

ORIGINAL

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12 **SUPERIOR COURT OF THE STATE OF CALIFORNIA**
13 **COUNTY OF LOS ANGELES, STANLEY MOSK COURTHOUSE**

14 MICHAEL REYNOLDS ENTERPRISE,
15 INC. DBA REYNOLDS TERMITE
16 CONTROL, individually and on behalf of
17 all others similarly situated,

18 Plaintiff,
19 vs.

20 STATE COMPENSATION
21 INSURANCE FUND, a public
22 enterprise fund; and DOES 1 through 50,
23 inclusive,

24 Defendants.

Case No. **19STCV05738**

CLASS ACTION

COMPLAINT FOR:

1. BREACH OF CONTRACT;
2. UNFAIR COMPETITION IN VIOLATION OF BUSINESS & PROFESSIONS CODE SECTION 17200 ET SEQ.; AND
3. CONCEALMENT

[C.C.P. § 425.10]

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1 Plaintiff Michael Reynolds Enterprise, Inc. dba Reynolds Termite Control (“Reynolds
2 Termite Control”), individually and on behalf of all others similarly situated (collectively
3 referred to as “Plaintiffs” or “Class Members”) allege against defendants State Compensation
4 Insurance Fund (“SCIF”) and Does 1 through 50, inclusive, as follows:

5 **INTRODUCTION**

6 1. This lawsuit is a class action brought on behalf of the Class Members who are
7 comprised of all SCIF insureds whose premium was calculated using a tier modifier greater than
8 1.00.

9 2. On November 16, 2018, the California Insurance Commissioner issued a
10 decision concluding as a matter of law that SCIF used an unlawful and unenforceable tier
11 modifier to calculate an insured’s premium for an insured’s policies effective December 2, 2015
12 to December 2, 2016, and December 2, 2016 to December 2, 2017. The tier modifiers SCIF
13 used for the policies were 1.5 and 1.2, respectively, thereby increasing the insured’s premium
14 by 50 and 20 percent, respectively. The Insurance Commissioner ordered SCIF to recalculate
15 the insured’s premium without applying the unlawful tier modifiers.

16 3. The decision, known as *In the Matter of the Appeal of A-Brite Blind & Drapery*
17 *Cleaning* (“A-Brite”) (Cal. Ins. Comm’r, November 16, 2018) AHB-WCA-17-26, is attached as
18 Exhibit “A.”

19 4. Upon information and belief, SCIF has used the same or similar tier modifiers to
20 calculate the premium of its insureds since 2013, and continues to do so to this day.

21 5. Plaintiffs seek restitution, injunctive relief and damages arising from SCIF’s use
22 of tier modifiers greater than 1.00 to calculate its insureds’ premiums, from the date SCIF first
23 used the same or similarly derived tier modifiers described in *A-Brite* to the present.

24 **THE PARTIES**

25 6. Reynolds Termite Control, is, and at all times relevant to this action was, a
26 corporation organized and existing under the laws of the State of California, and qualified to do
27 business in the State of California.

28 ///

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1 14. Upon information and belief, beginning in or about March 2013, SCIF began
2 using the aforementioned tier modifier as one of the modifiers that comprised its “rating plan
3 modifier.” SCIF continues to use a tier modifier as a component of its rating plan modifier.

4 15. SCIF uses the rating plan modifier (of which the tier modifier is a component),
5 as well as two other modifiers, in the calculation of the premium of its insureds. By way of
6 example, an insured may have employees whose rate for their classification code is \$5 per \$100
7 in payroll, or 5%. If that employer has \$1,000,000 in payroll for those employees, its base
8 premium would be \$50,000. Three modifiers are then applied to the base premium, each of
9 which can either increase, decrease, or have no effect on the premium. These are the (1)
10 experience modification, (2) premium discount modifier, and (3) rating plan modifier. Each is
11 expressed as a percentage that is applied in multiplicative fashion to the base premium.

12 16. For example, if the experience modification is 1.2 (120%), the premium discount
13 modifier is .9 (90%), and the rating plan modifier is 1.8 (180%), the resulting final premium
14 would be \$97,200 ($\$50,000 \times 1.2 \times .9 \times 1.8$). This class action only involves the tier modifier
15 component of rating plan modifier.

16 17. As detailed in the *A-Brite* decision, SCIF used and continues to use a secret tier
17 modifier formula that it failed to disclose, and for which it never obtained approval from the
18 California Department of Insurance (“CDI”) as required by law.

19 18. According to the Insurance Commissioner’s decision in *A-Brite*, SCIF never
20 published the algorithm that it used to determine tier modifiers for its insureds. Nor did SCIF
21 make publicly available the algorithm for any of its insureds to view. SCIF never included the
22 algorithm in the rate filings that it filed with the CDI. It never submitted the algorithm for
23 approval by the CDI, and the CDI never approved it.

24 19. SCIF used and continues to use tier modifiers greater than 1.00 for some of its
25 insureds, thereby causing an increase in premium that would not have occurred but for the use
26 of these unapproved tier modifiers.

27 20. In *A-Brite*, the Insurance Commissioner ordered SCIF to recalculate A-Brite’s
28 premium by removing tier modifiers greater than 1.00. The Insurance Commissioner found that

1 the use of the unlawful tier modifiers resulted in an additional \$8,805 in premium that A-Brite
2 had to pay to SCIF.

3 21. Reynolds Termite Control received a 1.50 tier modifier for its SCIF policy
4 effective January 1, 2015 to January 1, 2016, and it paid premium to SCIF based on SCIF's use
5 of that tier modifier. Upon information and belief, the use of the 1.50 tier modifier artificially
6 increased the premium of Reynolds Termite Control by \$22,871.83.

7 22. Reynolds Termite Control received a 1.10 tier modifier for its SCIF policy
8 effective January 1, 2017 to January 1, 2018, and it paid premium to SCIF based on SCIF's use
9 of that tier modifier. Upon information and belief, the use of the 1.10 tier modifier artificially
10 increased the premium of Reynolds Termite Control by \$4,556.57.

11 23. Upon information and belief, many other insureds, possibly numbering in the
12 many thousands, received tier modifiers greater than 1.00, thereby causing an increase in their
13 premium compared to what they would have paid without the tier modifier.

14 **CLASS ACTION ALLEGATIONS**

15 24. Reynolds Termite Control brings this action as a class action on behalf of the
16 following defined class:

17 All SCIF insureds whose workers' compensation insurance premium was
18 calculated using a tier modifier greater than 1.00.

19 25. Upon information and belief, the class consists of anywhere from hundreds to
20 thousands of current and former SCIF insureds. Due to this large number of potential class
21 members who have been harmed by SCIF's conduct, joinder of all potential class members into
22 one action would be impractical if not impossible. Only by bringing this action as a class action
23 can the interests of all Plaintiffs be economically tried before this court.

