



California Workers' Compensation Institute
1111 Broadway, Suite 2350, Oakland, CA 94607 • Tel: (510) 251-9470 • Fax: (510) 251-9485
Website: www.cwci.org

October 4, 2005

VIA E-MAIL

Andrea Hoch, Administrative Director
Bob Walensa, Audit Manager
Department of Industrial Relations
Division of Workers' Compensation
1515 Clay Street, 17th Floor
Oakland, CA 94612

RE: Labor Code Section 5814.6 – Administrative Audits and Penalties

Dear Ms. Hoch and Mr. Walensa:

Introduction

Labor Code Section 5814.6 became effective on June 1, 2004. It states:

(a) Any employer or insurer that knowingly violates Section 5814 with a frequency that indicates a general business practice is liable for administrative penalties of not to exceed four hundred thousand dollars (\$400,000). Penalty payments shall be imposed by the administrative director and deposited into the Return-to-Work Fund established pursuant to Section 139.48.

(b) The administrative director may impose a penalty under either this section or subdivision (e) of Section 129.5.

(c) This section shall become operative on June 1, 2004.

Section 5814.6 imposes an entirely new administrative penalty with the highest upper end limit in the Labor Code. It is the most significant monetary enforcement device available to the administrative director (AD). The conduct on which this penalty is based is equally as significant: knowing violations of Section 5814 “with a frequency that indicates a general business practice” of the employer or insurer. Just as the regulations cannot diminish or enhance the upper limit of the monetary penalty, neither can the regulations alter the level of conduct required by the statute in order to assess the penalty.

Knowingly Violates: A knowing violation of a statute requires scienter: knowledge of the nature of one's act or omission, the intent to engage in particular conduct, an intent to deceive, manipulate, or defraud. The AD's definition of "knowingly" (section 10225 (o)) relates only to knowledge imputed to a corporate entity. In so limiting the regulation, the definition eliminates an essential statutory requirement. If, in interpreting the enabling statute, the court determines that the administrative action in question has, in effect, altered or amended statute or enlarged or impaired its scope, then it must be declared void. Association for Retarded Citizens v. Department of Developmental Services (1985) 211 CR 758, 38 C3d 384, 696 P2d 150. The AD's regulation must clearly define "a knowing violation" in terms of scienter or the regulation will fail to implement an essential element of the statute, create ambiguity and confusion among the regulated community, and result in needless litigation.

A General Business Practice: One of the ways that the Legislature chose to enforce the obligations of the workers' compensation system is through monetary penalties. There are "automatic" penalties that are imposed without litigation (section 4650(d)), penalties for the unreasonable delay or denial of benefits (section 5814), and specific penalties imposed after the audit (sections 129 and 129.5). All of these penalties are based on particular enforcement philosophies and have distinct rationales. Labor Code section 5814.6, too, is based on a specific enforcement philosophy and has a distinct rationale. From the plain language of the statute, the 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.

A Single Administrative Penalty: The statute imposes a single administrative penalty, not to exceed \$400,000. Subsection (b) allows the AD to impose "a penalty" under either section 5814.6 or section 129.5(e). The section 5814.6 penalty is capped at \$400,000, based on a company's business practice of unreasonable denial or delay in the payment of any workers' compensation benefits. Section 5814.6 does not authorize multiple penalties, each capped at \$400,000, each for a different pattern of penalties for separate benefit payments.

Employer or Insurer: The statutory sanction applies to an "employer or an insurer", so that the business practice being scrutinized must be fairly attributed to the employer's or insurer's entire business operation. The regulations, therefore, must make it clear that in order to assess a section 5814.6 penalty, the finding of a general business practice must be based on the activities of the entire entity, not just a branch, an office, or an adjusting location.

Section 10225 – Definitions

Recommendation: 10225(b) -- Award

Award – means a Findings and Award, Stipulation with Request for Award, Stipulation and Award and/or Order, or a Stipulation and Order, by which a party is entitled to payment of ~~compensation or payment of~~ penalties under section 5814 of the Labor Code.

Comment: This language should be deleted because the assessment of administrative penalties under section 5814.6 is concerned only with the award of section 5814 penalties, not the payment of compensation.

Recommendation: Add: 10225(*) – Definition of Employer

“Employer” means a self-insured employer or a group of self-insured employers pursuant to Labor Code section 3700(b) and as defined by Title 8, California Code of Regulations, section 15201(s), a legally uninsured employer, a joint powers authority, or the state.

