



California Workers' Compensation Institute
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VIA E-MAIL

Carrie Nevans, Acting 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. Nevans 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 increase 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: The statute, by its terms, proscribes intentional misconduct committed with such a frequency as to constitute a company business practice or policy. As drafted, the proposed regulation permits the application of this penalty for negligence, inadvertent errors, and other lesser forms of misconduct that are penalized by a matrix of related penalties set out in the Labor Code. If the AD misdirects the section 5814.6 penalty, then there will be duplicate penalties imposed for the same conduct.

To establish a knowing violation of section 5814, an auditor must be able to provide evidence of 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, which may be required, but fails to apply the statutory standard of intent. In so limiting the regulation, the definition eliminates an essential statutory requirement. If, in interpreting the enabling statute, the administrative agency 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 by applying multiple layers of penalties for the same acts, and will result in needless litigation over the intent and application of section 5814.6.

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.

The appropriate application of a section 5814.6 penalty, therefore, requires an auditor to establish conduct equivalent to "a general business practice" or a company policy of unreasonable denial of delay in the payment of workers' compensation benefits. Proposed regulation 10225(j) continues to rely on a numerical indicator, changing from a single claim to a standard of "more than one" (meaning two). Finding "more than one" violation is too simplistic to accomplish the task set out by the Legislature in section 5814.6.

The work of the auditor under the plain meaning of the statute is more difficult and rightfully so in that the potential penalty is the largest administrative penalty permitted under the Labor Code. The regulation must define not just a pattern of conduct, which might reasonably be done with a numerical standard, but a pattern of conduct performed "with a frequency that indicates a general business practice." Establishing a pattern of intentional misconduct that constitutes a general business practice involves the consideration of the size of the employer or insurer, the scope of the conduct (whether it was isolated or pervasive), the awareness and involvement of company management, and other factors that will be unique to each review.

The regulation must reflect all of these elements to meet the mandate of the statutory scheme set forth in section 5814.6.

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, a claims administrator, or an adjusting location.

Section 10225 – Definitions

Recommendation: 10225(b) -- Award

(b) Award of compensation – means: 1) a Findings and Award; 2) a Stipulation with Request for Award; ~~3) an Order Approving Compromise and Release; 3) 4) a Stipulation and Award and/or Order; or 4) 5) a Stipulation and Order, by which a party is entitled to payment of compensation, or the party is entitled to payment of penalties under section 5814 of the Labor Code.~~

Delete newly added subsection (p). ~~(p) Penalty Award—means an order or award by a Workers’ Compensation Administrative Law Judge to pay penalties due to a violation of section 5814 of the Labor Code.~~

Reference to “penalty award” throughout section 10225.1 should be deleted and replaced with “award”.

Comment: The statute proscribes violations of Labor Code Section 5814, which imposed penalties when the payment of benefits has been “unreasonably delayed or refused”. Such a penalty cannot exist until a WCALJ makes a finding that a payment was unreasonably denied or delayed and issues an award. The recommended definition of award covers all the possible vehicles for awarding section 5814 penalties.

The compromise and release is a contractual resolution of one party’s rights and another party’s potential liability. Prior to the inclusion of the assessment of penalties in an award, the assertion of penalty is a mere allegation. Even if a compromise and release were specifically and solely addressing the issue of conduct in violation of section 5814, the resolution of that dispute by compromise and release precludes an admission of liability, eliminates the supporting finding by the WCALJ, and cannot, therefore, become the basis of a section 5814.6 penalty.

The inclusion of orders approving compromise and release in determining whether to assess any section 5814.6 penalty is beyond the authority of the AD.

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: See: Comments above.

Comment: 10225(o) -- Knowingly: See: Comments above.

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

(a) Administrative penalties shall only be imposed under this section based on violations of Labor Code section 5814, ~~after one or more~~ when multiple penalty 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, “after one or more”, inappropriately alters the statutory standard.

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

(8) \$1,000 for any other ~~penalty award 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 penalty award 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