24 26. The claims of Reynolds Termite Control are typical of the Class Members.
25 Reynolds Termite Control received a tier modifier of greater than 1.00 for one or more of its
26 policies and paid premium to SCIF based on SCIF's use of that tier modifier.

27 27. A class action is superior to other available methods for the fair and efficient
28 adjudication of this controversy.

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1 premium calculation that included a tier modifier greater than 1.00.

2 40. As found by the Insurance Commissioner, SCIF's use of a tier modifier greater
3 than 1.00 violated Insurance Code section 11735, which mandates all insurers to file all rates
4 and supplementary rate information, without exception, before using them in California. Under
5 Insurance Code section 11730, supplementary rate information includes any "minimum
6 premium, policy fee, rating rule, rating plan, and any other similar information needed to
7 determine applicable premium for an insured."

8 41. SCIF violated Insurance Code section 11735 by failing to file and disclose its tier
9 modifier algorithm, which would show why an insured would be placed in a certain tier that
10 increased its premium, as well as how that premium increase was derived and computed. This
11 violation constitutes an unlawful and unfair business act and practice within the meaning of
12 Business & Professions Code section 17200 et seq.

13 42. In addition, Insurance Code section 332 provides that each party to a contract of
14 insurance shall communicate to the other, in good faith, all facts within his knowledge which
15 are or which he believes to be material to the contract and as to which he makes no warranty,
16 and which the other has not the means of ascertaining. Insurance Code section 330 defines
17 concealment as neglect to communicate that which a party knows, and ought to communicate.
18 Insurance Code section 331 recognizes that concealment by a party is improper in the formation
19 of a contract of insurance.

20 43. SCIF's failure to disclose its tier modifier algorithm violated Insurance Code
21 sections 331 and 332, resulting in an unlawful and unfair business act and practice in violation
22 of Business & Professions Code section 17200 et seq.

23 44. Reynolds Termite Control and all other Class Member have suffered injury in
24 fact, and have lost money or property, as a result of this unlawful and unfair business act and
25 practice.

26 45. Pursuant to Business & Professions Code section 17200 et seq., Plaintiffs are
27 entitled to a permanent injunction for the benefit of the public enjoining SCIF from using a tier
28 modifier greater than 1.00 to calculate its insureds' premiums, unless and until SCIF obtains

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1 approval from the Insurance Commissioner for its use, and the algorithm or components of the
2 tier modifier are disclosed in a rate filing; to restitution of all premiums paid by the Class
3 Members that would not have been paid but for the use of tier modifiers greater than 1.00; and
4 to an award of attorney's fees pursuant to Code of Civil Procedure section 1021.5.

5 **THIRD CAUSE OF ACTION**

6 **(Concealment against Defendants SCIF and DOES 1 through 50)**

7 46. Reynolds Termite Control incorporates the preceding paragraphs of this
8 complaint.

9 47. Plaintiffs allege that a special relationship exists between an insured and insurer
10 akin to a fiduciary duty, and that, as reflected in the Insurance Code, an insurer is duty bound to
11 communicate to its insured, in good faith, all facts within the insurer's knowledge which are or
12 which the insurer believes to be material to the contract and as to which the insurer makes no
13 warranty, and which the insured has not the means of ascertaining. The insurer is also duty
14 bound to communicate that which the insurer knows, and ought to communicate. Failure to do
15 so is concealment, and it is improper for an insurer to engage in concealment in the formation of
16 an insurance contract.

17 48. SCIF had a duty to disclose to its insureds its tier modifier algorithm. SCIF
18 knew of how it determined its tier modifiers, which was material to the insurance contract. Its
19 insureds did not have the means of ascertaining this information, which SCIF purposely kept
20 secret.

21 49. Upon information and belief, SCIF concealed the tier modifier algorithm, with
22 the intent to derive more premium from the Class Members, while preventing Class Members
23 from being able to effectively question, challenge, or seek adjustment of the tier modifier.

24 50. Unaware of the basis for the tier modifier that was used to calculate the
25 premiums of the Class Members, each of the Class Members paid more in premium than they
26 would have but for the use of the tier modifier. Class Members would have behaved differently
27 had SCIF disclosed the basis for computing its tier modifier, or the fact that the California
28 Department of Insurance did not approve the use of its algorithm.

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EXHIBIT A

DEPARTMENT OF INSURANCE
EXECUTIVE OFFICE
300 Capitol Mall, 17th Floor
Sacramento, CA 95814
Tel. (916) 492-3500 Fax (916) 445-5280

**BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF CALIFORNIA**

In the Matter of the Appeal of)
)
A-BRITE BLIND & DRAPERY CLEANING,) FILE AHB-WCA-17-26
)
Appellant,)
)
From the Decision of the)
)
STATE COMPENSATION INSURANCE FUND,)
)
)
Respondent.)

DECISION

I. Introduction

A-Brite Blind & Drapery Cleaning (“Appellant”) brings this appeal against State Compensation Insurance Fund (“SCIF”) in connection with Appellant’s workers’ compensation policy (the “Policy”). The appeal concerns the annual policy periods beginning December 2, 2015 (the “2015 Period”), December 2, 2016 (the “2016 Period”), and December 2, 2017 (the “2017 Period”).

Appellant contends SCIF applied an incorrect rating plan modifier to the 2015 Period and 2016 Period, improperly calculated the premium discount modifier for all three periods, and miscalculated Appellant’s payroll for the 2015 Period. For the reasons discussed below, the

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Commissioner finds SCIF misapplied the rating plan modifier but correctly calculated the premium discount modifier. The Commissioner also finds Appellant failed to prove SCIF miscalculated the 2015 Period payroll.

II. Issues Presented

1. Did SCIF apply the correct rating plan modifier during the 2015 Period and 2016 Period, in accordance with SCIF's filings with the California Insurance Commissioner and applicable law?

2. Did SCIF apply the correct premium discount modifier to the Policy for the 2015 Period, the 2016 Period and the 2017 Period, in accordance with SCIF's filings with the Commissioner and applicable law?

3. Did SCIF miscalculate Appellant's payroll for the purposes of determining premium for the 2015 Period?

III. Procedural History

This appeal arises under Insurance Code section 11737, subdivision (f). Appellant initiated the proceedings on August 29, 2017, by filing an appeal from SCIF's July 25, 2017 decision concerning the rating plan modifier and premium discount modifier. On October 6, 2017, Appellant supplemented its appeal by filing copies of its correspondence with SCIF. The California Department of Insurance Administrative Hearing Bureau issued an Appeal Inception Notice on October 10, 2017. SCIF filed its response on October 24, 2017. The Workers' Compensation Insurance Rating Bureau of California ("WCIRB") also filed a response on October 30, 2017, electing not to actively participate in the appeal.

Administrative Law Judge ("ALJ") Clarke de Maignet conducted an evidentiary hearing

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in the California Department of Insurance's Los Angeles hearing room on January 16, 2018.¹ Kathleen Newman represented Appellant, and Stefan Janzen, Esq. represented SCIF at the hearing.

