum, pp. 1-2.)

Proceedings

The appeal was filed on September 16, 2003. In several status conferences and a hearing on various discovery and *in limine* motions, the nature and scope of the issues in dispute were defined. The issues were identified as follows: (1) Is SRI's appeal properly brought pursuant to Insurance Code section 11737(f)?; (2) To what extent, if any, is Section V, Rule 4 of the ERP applicable to SRI?; (3) Is State Fund's decision with respect to how it underwrote SRI's 2003 workers' compensation policy contrary to Section V, Rule 4 of the ERP?

SRI's claims for breach of contract, bad faith and damages were not litigated at hearing. The Commissioner does not have subject matter jurisdiction to determine these issues or to award damages in this administrative hearing.

SRI's appeal and subsequent briefs argue that State Fund's January 2003 and July 2003 rate filings are not lawful, but that challenge is not properly brought under Insurance Code § 11737(f) and also is not before the Commissioner in this matter. The application of the rate system is at issue here. SCIF originally claimed SRI's appeal was not properly brought under Insurance Code section 11737(f). However, during the evidentiary hearing, the parties stipulated that SRI is an aggrieved party for purposes of this appeal.

SCIF claims that Section V, Rule 4 of the ERP is in violation of Insurance Code sections 11736 and 11778 to the extent it limits State Fund's underwriting authority. However, the ALJ did not allow discovery or evidence on this issue. SCIF was allowed to present an offer of proof on whether the ERP regulations limited SCIF's underwriting authority and the parties were allowed to argue this issue in their post-hearing briefs.[4]

---

[4] SCIF's proffered testimony would indicate that when entering into a relationship with a labor contractor or a PEO, the client receives the experience modification of the labor contractor even though there has been no change in the workplace conditions. Additionally, there is nothing that further ties that client to the labor contractor thereafter. SCIF argues that this is contrary to Insurance Code §11736 that mandates that the rating plan shall provide adequate

Another PEO sought to file an amicus brief, but permission to file was not granted.

A three-day evidentiary hearing on the limited issues was conducted before Administrative Law Judge Marjorie Rasmussen in the San Francisco hearing room of the Administrative Hearing Bureau. At the hearing, SRI was represented by Dennis R. Murphy, Esq. and Mary Farrell Taylor, Esq. of Murphy Austin Adams Schoenfeld LLP. The WCIRB was represented by John N. Frye, Esq. of the Law Offices of John N. Frye and Brenda Keys, Esq. of the WCIRB. SCIF was represented by Ivor E. Samson, Esq., Sean McEneaney, Esq., and John Finston, Esq. of Sonnenschein, Nath & Rosenthal.

Following the evidentiary hearing, Judge Rasmussen ordered SRI and the WCIRB to respond to additional questions in writing under oath. This further testimony was admitted into evidence and the parties subsequently filed post-hearing briefs. As noted above, both parties briefed issues beyond those identified in the Pre-Hearing Order. The record was closed on August 12, 2004, and the matter was submitted for a decision.

Statement of Issues

Based on the testimony and the arguments the parties submitted in their respective briefs, the issues previously identified during the status conferences are more accurately stated at decision point as follows:

1. Is SRI a labor contractor covered under the provisions of the ERP and the Commissioner's precedential decisions?
2. With respect to the 2003 policy period, did SCIF comply with the provisions of the ERP and the Commissioner's precedential decisions when SCIF issued

---

incentives for loss prevention and premium differential so as to encourage safety. Further, in having to name the labor contractor as the insured, there is the potential that State Fund will be writing a policy for an out of state "person" which is contrary to Insurance Code §11778. (TR, p. 686-687.)

individual policies to SRI's experience-rated and non-experience-rated clients that indicated the client as the named insured instead of SRI?

Findings of Fact

The parties do not dispute the following relevant facts related to SRI's operations, only whether these facts prove that SRI is a labor contractor involved in an employee leasing arrangement under the ERP.

