



California Workers' Compensation Institute
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VIA E-MAIL

Carrie Nevans, Acting Administrative Director
Maureen Gray, Regulations Coordinator
Department of Industrial Relations
Division of Workers' Compensation, Legal Unit
P.O. Box 420603
San Francisco, CA 94142

Re: Labor Code Section 5814.6 – Administrative Audits and Penalties
Second 15-day Comment Period

Dear Mesdames Nevans and Gray:

These comments on the Labor Code Section 5814.6 Administrative Penalties regulations are presented on behalf of the members of the California Workers' Compensation Institute. Recommended modifications are indicated by underline and ~~strikethrough~~.

Proposed Regulation -- 10225.1(a) – 5-Year Period

(a) Administrative penalties shall only be imposed under this section based on violations of Labor Code section 5814, after more than one penalty awards ~~have~~ been issued by a workers' compensation administrative law judge on or after June 1, 2004 based on conduct occurring on or after April 19, 2004 for unreasonable delay or refusal to pay compensation within a five year time period. The five year period of time shall begin on the date of issuance of any penalty award not previously subject to an administrative penalty assessment pursuant to Labor Code section 5814.6.

Discussion

In previous commentary, the Institute recommended that this regulation, in order to be consistent with and not in conflict with the statute, should state:

10225.1(a): Administrative penalties shall only be imposed under this section ~~based on~~ when an employer or insurer has knowingly violated Labor Code section 5814, after ~~more than one~~ penalty awards have been issued by a workers' compensation administrative law judge for unreasonable delay or refusal to pay compensation with a frequency that indicates a general business practice.

In the same comments, the Institute argued that only a percentage standard that considered the ratio between the number of claims managed by the audit subject and the number of section 5814 penalty awards against it could meet the statutory provisions.

A Standard of Near Perfection

Under proposed section 10225.1(a), to be considered a “clean” operation and avoid scrutiny under section 5814.6, a claims administrator could have no more than one 5814 penalty award assessed within a 5-year period, regardless of its size or the number of covered injured workers. Such a standard of perfection is unreasonable and unattainable. It demonstrates either a profound inexperience with or indifference to the real world complexities of workers’ compensation claim management. It is simply not possible to manage a case load of workers’ compensation claims in the state of California to that level of perfection.

More importantly, that is not what Labor Code section 5814.6 mandates.

For the section 5814.6 penalty to apply, the statute requires that an employer or insurer “knowingly violates Section 5814 with a frequency that indicates a general business practice.” The Division defines a knowing violation as imputed corporate knowledge. The regulation establishes that “a frequency that indicates a general business practice” is “more than one” penalty award. Now, the time period to consider these sorts of violations is to be a rolling 5-year period.

The gulf between the authority of the enabling statute and the implementing regulations has only increased.

The plain language of the statute indicates that the section 5814.6 penalty exists in order to sanction employers and insurers who have incurred penalty awards for so many violations of Labor Code section 5814 as to indicate a general business practice of the unreasonable denial or delay in the payment of workers’ compensation benefits. The current claims audit program, under Labor Code section 129 and 129.5, also recognizes that in all human endeavors of this type, a certain margin of error is reasonable and proper (See: Title 8, CCR, section 10107.1(c)(3)(B) & (C)). In these proposed regulation, there is no margin of error. Every payment must be made perfectly or you will be exposed to the largest penalty available in the system.

Proportionality

The regulations give no consideration to the number of files managed by a claims organization. By its constrained definition of a general business practice, the Division failed to address a key element of the statute – the frequency of section 5814 penalty awards. As we have previously expressed, we believe that the Division has exceeded the scope of the statute and expanded the number of claims administrators potentially exposed to section 5814.6 penalties, which it has no authority to do.

The Ripple Effect of Deterrence

Authority

Government Code section 11342.2 provides:

Whenever by the express or implied terms of any statute a state agency has authority to adopt regulations to implement, interpret, make specific or otherwise carry out the provisions of the statute, no regulation adopted is valid or effective unless consistent and not in conflict with the statute and reasonably necessary to effectuate the purpose of the statute.