Kathleen Newman, one of Appellant's general partners, testified on Appellant's behalf. Keith Mills, an underwriting systems analyst at SCIF, and Marina Montoya, a senior payroll auditor at SCIF, both testified on SCIF's behalf.

The evidentiary record includes the foregoing testimony, SCIF's pre-filed Exhibits 201 through 218, and the ALJ's pre-filed Exhibits 1 and 2, all of which were admitted in evidence at the hearing. It also includes Exhibits 3, 101, 219, and 220, which were introduced and admitted at the hearing. Lastly, the evidentiary record includes Exhibit 102, which Appellant submitted on January 31, 2018 and the ALJ admitted on February 9, 2018. Upon order of the ALJ, certain personal information pertaining to Appellant's employees was redacted from Exhibits 3 and 102, and the unredacted pages were sealed in the administrative record.

At the ALJ's request, SCIF submitted a post-hearing brief on February 6, 2018. The ALJ closed the evidentiary record on February 9, 2018. On March 12, 2018, the ALJ reopened the record and ordered SCIF to provide additional post-hearing briefing and submit further evidence. SCIF filed the additional brief but refused to comply with the ALJ's order to submit the evidence.² The ALJ again closed the evidentiary record on March 23, 2018.

On June 15, 2018 a Proposed Decision was submitted to the Insurance Commissioner in this matter. On August 9, 2018, the Commissioner, pursuant to the provisions of 10 CCR

¹ These proceedings were conducted in accordance with California Code of Regulations, title 10, sections 2509.40 through 2509.78, and the administrative adjudication provisions of the California Administrative Procedure Act referenced in section 2509.57 of those regulations.

² The evidence at issue was SCIF's tiering algorithm and related calculations. See the discussion in part V(B)(3) below.

2509.69, chose not to adopt the proposed decision as his decision, but to decide the case upon the record.

IV. Factual Findings

The Commissioner makes the following findings of fact, based on a preponderance of the evidence in the record.

A. Appellant's Business

A-Brite Blind and Drapery Cleaning ("A-Brite") is a general partnership, whose partners include Kathleen Newman and her husband, Randall Newman.³ The Newmans are also the shareholders of a corporation named Firetect, Inc. ("Firetect").⁴ Ms. Newman is Firetect's president.⁵ The Newmans, as A-Brite's general partners, and Firetect are jointly insured as a single employer under the Policy.⁶

Appellant is in the business of cleaning residential and theatrical blinds and drapery, as well as treating drapery with fire retardant.⁷ The business is headquartered in Valencia, Los Angeles County, California, and has been in operation for 30 years.⁸

B. Appellant's Policy and Claims History

SCIF has provided workers' compensation insurance to Appellant for about the last 20 years.⁹ The Policy at issue in this case renewed on December 2, 2015, 2016 and 2017, the starting dates of the 2015 Period, 2016 Period, and 2017 Period, respectively.¹⁰ For those

³ Transcript of Proceedings on January 16, 2018 ("Tr.") at 25:10-26:3.

⁴ Tr. 26:18-25.

⁵ Tr. 27:22-23.

⁶ Evidentiary Hearing Exhibit ("Exh.") 208 at 208-1. Throughout this Proposed Decision, the term "Appellant" refers to A-Brite and Firetect jointly, except where otherwise required by the context.

⁷ Tr. 26:4-17.

⁸ Tr. 25:1-4.

⁹ Tr. 38:11-14; Exh. 219.

¹⁰ Tr. 10:3-18; Exh. 208 at 208-1; Exh. 218 at 218-1.

periods, Appellant dealt directly with SCIF and did not use an insurance broker.¹¹

During the 20 years it has been insured by SCIF, Appellant received a single workers' compensation claim.¹² That claim resulted from a bruise sustained by one of Appellant's employees on September 10, 2015.¹³ SCIF initially reserved \$24,000 to cover the estimated losses and expenses.¹⁴ However, the claim closed on November 6, 2015 with substantially lower total combined losses and expenses of \$819, which SCIF paid.¹⁵

C. Determination of Premium under the Policy

The Policy provides that Appellant's premiums are determined by SCIF's "manuals of rules, rates, rating plans and classifications."¹⁶ SCIF's manuals and rating plans include several modifiers, which affected Appellant's premium.¹⁷

1. Rating Plan Modifier

SCIF determined the premiums for the 2015 Period and 2016 Period in part based on a "rating plan modifier."¹⁸ SCIF applied the rating plan modifier to Appellant's "standard premium" to arrive at a "modified premium."¹⁹ The rating plan modifier resulted from multiplying four components, namely, (a) a "territory modifier," based on geographical area, (b) a "claims free" modifier, for policyholders with claims below a certain level, (c) a "direct placement" modifier for policyholders who deal with SCIF directly rather than through a

¹¹ Tr. 37:23-24, 38:5-7; Exh. 206; Exh. 215.

¹² Tr. 28:21-29:11; Exh. 3 at 3-3 through 3-6.

¹³ Exh. 201 at 201-1.

¹⁴ Exh. 1 at 1-40.

¹⁵ Tr. 65:8-9; Exh. 201 at 201-1.

¹⁶ Exh. 209 at 209-4 [Part Five, § A].

¹⁷ Exh. 1; Exh. 2.

¹⁸ Exh. 210 at 210-1; Exh. 218 at 218-2.

¹⁹ Exh. 212 at 212-1. In Appellant's case, standard premium is equal to base premium, which is calculated by multiplying Appellant's workers' compensation payroll in each employment classification by SCIF's base rate for the respective classification. (*Ibid.*)

broker, and (d) a "tier modifier," based on a rating tier assigned according to a "tier score" calculated using an algorithm.²⁰ These modifiers are typically expressed as numerical coefficients. For example, a modifier of 0.80 reduces premium by 20 percent, while a modifier of 1.20 increases it by 20 percent.

a. Territory Modifier

In the 2015 Period and 2016 Period, SCIF applied a territory modifier of 1.15 to the Policy²¹. SCIF's rate filings with the Commissioner included a 1.15 territory modifier for Los Angeles County, effective April 1, 2015.²²

b. Claims Free Modifier

During the 2015 Period, SCIF applied a 10 percent "claims free" credit to the Policy (*i.e.*, a modifier of 0.90).²³ For unclear reasons, SCIF did not apply the credit to the 2016 period.²⁴ Under SCIF's rate filings effective during those periods, the credit was applicable to policyholders continuously insured with SCIF who incurred no more than \$1,000 in workers' compensation claims during the three years preceding the policy period (or two years for policyholders with less than \$10,000 in annual base premium).²⁵

c. Direct Placement Modifier

SCIF applied a three percent "direct placement" credit (0.97 modifier) to the Policy

²⁰ Tr. 58:14-59:8. See also Tr. 15:3-17:18 regarding trade secret privilege claimed by SCIF in the algorithm.