SRI's Operations

Since 1974, SRI has offered employers a human resource management service program that includes payroll, risk and benefit management services. SRI also has a division called Employer Concepts that provides human resource services to employers that do not provide health benefits to their employees. (Reporter's Transcript (RT), p. 30.) SRI markets its services to employers through various advertising mediums. (Exhibits 84-92.) Once an employer decides it wants the services offered by SRI, the employer fills out a questionnaire that provides SRI with the company's background and credit information. If Mr. Ahlswede, the founder of SRI, decides that the employer is a suitable client for SRI, a "Subscription Service Agreement" is offered to the employer. (RT, pp. 32-36; Exhibits 30 and 117)

The subscription service agreement constitutes a complete description of the rights and obligations of SRI and its clients.[5] (RT, p.250.) The contract states that SRI and the client "shall be co-employers of the personnel, ("Personnel" or "Employees") provided by SRI to Client." SRI becomes the administrative or "General Employer" and the client becomes the work-site or

[5] Appellant offered Exhibits 30 and 117 as typical contracts in use during the time at issue and they were admitted as such. (RT, pp. 43-44.) Additionally, Exhibits 18-25, and 29 also were admitted into evidence as examples of subscription service agreements used by SRI. While these contracts are similar to Exhibits 30 and 117, they were entered into prior to the 2003 policy year at issue and the ALJ does not reference them in the decision except to note that Exhibit 20 contains a unique clause that gives the employee jointly employed by SRI and its client the option of becoming the employee solely of SRI or the client upon termination of the subscription service agreement. (Exhibit 20, p. 0101.) This clause does not appear in Exhibit 30 or 117.

"Special Employer" under applicable California and federal law. (Exhibit 30, p. 0189; Exhibit 117, p. 117-1.) The client must identify in writing which of its workers will be covered under the subscription service agreement with SRI. (Exhibit 30, p. 0189; Exhibit 117, p. 117-1.) SRI does not become general employer of any personnel until the employee completes a hire form and the client pays the initial invoice covering the employee. (Exhibit 101; Exhibit 30, p. 0189.)

While SRI holds no ownership interest in the client's business, under the contract, SRI is responsible for completing various administrative functions, including the administration of all payroll, withholding and employee benefits for the employees covered under the contract. Specifically, this includes the payment of personnel from SRI's own accounts, the withholding of income and payroll taxes, the payment of unemployment insurance taxes and state disability insurance contribution, all payroll tax reports and deposits and the acquisition of and payment for workers' compensation insurance. (Declaration of Kent Ahlswede, dated March 22, 2004, p. 2; Exhibit 30, pp. 0190-0192; Exhibits 100-103; Exhibits 105-111; Exhibit 117, p. 117-2.)

The client's responsibilities include the on-site management of the employees, the discharge of any fiduciary responsibility or compliance with any applicable licensure, regulatory, or statutory requirements and workplace safety. (Exhibit 30, p. 0191; Exhibit 117, p. 117-1 - 117-3; RT, pp. 183-184.) The client retains the right to interview prospective employees but its right to hire or fire employees is subject to SRI's approval. By the same token, the client sets the employees' pay rates and benefits packages and provides the funds from which SRI draws to pay the employees' wages, benefits and taxes. (Exhibit 30, p. 0191; Exhibit 117; RT p. 151-153, 185-186, 190-191, 256.) SRI and the client are both liable for employment-related lawsuits filed by the employees covered by the subscription service agreement. (TR, p. 120; Exhibit 30, p. 0193; Exhibit 117, p. 117-2.)

The subscription service agreement may be terminated for cause or by either party at any time by giving 30 days written notice. However, the parties to the contract must comply with its terms through the date of the termination and the client has the responsibility of keeping all personnel time records and benefit information for specified periods of time after the agreement is terminated. (Exhibit 30, p. 0194-0196, Exhibit 113; Exhibit 117, p. 117-3.) While the testimony was unclear as to whether SRI continues to be the employer of the terminated client's workers, the contract terms indicate that SRI's ends its co-employment relationship with the employees assigned to its client when the contract with the client is terminated.[6]

Attached to the subscription service agreement and made part of the contract are exhibits designating the benefits and fee schedule. (Exhibit 117, p. 117-5 – 117-6.) The fee schedule is discussed with the client and will vary depending on the types of services and benefits requested by the client. However, SRI does not tell the client what it pays SCIF for workers' compensation coverage. Instead, SRI bills the non-experienced-rated and experience-rated client for this insurance at the rate that "it would cost them if they had a separate policy with State Fund." (RT, pp. 274- 275.)