Comment: While the statute applies this administrative penalty only to employers or insurers, the regulation defines an insurer but not an employer. For clarity and consistency, the statutory term “employer” should be specifically defined in the regulations.

Recommendation: 10225(k) -- Indemnity

Indemnity - means payments made directly to an eligible person as a result of a work injury and as required under Division 4 of the Labor Code, ~~including but not limited to temporary disability indemnity, salary continuation, permanent disability indemnity, vocational rehabilitation temporary disability indemnity, vocational rehabilitation maintenance allowance, and death benefits,~~

Comment: For consistency, the definition of indemnity should be the same as any other regulatory definition. This definition could also be accomplished with a citation to other regulations defining the term.

Comment: 10225(j) -- General Business Practice: It must be clear from the regulation that a penalty under section 5814.6 cannot be applied for a single violation of section 5814 no matter how egregious the conduct. It must be clear that to be sanctionable, the conduct in question must be committed with the requisite frequency, that the penalties awarded arise from separate, discrete acts or omissions, and that they arise from a habit, custom, usage, or business policy of the employer or insurer.

Subsection (j) as written is not a clear translation of the statutory authority. Rather the regulation implies that an audit subject can be penalized for the conduct of a single claims administrator within a single file at one claims office for an insurer or employer.

The statute plainly applies only to a general business practice of an employer or insurer, so that, viewing the conduct as a whole, the auditor is able to conclude that the practice or practices are sufficiently pervasive or sufficiently authorized by the employer or insurer that the conduct can be considered a "general business practice" of the employer or insurer, as opposed to the proclivities and/or the independent actions of a single employee that is contrary to the claims administrator's established policies or completely at odds with the conduct of other claims administrators in the same location. While the audit findings of a single adjusting location may be sufficient to support a section 5814.6 penalty, the regulation must be clear that the penalty cannot be imposed against one office location or branch but must be attributable to the employer or insurer.

Comment: 10225(o) -- Knowingly: The definition of "knowingly" has removed the concept of scienter entirely and erroneously equates imputed knowledge with intentional misconduct. The regulation states clearly that the penalty must be based on a pattern of proven violations of section 5814 penalties. The penalty is assessed against the employer or insurer for its practice of knowingly violating section 5814. A finding of multiple awards of 5814 penalties, alone, does not meet the statutory criterion for the 5814.6 penalty, yet the proposed regulation seems to indicate that it would.

Section 5814 penalties are assessed for the unreasonable delay or denial of benefit payments. An unreasonable delay penalty can be based on intentional misconduct, inadvertence, mistakes, and/or simple negligence. The conduct underlying the section 5814.6 penalty is at the opposite end of the spectrum – a pattern of knowing violations that constitutes a general business practice of the employer or insurer – and the regulation should clearly reflect that more stringent statutory criteria.

Recommendation: 10225.1(a) – Standard: Multiple Awards of 5814 Penalties

Administrative penalties shall only be imposed under this section based on violations of Labor Code section 5814, ~~after one or more~~ when multiple awards has 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.

Comment: Labor Code Section 5814.6 calls for the imposition of administrative penalties for "violates Section 5814 with a frequency that indicates a general business practice". The standard proposed by the regulation, "one or more awards", inappropriately alters the statutory standard.

Recommendation: 10225.1(g)(8) – Other Violations:

(8) \$1,000 for any other ~~finding~~ awards issued by a Workers' Compensation Administrative Law Judge pursuant to Labor Code section 5814 not otherwise specified in this section.

Comment The phrase, "...any other finding by a Workers' Compensation Administrative Law Judge pursuant to Labor Code section 5814 ..." seems to be unique to this subsection. Subsection (a) states that all penalties must be based on awards issued by a workers' compensation administrative law judge and that refers to the entire penalty schedule. For consistency, this section should reference "awards issued by a workers' compensation administrative law judge".

Thank you for the opportunity to participate in these discussions prior to official rulemaking. I think the informal comment period has been very useful. Please advise, if I can be of any other assistance.

Sincerely,

Michael McClain
Vice President & General Counsel

MMc/ws

cc: CWCI Legal Committee
CWCI Claims Committee
CWCI Medical Care Committee
CWCI Associate Members
CWCI Industry Affairs Committee