²¹ Exh. 206 at 206-3; Exh. 215 at 215-3.

²² Exh. 1 at 1-9, 1-27.

²³ Exh. 206 at 206-3; Exh. 208 at 208-2.

²⁴ Exh. 215 at 215-3; Exh. 218 at 218-2.

²⁵ Exh. 1 at 1-4; Exh. 2 at 2-1.

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for both the 2015 Period and 2016 Period.²⁶ A 2011 SCIF rate filing with the Commissioner describes this three percent credit.²⁷

d. Rating Tier Modifier

SCIF assigns policyholders to various “rating tiers,” each with its own modifier.²⁸ SCIF assigns tiers based on “tier scores.”²⁹ Tier scores are calculated by SCIF using software it alternately refers to as the rating engine, tiering engine, scoring engine, or quote engine.³⁰ SCIF treats the tiering algorithm as a closely-guarded secret and does not allow it to be viewed by customers, members of the public, or even SCIF’s own underwriting staff.³¹ SCIF does not indicate tier scores on its policies, quotes or billing statements; nor does it provide customers with any calculations showing how the scores are calculated, even if customers specifically request that information.³² The algorithm is not included in any of SCIF’s rate filings with the Commissioner.³³

The algorithm takes into account the policyholder’s prospective estimated premium, payroll and number of employees.³⁴ It also factors in three years of the policyholder’s historical premium and loss data.³⁵ That data includes the frequency and number of workers’ compensation claims and whether those claims involved medical expenses or compensation for

²⁶ Exh. 206 at 206-3; Exh. 208 at 208-2; Exh. 215 at 215-3; Exh. 218 at 218-2.

²⁷ Exh. 1 at 1-1; Exh. 2 at 2-2.

²⁸ Tr. 56:10-17; Exh. 1 at 1-26; Exh. 2 at 2-27.

²⁹ Tr. 74:22-75:2.

³⁰ Tr. 62:24, 65:19-21; 74:20-25.

³¹ Tr. 14:22-17:18; Tr. 74:20-75:13; See also SCIF Letter to ALJ renewing objection, dated February 1, 2018.

³² Tr. 97:3-21, 101-3; 102-17; Exh. 101; Exh. 205; Exh. 208.

³³ See Exh. 1, Exh. 2.

³⁴ Tr. 57:8-11.

³⁵ Tr. 57:11-13, 83:10-19.

lost employee time or disability.³⁶

Each rating tier has an associated modifier.³⁷ Starting in 2013 and through the commencement of the 2015 Period, SCIF employed a rating framework with four tiers, A through D.³⁸ In the year preceding the 2015 Period, Appellant was assigned to Tier B, which at the time had a rating tier modifier of 0.951.³⁹

SCIF revised its tier rating framework for the 2015 Period.⁴⁰ Tier A received a modifier of 0.65. Tier B was assigned a modifier of 1.0. Tier C received a factor of 1.5, and tier D was assigned a modifier of 2.0.⁴¹

In the 2015 Period, Tier D applied to tier scores of at least 0.30092.⁴² Using its secret algorithm, SCIF initially calculated Appellant's tier score as 0.419525161.⁴³ Consequently, SCIF moved Appellant from Tier B to Tier D, thereby doubling Appellant's premium.⁴⁴ The tier score increase resulting in Appellant's move to Tier D was precipitated by the lone workers' compensation claim in 2015, for which SCIF initially reserved \$24,000 in estimated losses and expenses.⁴⁵ SCIF notified Appellant of the tier change and premium increase in a renewal quote dated October 5, 2015.⁴⁶ Nothing in the record or in SCIF's rate filings explains how Appellant's tier scores were calculated.

³⁶ Tr. 57:15-25.

³⁷ Tr. 56:10-17; 58:12-17; Exh. 1 at 1-26; Exh. 2 at 2-33, 2-34.

³⁸ Tr. 56:18; Exh. 1 at 1-26.

³⁹ Tr. 59:11-12.

⁴⁰ Tr. 59:21-24; Exh. 1 at 1-26.

⁴¹ *Ibid.*

⁴² *Ibid.*

⁴³ Exh. 1 at 1-39.

⁴⁴ Tr. 61:5-6.

⁴⁵ Tr. 61:5-64:10; Exh. 1 at 1-40.

⁴⁶ Exh. 205 at 205-3.

Appellant complained to SCIF about the increase,⁴⁷ which resulted in SCIF recalculating the tier score and reassigning Appellant to Tier C on January 25, 2016, with a tier modifier of 1.5.⁴⁸ The sole factor lowering Appellant's tier score from the Tier D range to the Tier C range was SCIF's entry into the scoring engine of \$819 in actual losses and expenses for the 2015 claim rather than the \$24,000 that was originally estimated.⁴⁹ In contrast, if Appellant had incurred no workers' compensation claims in the three years prior to the 2015 Period, SCIF would have assigned Appellant to Tier B with a modifier of 1.0.⁵⁰

Starting in the 2016 Period, SCIF increased the number of rating tiers to a numerical system ranging from four to seven.⁵¹ SCIF continued to maintain that its algorithm was confidential and did not include it in its rate filings with the Commissioner. For policyholders with standard premium between \$10,000 and \$25,000, the new Tier 3 had a modifier of 1.0, which would have no impact on premium. And Tier 4 had a factor of 1.2, which would increase standard premium by 20 percent.⁵² SCIF assigned Appellant to Tier 4 for the 2016 Period.⁵³ If Appellant had incurred no workers' compensation claims in the three prior years, SCIF would have assigned Appellant to Tier 3.⁵⁴

In other words, the lone \$819 claim in a 20-year period resulted in a 50 percent (or \$6,971) increase to Appellant's premium for the 2015 Period and a 20 percent (or estimated \$1,834) increase for the 2016 Period.⁵⁵

⁴⁷ Exh. 3 at 3-7.

⁴⁸ Tr. 33:12-23, 64:11-65:16; Exh. 3 at 3-30.

⁴⁹ Tr. 64:21-65:21; Exh. 1 at 1-36 through 1-41.

⁵⁰ Tr. 105:21-106:14.

⁵¹ Tr. 72:12-14; Exh. 2 at 2-27.

⁵² Tr. 93:6-14; Exh. 2 at 2-27.

⁵³ Tr. 72:7-11; Exh. 2 at 2-39.

⁵⁴ Tr. 106:15-107:3.

⁵⁵ Exh. 212 at 212-1; Exh. 215 at 215-3.