Types of Policies Covering Employee Leasing Arrangements

The WCIRB collects loss data for purposes of calculating an employer's experience modification. The WCIRB tracks the payroll and losses of each employer by reference to the named insured on each workers' compensation insurance policy. When a labor contractor enters into an employee leasing arrangement with an experience-rated client, the insurance carrier issues a separate insurance policy to the experience-rated client listing the labor contractor as the named insured. (RT, p. 588.) Insurance carriers have more options on how they may issue

[6] *See also*, Exhibit 93, "In the event a PEO relationship is terminated, the co-employees will cease to work for the PEO but will continue as employees of the client."

policies when the labor contractor enters into an employee leasing arrangement with a non-experience-rated client. In this instance, an insurer may issue a master policy to the labor contractor that covers all of the leased employees of its non-experience-rated clients or the insurer may issue individual policies to each of the non-experience-rated clients with an endorsement listing the labor contractor as the named insured. (RT, pp. 601-602.) From the WCIRB's perspective, it is easier to process the loss data generated under a master policy because the WCIRB has only one policy to review whereas the WCIRB must process each of the individually written policies should the insurer elect the second option. An insurer may elect to issue separate policies to each of the labor contractor's clients, while naming the labor contractor as the named insured, in order to keep better track of the types of risks it is insuring. However, the loss data developed under each of these separate policies ultimately must be reported to the WCIRB to calculate the labor contractor's experience modification. (RT, pp. 600-606.)

Thus, the WCIRB is able to track the loss data generated by the labor contractor's administrative staff and the leased employees of its non-experience-rated clients because the labor contractor is listed as the named insured on the policy covering this risk. If the WCIRB receives loss data for a non-experience-rated client but the policy covering that client does not list the labor contractor as the named insured, the WCIRB is unable to correlate that data to the labor contractor's loss history or use that data to calculate the labor contractor's experience modification. (RT, pp. 618-619.)

The Commissioner has approved four standard policy endorsement forms to be used for policies covering employee leasing arrangements although insurance carriers may use their own endorsement forms when issuing such policies. Two of the forms are endorsements for policies covering leasing arrangements between labor contractors and non-experienced-rated clients and

two of the forms are endorsements for policies covering leasing arrangements between labor contractors and experienced-rated clients. (RT, p. 586-587, 596; Exhibit 68, pp. 0369-0374.)

Discussion

The ERP and a precedential decision of the Commissioner each require that workers' compensation insurance policies covering employee leasing arrangements be written in the name of the labor contractor rather than in the name of the individual clients of the labor contractor. This requirement applies whether the client is experience-rated or not.

The General Rule

Pursuant to Section III, Rule 3 of the ERP:

> "The entire California workers' compensation insurance experience of a risk (except as hereinafter provided) developed under any policy which provides California workers' compensation insurance coverage for all or a part of the risk's operations and which incepts within the experience period shall be reported and used in determining its experience modification."

Section II, Rule 13 of the ERP defines the term "risk" as:

> "All insured operations of any entity within California and, if two or more entities are combinable for experience rating purposes in accordance with Section IV, Rule 2, all operations of such entities within California, regardless of whether such operations or any part of them are insured by one or several insurers."

Section II, Rule 6 of the ERP defines an "entity" as follows:

> "An individual, joint venture, partnership, limited liability partnership, corporation, limited liability company, unincorporated association or fiduciary operation (e.g. trust, receivership or estate of deceased individual)."

A labor contractor that is a corporation qualifies as an entity under the ERP's definition and its risks include all of its clients' operations for which it provides employees. Thus, the general rule would mandate that the labor contractor's experience modification be based on the

loss experience of its own administrative staff and the workers leased to its clients, except in those situations that fall within the Employee Leasing Rule exception of the ERP.

The Employee Leasing Rule

When an experience-rated client enters into an employee leasing arrangement, an exception to the general rule may be triggered. This exception is set forth in Section V, Rule 4 of the ERP which states:

> **"4. Application of Experience Modification to Policies Covering Employee Leasing Arrangements.** If an experience-rated entity enters into an employee leasing arrangement pursuant to which (a) the employment of a majority of employees of the experience-rated entity is or was transferred to one or more labor contractors and (b) the services of the employees or other individuals thereafter are provided to the entity, then a separate policy must be written for each such experience-rated entity and the experience modification of the entity will apply to the coverage for the labor contractor's liability to provide workers' compensation benefits for the workers leased to the entity. In addition, the experience reported in connection with the coverage for the labor contractor's liability to provide workers' compensation benefits for the workers leased to the entity shall be used in the future experience ratings of the entity entering into the employee leasing arrangement. The experience reported in connection with the coverage for the labor contractor's liability to provide workers' compensation benefits for the workers leased to the entity shall not be used in the future experience ratings of the labor contractor.
>
> As used in this Rule, "Employee Leasing" shall mean an arrangement whereby an entity utilizes the services of a third party to provide its workers for a fee or other compensation. The third party providing employee-leasing services shall be referred to as a "labor contractor". The entity receiving the services shall be referred to as a "client".
>
> The separate policy shall contain the name of the labor contractor as the named insured; however, the experience modification applicable to the client shall apply to the separate policy. The separate policy shall be endorsed with the client's name and address, as well as an indication that the policy covers an employee leasing arrangement." (Emphasis added.)