The penalty standard proposed in these regulations -- “not more than one section 5814 penalty within a 5-year period” – would have a chilling effect on otherwise permissible claim management activities across the board and is, therefore, in conflict with the statute. The art of crafting proper penalty regulations is to balance the desired deterrent effect with sufficient latitude, so that the penalties do not impede claim management activities mandated or permitted by statute. Administrative regulations that alter or amend the statute or enlarge or impair its scope are void, and courts not only may, but it is their obligation to strike down such regulations. Morris v. Williams (1967) 63 CR 689, 67 C2d 733, 433 P.2d 697.

Section 10225.1(a) is not fairly balanced. The regulation imposes such a high standard that potential liability for the 5814.6 penalty will affect every aspect of the claims management. Yet, the law requires claims administrators (and they owe a duty to their policyholders) to stop excessive and unnecessary medical care, to report and investigate fraud by medical care providers and injured workers, to prevent the payment of excessive temporary disability payments, and to ensure that permanent disability is appropriately assessed and paid.

If the standard by which the claims administrators will be judged is “not more than one section 5814 penalty within a 5-year period”, then the administrative director is determining not only how workers’ compensation claims will be managed, but also whether the claims organization can afford to risk using the tools provided by the statutes at all. Policyholders and system stakeholders expect workers’ compensation claims to be managed and payments to be appropriate – not excessive or beyond what the law requires, not too little or too late.

One can assume that the 5814.6 penalty and the implementing regulations are intended to deter incompetent, under-staffed, and ill-trained claims organizations that negligently process payments and treatment requests. But the by-product of that deterrence, when the standard is near-perfection, is that in order to avoid potentially significant penalties, all claims administrators must be more tentative and cautious.

It is not sufficient for the AD to determine the scope of the enforcement scheme by ad hoc policies decisions made outside the regulations. In order to avoid the chilling effect on permissible claims activity, the regulation must determine the proper balance, must clearly state the criteria for adherence to the statute, and must establish a reasonable and fair application, or the regulations are too intrusive on the authority of the statute.

Clarity

Government Code section 11349(c): "Clarity" means written or displayed so that the meaning of regulations will be easily understood by those persons directly affected by them. Under CCR, Title 1, section 16(a), a regulation shall be presumed not to have complied with the clarity standard if:

- The regulation can, on its face, be reasonably and logically interpreted to have more than one meaning and the varying interpretations cannot be harmonized by settled rules of construction;
- The regulation uses language incorrectly. This includes, but is not limited, to incorrect spelling, grammar or punctuation.

Discussion

An important purpose of the Administrative Procedures Act is to ensure that the rules and regulations adopted by state agencies are easy to understand. In establishing the clarity standard, the Legislature made the following finding (Government Code section 11340(b)):

"The language of many regulations is frequently unclear and unnecessarily complex, even when the complicated and technical nature of the subject matter is taken into account. The language is often confusing to the persons who must comply with the regulations..."

The Institute believes that the proposed regulation, section 10225.1(a), includes both defects: the regulation can be reasonably interpreted to have more than one meaning and its structure creates this confusion. This is particularly the case for the 5-year period.

It is difficult to determine whether the 5-year period is a fixed period or a rolling period. If Company A incurs two 5814 penalty awards in January 2005 and 3 more in August of 2005, one interpretation of the proposed regulation is that an investigation can be initiated in January and concluded with a section 5814.6 penalty award. Then the process would begin again in August, resulting in a new section 5814.6 penalty. Taking this interpretation to the extreme, this could happen on a weekly or daily basis.

Another interpretation suggests that claims administrators would be audited over a 5-year period and any and all penalty awards would be assessed in a single section 5814.6 penalty.

Or, a claims administrator that managed 8700 files and receives two qualifying awards within a 5-year period could have a section 5814.6 penalty imposed in the same manner as a claims organization that managed 400 files and has had 27 section 5814 penalties imposed on them.

Structurally, with regard to the first sentence in section 10225.1(a), there appear to be 4 or 5 prepositional phrases, some of which modify the subject of the sentence (administrative penalties), and some of which modify the verb (shall be imposed). The meaning of the sentence could be clarified if these related phrases were in proximity to the phrase they modify. If the Division cannot restructure the sentence, then it should use additional sentences or language to clarify the point.

Thank you for your consideration. Please contact me for further clarification or if I can be of any other assistance.

Sincerely,

Michael McClain
General Counsel and Vice President

MMc/pm

cc: Ms. Destie Overpeck
CWCI Medical Care Committee
CWCI Claims Committee
CWCI Legal Committee
CWCI Associate Members