2. Premium Discount Modifier

Appellant's premiums for each of the 2015 Period, 2016 Period and 2017 Period were calculated in part using a "premium discount modifier."⁵⁶ That modifier applied a flat discount of 11.3% to all modified premium over \$5,000.⁵⁷ SCIF's 2011 rate filings with the Commissioner describe that discount.⁵⁸

D. Policy Audit

On March 27, 2017, SCIF conducted an audit for the 2015 Period.⁵⁹ The audit found Appellant's workers' compensation payroll was \$188,995. Based on that audit, SCIF determined that Appellant incurred a base premium of \$13,942.87, a modified premium of \$20,996.99,⁶⁰ a total premium of \$19,189.36,⁶¹ mandatory surcharges of \$629.83, and total charges of \$19,819.19.⁶²

V. Discussion

Appellant argues SCIF's rating plan modifiers and premium discount modifiers were incorrectly applied.⁶³ Appellant further contends SCIF miscalculated Appellant's 2015 Period payroll. SCIF argues all of the modifiers were valid and correctly applied.⁶⁴ SCIF also stands behind its audit and further asserts the Commissioner may lack jurisdiction to determine the payroll calculation issue.⁶⁵ For the reasons discussed below, the Commissioner finds that (1)

⁵⁶ Tr. 71:6-72:6; Exh. 210 at 210-1; Exh. 218 at 218-2.

⁵⁷ Tr. 71:6-16; Exh. 210 at 210-1; Exh. 218 at 218-2.

⁵⁸ Exh. 1 at 1-2, 1-3.

⁵⁹ Tr. 115:14-25; Exh. 211 at 211-1.

⁶⁰ Obtained by multiplying the base premium by a rating plan modifier of 1.50593. (Exh. 212 at 212-1.)

⁶¹ Obtained by multiplying the modified premium by a premium discount modifier of 0.91391. (*Ibid.*)

⁶² Obtained by adding the total premium and the mandatory surcharges. (*Id.* at 212-1, 212-2.)

⁶³ Appeal dated August 25, 2017 ("Appeal").

⁶⁴ SCIF's Response to the Appeal, dated October 18, 2017, at 3-4.

⁶⁵ Letter from SCIF to the ALJ, dated February 9, 2018.

the Commissioner has jurisdiction over all issues in this appeal, (2) SCIF misapplied the rating plan modifier, (3) SCIF correctly applied the premium discount modifier, and (4) Appellant failed to meet its burden of proof to show SCIF miscalculated Appellant's payroll.

A. The Commissioner Has Jurisdiction over This Appeal

1. Applicable Law

a. The Statutory Rate Filing Scheme

California has an "open rating" workers' compensation regulatory system, in which each insurer sets its own rates and files them with the Commissioner. This framework is intended to curtail monopolistic and discriminatory pricing practices, ensure carriers charge rates adequate to cover their losses and expenses, and provide public access to rate information so that employers may find coverage at the best competitive rates.⁶⁶

Insurance Code section 11735 lays out the statutory filing requirements. Subdivision (a) of that section provides in part, "Every insurer shall file with the commissioner all rates and supplementary rate information that are to be used in this state. The rates and supplementary rate information shall be filed not later than 30 days prior to the effective date." The term "rate" means "the cost of insurance per exposure base unit," subject to certain limitations.⁶⁷ And "supplementary rate information" means "any manual or plan of rates, classification system, rating schedule, minimum premium, policy fee, rating rule, rating plan, and any other similar information needed to determine the applicable premium for an insured."⁶⁸

b. Jurisdiction over Private Party Appeals

Insurance Code section 11737, subdivision (f), confers jurisdiction on the

⁶⁶ See generally Ins. Code §§ 11730-11742.

⁶⁷ Ins. Code § 11730, subd. (g). Rates exclude the application of individual risk variations based on loss or expense considerations, as well as minimum premiums.

⁶⁸ Ins. Code § 11730, subd. (j).

Commissioner to hear and decide private party appeals concerning the application of insurers' section 11735 filings. Specifically, the statute provides in pertinent part:

Every insurer... shall provide within this state reasonable means whereby any person aggrieved by the application of its filings may be heard by the insurer... on written request to review the manner in which the rating system has been applied in connection with the insurance afforded or offered. ... Any party affected by the action of the insurer... on the request may appeal... to the commissioner, who after a hearing ... may affirm, modify, or reverse that action.

2. Analysis

Appellant asserts SCIF failed to correctly apply the rates and supplementary rate information filed under Insurance Code section 11735. Specifically, Appellant contends SCIF misapplied its filed rating plan modifiers and premium discount modifiers to SCIF's filed rates. Appellant further contends SCIF miscalculated Appellant's 2015 Period payroll. If true, that would result in the application of SCIF's filed rates to the wrong exposure level. Appellant requested that SCIF remedy these issues. SCIF rejected that request, and Appellant timely filed this appeal.⁶⁹ Because the issues on appeal concern the manner in which SCIF applied its rating system to the Policy, the Commissioner has jurisdiction under Insurance Code section 11737, subdivision (f).

B. Use of the Tier Modifier Resulted in a Misapplication of SCIF's Filed Rates.

SCIF's rating plan modifier consists of four components, one of which is the tier

⁶⁹ See Cal. Code Regs., tit. 10, § 2509.46 ["An appeal is timely if it is filed either within 30 days after rejection of a Complaint and Request for Action or rejection of review thereof . . ."]. California Code of Regulations, title 10, section 2509.42, subdivision (q) provides in part, "Service by first class mail . . . is complete at the time of deposit with the carrier, but any . . . right or duty to do any act or make any response within any prescribed period of notice . . . shall be extended for a period of five days." SCIF mailed its rejection of Appellant's complaint and request for action on July 25, 2017 (See Appeal). Appellant filed this appeal within the 35 day window on August 29, 2017. (*Ibid.*)

modifier. For the reasons discussed below, the tier modifier is an improper adjustment to SCIF's filed rates.

1. SCIF Misapplied its Filed Rates Due to its Use of an Unfiled Tiering Algorithm.

SCIF uses a proprietary algorithm to calculate the tier modifier. SCIF contends it is not legally required to file the algorithm with the Commissioner, and that use of the unfiled algorithm to determine Appellant's premium was lawful. The Commissioner disagrees.

a. Applicable Law

Insurance Code section 11735, subdivision (a), requires insurers to file all rates and supplementary rate information, without exception, before using them in California. The term "supplementary rate information" includes any "minimum premium, policy fee, rating rule, rating plan, and any other similar *information needed to determine the applicable premium for an insured.*"⁷⁰ "[M]oney paid by an insured to an insurer for coverage constitutes premium regardless of its name."⁷¹ Thus, any information necessary to determine amounts owed by an insured to its insurer is supplementary rate information. If SCIF wished to apply its Tiering algorithm to Appellant's rate, it was required to file the algorithm and allow it to be subject to public inspection under Insurance Code section 11735.

Insurers may only charge premium in accordance with their filed rates and supplementary rate information.⁷² As the Commissioner determined in his precedential

⁷⁰ Ins. Code § 11730, subd. (j), emphasis added.