Therefore, a separate policy must be issued in the name of the labor contractor for each client that meets the requirements under the exception of Section V, Rule 4. In this situation, the loss experience of the workers providing services to the experience-rated client will apply to the

separate policy covering the experience-rated client and will not be included in the calculation of the labor contractor's experience modification. This exception to the general rule was promulgated so that an experienced-rated client would not be able to avoid an experience modification by entering into employee leasing arrangement. (Exhibits 1-9.)

Is SRI A Labor Contractor Engaged In Employee Leasing?

Based on the applicable law and facts of this case, the answer to this question is yes. The Commissioner has indirectly addressed the definitional question in a challenge to the ERP's employee leasing provisions similar to the appeal here, *In the Matter of the Appeal of Par Excellence, Inc.* (ALB WCA-92-4 October 10, 1994.) In *Par Excellence*, the appellant was assumed to be a labor contractor. Par Excellence, Inc. wanted its loss experience for purposes of calculating its experience modification to be limited to that developed by its own corporate staff. The Commissioner upheld the WCIRB's decision that the payroll and losses of this labor contractor's non-experience -rated clients were correctly combined with the loss experience of the entity's own corporate staff and temporary employees to determine its experience modification.

In *Par Excellence* the appellant was described as "a personnel agency that, in addition to other services, provides temporary employees, leased staff and personnel administration to various clients." (*Id.*, p. 4.) The employee leasing arrangement that Par Excellence Inc. used is described as follows:

> "In an employee or staff leasing arrangement, Appellant enters into a contractual agreement in which Appellant becomes a co-employer of all or a part of a client's workforce. Under the arrangement, Appellant becomes the employer of record for tax and payroll purposes, and payroll is reported under one federal and state tax ID number. The Appellant pays federal and state taxes, unemployment insurance and workers' compensation insurance premiums, and sums due for other mandated benefits. Each of these costs are ultimately billed to and paid for by the client, which retains all management control over the day-to-day work

performed by the employees. The Appellant holds no ownership interest in the business of a client." (*Id.*, p. 4.)

While noting that neither the Commissioner's regulations nor the Insurance Code provided a definition of an "employer" that would help in determining the issues on appeal, the Commissioner in *Par Excellence* concluded that Insurance Code section 11663 acknowledged a dual employer arrangement between a general and special employer. Applying this statute to the facts on appeal, the Commissioner in *Par Excellence* further concludes that the appellant was a general employer and its clients were special employers. The Commissioner holds that the labor contractor, as the payroll employer, is "the employer for purposes of the application of the workers' compensation law generally, and the Experience Rating Plan specifically." (*Id.* p. 8.) The Commissioner further holds that since the labor contractor is the entity (corporation) within the definition of the ERP, its insured operations at any place where corporate staff, temporary staff, or leased staff are located constitute the risks contemplated by the ERP. "The client businesses, even though they are co-employers, are not considered individual risks within the meaning of the experience rating plan." (*Id.* pp. 8-10.)

Accordingly, because SRI under its subscription service agreements "hires" employees and is the payroll employer of its clients' leased employees, it is "the employer for purposes of the application of the workers' compensation law generally, and the Experience Rating Plan specifically." (*Id.* p. 8.) SCIF policies covering SRI's experience-rated and non-experience-rated clients for the 2003 policy period, therefore, should list SRI as the named insured rather than the individual clients as SCIF has done. Because the ALJ concludes that SRI is a labor contractor under the ERP and the precedential decisions of the Commissioner, SCIF's arguments regarding underwriting need not be addressed.

SCIF contends however, that *Par Excellence* is inapplicable here because the factual question of whether Par Excellence Personnel, Inc. was involved in employee leasing was not at issue and the decision did not analyze whether the clients/employers were involved in an employee leasing arrangement. Thus, the question of whether there was a "transfer" or "change" in employer status was not addressed in *Par Excellence*. (SCIF Post Hearing Memorandum, p. 25-26.)