⁷¹ *In the Matter of the Appeal of Shasta Linen Supply, Inc.* (Cal. Ins. Comm'r, June 22, 2016, AHB-WCA-14-31) (*Shasta Linen*) at 48-49; see also *Troyk v. Farmers Group Inc.* (2009) 171 Cal.App.4th 1305, 1325 ["[I]nsurance premium includes not only the 'net premium,' or actuarial cost of the risk covered (i.e. expected amount of claims payments), but also the direct and indirect costs associated with providing that insurance coverage and any profit or additional assessment charged."]

⁷² Ins. Code § 11735, subd. (a); Ins. Code § 11730, subd. (j); See *Appeal of Gary E. Milne* (Cal. Ins. Comm'r Feb. 19, 1999, AHB-WCA-97-11) at 10 ["[I]nsurers do not have unrestricted discretion to set

decision *In the Matter of the Appeal of Shasta Linen Supply, Inc.*, an insurer's use of unfiled rates or supplementary rate information is unlawful.⁷³ That is true regardless of whether the Commissioner first disapproved the unfiled rates under Insurance Code section 11737.⁷⁴

b. Analysis

i. The Tiering Algorithm Constitutes Supplementary Rate Information.

SCIF determined Appellant's premiums for the 2015 Period and 2016 Period in part based on a "rating plan modifier"⁷⁵ that increased Appellant's premium.⁷⁶ The rating plan modifier resulted from multiplying four component modifiers, including a "tier modifier." Tier modifiers, in turn, are tied to "rating tiers" assigned to policyholders based on "tier scores" that SCIF calculates using an algorithm that SCIF claims is proprietary. The algorithm takes account of the policyholder's prospective estimated premium, payroll and number of employees,⁷⁷ as well as the policyholder's historical premium and loss data.⁷⁸ There is no way for the policyholder or anyone else to calculate a tier score without the algorithm. Without the tier score, it is impossible to determine which rating tier applies, and which tier modifier to assign the policyholder. Since a policyholder's base premium during the 2015 Period, for example, could have been reduced by as much 45 percent or increased by up to 100 percent

workers' compensation insurance rate levels under open rating. The open rating system contemplates competitive pricing consistent with the public interest in fair and adequate insurance."]

⁷³ *Shasta Linen* at 52. *Shasta Linen* was designated precedential under Gov. Code section 11425.60, subdivision (b).

⁷⁴ See *Ibid.*

⁷⁵ Exh. 210 at 210-1; Exh. 218 at 218-2.

⁷⁶ Exh. 212 at 212-1. In Appellant's case, standard premium is equal to base premium, which is calculated by multiplying Appellant's workers' compensation payroll in each USRP classification by SCIF's base rate for the respective classification. (*Ibid.*)

⁷⁷ Tr. 57:8-11.

⁷⁸ Tr. 57:11-13.

depending on the rating tier, it is not possible to determine premium without the algorithm.⁷⁹ Because the algorithm is a key component of the rate calculation, it constitutes “information needed to determine the applicable premium for an insured[,]” thereby satisfying the definition of “supplementary rate information” under Insurance Code section 11730, subdivision (j).⁸⁰

ii. SCIF’s Use of the Unfiled Algorithm Was Unlawful, Contravened Public Policy, and Misapplied SCIF’s Filed Rates.

Insurers must file all supplementary rate information under Insurance Code section 11735, subdivision (a), and under subdivision (b), which requires that information be publicly available. But SCIF withheld the algorithm—a critical piece of information that determines policyholders’ rates—based on its assertion that “any policyholder (or future policyholder) can potentially ‘game the system’ if the algorithm was known to them” and that other insurers “could, conceivably, use knowledge of the algorithm to gain a competitive advantage over State Fund[.]”⁸¹ SCIF’s position ignores the mandate of the statute and frustrates the public policy concerns behind it.

Among the policy aims of section 11735, two important goals of the public inspection provisions are to enable employers to obtain coverage at the best rates and to curtail monopolistic pricing practices.⁸² When rate information is transparent, policyholders are better able to compare coverage and reduce their costs. Transparency reduces the likelihood that

⁷⁹ Exh. 1 at 1-26.

⁸⁰ Without the algorithm, it is impossible for the Commissioner to determine whether the applied rates tend to create a monopoly in the market, are inadequate or unfairly discriminatory. (See Ins. Code §§ 11732, 11732.5, 11737, subd. (b), (c).)

⁸¹ Letter from State Fund to the ALJ, dated February 1, 2018, objecting to disclosure of the algorithm. In fact, SCIF violated the ALJ’s order to submit a copy of the algorithm in this appeal. (See SCIF’s Amended Objection to Order Vacating Evidentiary Ruling; Order to Disclose Tiering Algorithm, dated March 22, 2018 (“Obj. to Order to Disclose”).)

⁸² See generally Ins. Code §§ 11730-11742.

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insurers will gain a monopolistic advantage when all carriers' pricing information is public.

In furtherance of those aims, the Legislature passed Insurance Code section 11742 to mandate the establishment of an online rate comparison guide. Subdivision (a) of that section provides:

The Legislature finds and declares that the insolvencies of more than a dozen workers' compensation insurance carriers have seriously constricted the market and lead to a dangerous increase in business at the State Compensation Insurance Fund. Yet more than 200 insurance companies are still licensed to offer workers' compensation insurance in California. Unfortunately, many employers do not know which carriers are offering coverage, and it is both difficult and time consuming to try to get information on rates and coverages from competing insurance companies. A central information source would help employers find the required coverage at the best competitive rates.

When insurers use secret unfiled formulas to modify their filed rates, they directly frustrate the Legislature's intent behind the comparison guide and section 11735's public inspection provisions. Rate disclosure confers little value if the public does not have access to the formulas carriers use to modify their rates. Meaningful price comparison is simply impossible without those formulas.

By hiding its algorithm, SCIF obscured Appellant's looming premium increase until Appellant was in no position to avoid it. Appellant's witness testified, "I could not fathom what a negative monetary impact it would have on our small business to have a claim after over 20 years in business. One claim for \$819. ... When I received the final renewal for 2015, I was shocked."⁸³ If Appellant or its advisors had access to the algorithm, they could have determined in advance the claim's impact on premium and potentially mitigated the effects. At a minimum, Appellant would have had additional time to shop for a less expensive policy.

⁸³ Tr. at 29:8-25.

Insurance Code section 11735 and the legislative policy behind it required that SCIF file the algorithm as supplementary rate information. SCIF failed to do so, rendering its use of the unfiled algorithm unlawful. By effectively increasing SCIF's filed rates by 50 percent for the 2015 Period and 20 percent for the 2016 Period, SCIF's use of the algorithm resulted in the misapplication of those rates.

2. SCIF Wrongly Asserts it Complied with the Commissioner's Regulations, Thus Fulfilling the Statutory Filing Requirements.