Moreover, SCIF contends that the employee leasing provisions do not apply to SRI because SRI is not engaged in employee leasing arrangements as evidenced by the following facts: (1) SRI's clients are involved in identifying, interviewing and hiring employees; (2) SRI contractually provides services rather than employees to its clients; (3) SRI's clients set the rate of employee compensation and provide the funds from which SRI draws to cover the salary of benefits on the employees; (4) SRI's clients are responsible for maintaining employee time records and benefits after the subscription agreement is terminated; (5) SRI and the client are both named as parties to any employment-related lawsuits; and (6) SRI is not an owner of the client's business and has no control over workplace safety at the clients' place of business. According to SCIF, the foregoing facts demonstrate that while the clients may have transferred the title of "employer of record," to SRI, the clients have not transferred their employees to SRI and had them leased back. (SCIF Post Hearing Memorandum, p. 25.)

Claiming that *Par Excellence* is inapplicable to this appeal, SCIF narrowly defines an employee leasing arrangement. According to SCIF, the employee leasing arrangement is defined in Section V, Rule 4 of the ERP. This rule contemplates a break in the employment relationship between the client and its employees after which the labor contractor leases back the employees to the client for a fee or other compensation. Without this break in the employment relationship,

Section V, Rule 4 would not be necessary because the client would retain sufficient employer responsibility to qualify as an employer for workers' compensation purposes. (SCIF Post Hearing Memorandum, p. 4-7.)

SCIF's arguments and the evidence in support of its position are not persuasive. The Commissioner has defined employee leasing arrangements more broadly in *Par Excellence* by recognizing that a co-employment arrangement may exist in an employee leasing arrangement, such as exists in SRI's operations. The Commissioner has determined, then, that an entity may provide payroll and other administrative and human resource type services, like those provided by SRI, in exchange for fees that cover the amount of employee payroll and other administrative costs and be considered a labor contractor. Furthermore, whether a labor contractor, such as SRI, retains some or all control over certain personnel functions is not relevant to a determination of whether an employee leasing arrangement exists. In *The Appeal of Leastaff, Inc. et al.*, File no ALB-WCA-95-20 (March 10, 1999) the Commissioner noted that the concept of control was expressly removed from the employee leasing rules when the new rules were promulgated in 1990. (*Leastaff*, pp. 6-7.)

SCIF argues however, that an expansive interpretation of *Par Excellence* would be contrary to the goals of the ERP on several grounds: (1) labor contractors that develop a favorable experience modification could market that experience modification to non-experience-rated employers who would derive the benefit of a lower rate over similarly-situated employers not in an employee leasing arrangement and even though no change in workplace safety has occurred; (2) non-experience-rated employers would be able to switch experience modification simply by switching leasing companies; and (3) non-experience-rated employers could avoid ever developing an experience modification by remaining in a employee leasing arrangement.

There is no evidence in the record on appeal that indicates any such subterfuge has been committed in the underlying matter. While SCIF's concerns have merit, the WCIRB correctly observes in its reply brief that SCIF should raise these policy arguments and seek revision of the ERP at a public hearing at which time the Commissioner, in his regulatory capacity, may consider whether to, and, if so, how to revise the ERP. Revisions to the ERP are not appropriately made in an adjudicatory proceeding involving a dispute between one insurer and one insured. SCIF is encouraged to write to the Commissioner in his quasi-legislative capacity and to the WCIRB requesting the revisions it seeks and explaining its reasons.

Furthermore, the Administrative Law Judge recommends that the WCIRB conduct a comprehensive analysis of California's employee outsourcing businesses that includes input from SCIF and the insurance industry, employers and the general public.[7] The study should support recommendations to the Commissioner concerning the definition of pertinent terms, such as "employee leasing arrangements" and ERP rules revisions with respect to how the loss experience associated with employee leasing arrangements are to be reported to the WCIRB and whether and/or to what extent insurers could use various policy frameworks to underwrite employee leasing arrangements.[8] Following the completion of the study and after reviewing the WCIRB's recommendations, the Commissioner will make a determination whether *Par Excellence Personnel, Inc. (*File No. ALB-WCA-92-4) should be removed from the list of decisions designated as precedential.