SCIF argues it complied with the Commissioner's rate filing regulations and in so doing satisfied Insurance Code section 11735's filing requirements. Specifically, SCIF asserts that the Commissioner has authority under the regulations to determine what constitutes supplementary rate information. SCIF asserts that the Commissioner's acceptance of its rate filing without the tiering algorithm *ipso facto* constituted a determination that the algorithm was not supplementary rate information. Therefore, SCIF contends that the algorithm did not need to be filed under section 11735.⁸⁴ SCIF's interpretation of the rate filing process and regulations is wrong.

a. Applicable Law

In addition to complying with the statutory filing requirements under Insurance Code section 11735, workers' compensation insurers must file their rates in accordance with California Code of Regulations, title 10, sections 2509.30 *et seq.* Section 2509.32, subdivision (e), which provides:

A complete rate filing is one for which the insurer has completed the Filing Form and submitted all necessary attachments and exhibits. Necessary attachments and exhibits are those materials that, together with the Filing Form, are

⁸⁴ Obj. to Order to Disclose at 4-6.

sufficient to enable the Commissioner to determine the rates the insurer would charge its insureds. Unless the Commissioner notifies the insurer within 30 days of the filing date that its rate filing is incomplete, the rate filing will be considered complete.

b. Analysis

SCIF did not comply with the regulations, which broadly set forth the information that is required in an insurer's rate filing—insurers must file *all* information that is necessary to determine an insurer's rates, which would encompass SCIF's algorithm. The statute does not give the Commissioner the power to exclude information in violation of the statute's language that all such information must be filed.

The regulation provides further clarification of Insurance Code section 11735, subdivision (b)'s requirement that "[r]ates filed pursuant to this section shall be filed in the form and manner prescribed by the commissioner." Section 2509.32, subdivision (e), does not suggest that an insurer's failure to file supplemental information relieves it from its obligation to comply with statutory law; indeed, the regulation expressly mandates that insurers file information "sufficient to enable the Commissioner to determine the rates the insurer would charge its insureds." The regulation is consistent with the statute, which broadly defines the term "supplementary rate information" to include "minimum premium, policy fee, rating rule, rating plan, and any other similar information needed to determine the applicable premium for an insured." Indisputably, if SCIF intended to use the algorithm to modify its rates, the algorithm would be necessary to determine SCIF's rates. Since SCIF's algorithm falls squarely within the statutory and regulatory definitions, SCIF was required to file it. SCIF knew that its rate filing was not complete because SCIF knew the algorithm is necessary "to enable the Commissioner to determine the rates the insurer would charge its insureds." Section 2509.32(e) does not purport to allow insurers to

avoid the filing requirements that are specified in Insurance Code section 11735 under any circumstance. Rather, it provides the form and manner of compliance and reiterates the provisions in the statute.

SCIF cites no basis to support its assertion that it need not comply with statutory and regulatory law so long as the Commissioner accepted its filing as complete. SCIF seems to confuse the Commissioner's acceptance of its filing with the Commissioner's limited power to disapprove rates under certain narrowly-tailored circumstances, if he determines that the premiums charged, in the aggregate, would be inadequate to cover an insurer's losses and expenses, unfairly discriminatory, or tend to create a monopoly in the market.⁸⁵ While applicable law grants the Commissioner authority to reject a rate filing if an insurer fails to comply with the filing requirements or if the filing is incomplete,⁸⁶ the Commissioner lacks the authority to override a statutory mandate that insurers file all supplemental rate information. The Commissioner's determination that a filing is complete is a ministerial function to determine whether the paperwork includes the Filing Form, exhibits and attachments necessary to comprise a complete filing as defined in Title 10 California Code of Regulations section 2509.32(e). The Commissioner's acceptance of SCIF's rate filing as complete is not a substantive endorsement that SCIF has met its statutory obligation to file all of supplementary rate information that it uses to calculate an insured's premium, such as the unfiled algorithm. Whatever else may be said of the legal importance of an administrative action to deem a filing complete, the scope of such action cannot serve to protect formulae an insurer withholds from its filing, and then applies outside of the filing process to calculate a policyholder's applicable

⁸⁵ Ins. Code § 11737(b).

⁸⁶ Tit. 10, Cal. Code Regs. § 2509.32(c).

premium.⁸⁷

Moreover, SCIF's failure to file its algorithm undermined an additional purpose of the statute that required it to file its algorithm, preventing A-Brite's ability to access crucial information that greatly affected its workers' compensation insurance rates.

SCIF's argument also overlooks section 11735's important public policy consideration in requiring that pricing information be publicly available to assist employers shopping for coverage. Given this policy, as well as section 11730's broad definition of "supplementary rate information," and section 11735's express requirement that insurers file *all* of that information before using it, an insurer's failure to file such information would frustrate the public's statutory right to access that information. The Commissioner's acceptance of SCIF's rate filing as complete does not relieve SCIF from its responsibility to file its supplementary information as required by law. More to the point, SCIF's failure to file the supplementary information cannot inure to the prejudice of A-Brite. SCIF unlawfully misapplied its rates by modifying them with an unfiled algorithm. The Commissioner will not affirm its use of the unfiled algorithm to A-Brite's prejudice.

3. Trade Secret Privilege Did Not Exempt the Algorithm from Statutory Filing and Disclosure Requirements.

SCIF argues that even if the tiering algorithm is supplementary rate information, it remains protected from disclosure under the trade secret privilege.⁸⁸ Specifically, SCIF contends that because section 11735 does not expressly override the subsequently enacted

⁸⁷ (See, e.g., *State Compensation Ins. Fund v. Superior Court* (2001) 24 Cal.4th 930 [insurer's misallocation of expenses which were reported to WCIRB, thereby resulting in higher premiums for insured, is not conduct immune from civil liability]; accord *Donabedian v. Mercury Ins. Co.* (2004) 116 Cal.App.4th 968, 992-93 [11 Cal.Rptr.3d 45, 62] ["It is possible for an insurance carrier to file with the Department a rate filing and class plan that satisf[y] all of the ratemaking components of the regulations; and still result in a violation of the Insurance Code as applied." (emphasis in original)]; see also *MacKay v. Superior Court* (2010) 188 Cal.App.4th 1427, 1450 [115 Cal.Rptr.3d 893, 911], as modified (Oct. 20, 2010) ["...underlying conduct challenged was not the charging of an approved rate, but the application of an unapproved underwriting guideline..."].)

⁸⁸ Obj. to Order to Disclose at 6-8.

trade secret protections of Government Code section 6254, section 11735 does not require the filing and public disclosure of trade secrets. The Commissioner is not persuaded.

a. Applicable Law

Civil Code section 3426.1 defines a "trade secret" as information that "(1) [d]erives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and [(1)] (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."