---

[7] The WCIRB last conducted a study of California's employee outsourcing businesses in 1997. (RT, p. 681)

[8] For example, the NAIC White Paper focused on the ramifications of using a "master policy" framework, which "is typically characterized by an insurer issuing a single policy covering the employees of all of the client employers, including the internal employees of the master policyholder." The study contrasted the master policy arrangement with the Multiple Coordinated Policies ("MCP") framework in which a single insurer issues a central policy for the employee leasing company with separate policies for each client company. The study noted that employment outsourcing companies have generally sought to obtain coverage through a master policy while the MCP approach raises fewer regulatory problems but more administrative burdens for insurers and employment services outsourcing companies. (Exhibit 83, p. 0472.)

Conclusion

Based on the evidence and applicable law, SRI is a labor contractor under the provisions of the ERP and the Commissioner's precedential decisions. SCIF's decision to issue separate policies to SRI's clients in their own names is contrary to the reporting rules of the ERP. SCIF's public policy concerns over the application of the ERP rules to evolving employee leasing arrangements/co-employer situations should be addressed at a public hearing on the rules rather than in this adjudicatory proceeding.

ORDER

1. SCIF shall rescind the individual policies it issued to SRI's experience-rated and non-experience-rated clients in the name of the individual clients for the 2003 policy period.
2. SCIF shall issue individual backdated policies for the 2003 policy period in SRI's name to each of SRI's experience-rated clients.
3. SCIF shall issue one or more backdated policies for the 2003 policy period in the name of SRI covering the employees who provide administrative services to SRI and those who provide services to SRI's non-experience-rated clients.
4. The WCIRB is directed to conduct a comprehensive analysis of California's employee outsourcing industry to determine whether the ERP rules governing these entities need to be revised and shall consult with SCIF on this issue. The WCIRB shall report its findings and recommendations to the Commissioner prior to the September 2005 public workers' compensation insurance pure premium hearing.

* * *

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

Dated: September 9, 2004

MARJORIE A. RASMUSSEN
Administrative Law Judge
California Department of Insurance

DEPARTMENT OF INSURANCE
ADMINISTRATIVE HEARING BUREAU
45 Fremont Street, 22nd Floor
San Francisco, CA 94105
Telephone: (415) 538-4102
FAX: (415) 904-5854

ORIGINAL

BEFORE THE INSURANCE COMMISSIONER

OF THE STATE OF CALIFORNIA

FILED

DEC 9 2004

ADMINISTRATIVE HEARING BUREAU

In the Matter of the Appeal of **STAFF RESOURCES, INC.,** Appellant, From the Decision of **STATE COMPENSATION INSURANCE FUND,** Respondent.	FILE AHB-WCA-03-54

AMENDMENT TO ORDER ADOPTING PROPOSED DECISION ON RECONSIDERATION AND ORDER DESIGNATING DECISION AS PRECEDENTIAL

By Order dated November 1, 2004, the Insurance Commissioner adopted the proposed decision in the Matter of the Appeal of Staff Resources, Inc. subject to the amendment of proposed ordering paragraph 4. On November 16, 2004, State Compensation Insurance Fund ("State Fund") timely filed a motion for reconsideration of part of the Order adopting the proposed decision. No responses to the motion for reconsideration were filed.

Having duly considered the moving papers in support of State Fund's motion for reconsideration and for good cause shown, the Insurance Commissioner grants State Fund's motion and modifies the November 1, 2004, Order as follows:

IT IS HEREBY ORDERED that the November 1, 2004, Order adopting the proposed decision of Administrative Law Judge Marjorie A. Rasmussen is further amended as follows:

1. The proposed ordering paragraph 1 is amended accordingly: "SCIF shall reform the individual polices it issued to SRI's experience-rated and non-experience rated-clients in the name of the individual clients for the 2003 policy period by changing the named insured under said policies to 'Staff Resources, Inc.' SRI shall be responsible for the payment of premium under the reformed policies consistent with applicable law and the California Workers' Compensation Insurance Experience Rating Plan but shall be given credit for amounts already collected and retained by State Fund under said policies for those employees co-employed with SRI. Paragraphs 2 and 3 of this Order are to be interpreted consistent with this revision."

2. Pursuant to Government Code section 11425.60, I hereby designate the decision with both amended Orders as precedential.

3. The duties of the parties as set forth in the ordering paragraph number 4 of the decision as amended shall not be impacted by this Order making the decision precedential.

4. The stay issued on November 29, 2004, extending the effective date of the decision until December 30, 2004, is lifted. This Order shall be effective December 8, 2004.

DATED: December 8, 2004

John Garamendi
Insurance Commissioner

By: _____
RICHARD D. BAUM
Chief Deputy Commissioner