Evidence Code section 1060 provides: "If he or his agent or employee claims the privilege, the owner of a trade secret has a privilege to refuse to disclose the secret, and to prevent another from disclosing it, if the allowance of the privilege will not tend to conceal fraud or otherwise work injustice." Like the rest of the Evidence Code, that section applies to court actions.⁸⁹ It has no applicability to administrative or other governmental proceedings unless expressly invoked by statute or regulation.⁹⁰

Government Code section 6254 exempts certain trade secrets from the disclosure requirements of the California Public Records Act.⁹¹ In particular, subdivision (ab) of that section states the act does not require disclosure of "[t]he following records of the State Compensation Insurance Fund:"

(3) Records related to the impressions, opinions, recommendations, meeting minutes of meetings or sessions that are lawfully closed to the public, research, work product, theories, or strategy of the fund or its staff, on the development of rates, contracting strategy, underwriting, or competitive strategy pursuant to the powers granted to the fund [under the

⁸⁹ Evid. Code § 300.

⁹⁰ 31 Cal.Jur.3d Evidence, § 7; see also *Big Creek Lumber Co. v. County of San Mateo* (1995) 31 Cal.App.4th 418, 430 fn. 16.

⁹¹ Cal. Gov. Code § 6250 et seq.

Insurance Code].

...

(5)(A) Records that are trade secrets pursuant to... [Evidence Code section 1060], including without limitation, instructions, advice, or training provided by the State Compensation Insurance Fund to its board members, officers, and employees regarding the fund's special investigation unit, internal audit unit, and informational security, marketing, rating, pricing, underwriting, claims handling, audits, and collections.

In addition, section 6254, subdivision (k) exempts the following information from the Public Records Act's disclosure requirements: "Records, the disclosure of which is exempted or prohibited pursuant to federal or state law, including, but not limited to, provisions of the Evidence Code relating to privilege."

b. Analysis

Trade secret privilege does not limit section 11735's public inspection requirements. The California Supreme Court's analysis and holding in *State Farm Mutual Automobile Insurance Co. v. Garamendi*⁹² are instructive. That case concerned Insurance Code section 1861.07, which broadly requires public disclosure of "[a]ll information provided to the commissioner" in connection with insurance rate approval applications (unrelated to workers' compensation). The plaintiff insurance company argued Government Code section 6254's trade secret provisions limited section 1861.07's disclosure requirements. Specifically, the plaintiff contended that since section 1861.07 expressly excludes a specific subdivision of section 6254, the Legislature implicitly intended all other subdivisions to apply, including those that exempt trade secrets from disclosure. The Court disagreed, holding that the public disclosure rule covering "[a]ll information provided to the commissioner" under section 1861.07 is absolute.⁹³ That section's exclusion of the specific provision of section 6254

⁹² *State Farm Mut. Automobile Ins. Co. v. Garamendi* (2004) 32 Cal.4th 1029.

⁹³ *Id.* at 1042-1043, emphasis in original.

“merely buttresses this rule.”⁹⁴ Thus, the Court concluded that information provided to the commissioner under section 1861.07 was not subject to trade secret privilege under section 6254 or, by extension, Evidence Code section 1060.⁹⁵

Insurance Code section 11735’s public disclosure requirement is similarly absolute. The statute requires the filing of “*all* rates and supplementary rate information that are to be used in this state” and “[*a*]ll rates, supplementary rate information, and any supporting information for rates filed under this article, as soon as filed, shall be open to public inspection at any reasonable time...”⁹⁶

Finally, contrary to SCIF’s assertions,⁹⁷ it is immaterial that Government Code section 6254 was enacted after Insurance Code section 11735. Section 6254 limits public disclosure obligations under the Public Records Act, so the Public Records Act cannot reasonably be construed to limit the Insurance Commissioner’s review and acceptance of supplementary rate information under the Insurance Code. Specifically, the lead-in to section 6254 states that “this chapter does not require the disclosure” of the information exempted pursuant to that section. And “this chapter” refers to Government Code, division 7, chapter 3.5, *i.e.*, the Public Records Act. A plain reading of the Public Records Act limits its application to the chapter within the Government Code, and is plainly inapplicable to the construction of the Insurance Code and workers’ compensation insurance rate filing requirements concerning the Insurance Commissioner. Because a plain reading of Government Code section 6254 and Insurance Code section 11735 demonstrates two separate and independent areas of authority, the order

⁹⁴ Id. at 1042.

⁹⁵ Id. at 1047. As noted above, privilege under Evidence Code section 1060 is incorporated by reference in Government Code section 6254, subdivision (k).

⁹⁶ Emphasis added.

⁹⁷ Obj. to Order to Disclose at 7.

in which they were enacted is of no consequence here.

For these reasons, the trade secret privilege does not exempt the tiering algorithm from Insurance Code section 11735's filing and public inspection provisions.

4. SCIF Must Exclude The Unfiled Tier Modifier in Computing Appellant's Rates.

Section 11737, subdivision (f), grants the Commissioner broad authority to award remedies in workers' compensation appeals. The statute authorizes him to "affirm, modify, or reverse" an insurer's action concerning the application of its rating system. The statute contains no language restricting remedies the Commissioner may order to modify or reverse an insurer's action. Nor has any California court inferred such restrictions from the statute. Indeed, the breadth of the Commissioner's authority is consistent with his comprehensive role to "require from every insurer a full compliance with all the provisions of [the Insurance Code]."⁹⁸

SCIF failed to apply the correct rate to the policy by unlawfully applying the unfiled rating tier modifier component for the 2015 Period and 2016 Period. SCIF must recalculate the rates for those Periods without applying the unfiled rating tier modifier.

C. The Claims Free Modifier Applies to Both the 2015 Period and the 2016 Period.

The Commissioner finds SCIF correctly applied a claims-free modifier to the 2015 Period but improperly failed to apply that modifier to the 2016 Period.

Under a SCIF rate filing that was in effect during the 2015 Period and 2016 Period, a claims-free modifier of 0.90 applied to policyholders continuously insured with SCIF and incurring no more than \$1,000 in workers' compensation claims during the three years

⁹⁸ Ins. Code § 12926.

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preceding the current policy period (or two years for policyholders with less than \$10,000 in annual base premium).⁹⁹ In the three years preceding the 2015 Period, Appellant was continuously insured with SCIF and incurred no workers' compensation claims. Accordingly, SCIF correctly applied the claims free modifier to the Policy for that period.¹⁰⁰

However, SCIF did not apply the modifier to the 2016 Period.¹⁰¹ In September of 2015, Appellant incurred a single workers' compensation claim, which was closed on November 6, 2015. The total losses and expenses incurred in connection with that claim were \$819.¹⁰² Thus, Appellant incurred less than \$1,000 in claims in the three years preceding the beginning of the 2016 Period. Accordingly, SCIF should have applied the 0.90 claims-free modifier to that period as well.

D. SCIF Correctly Calculated the Remaining Modifiers.

The Commissioner finds the remaining components of the rating plan modifier—i.e., the direct placement modifier and the territory modifier—were correctly applied for the 2015 Period and the 2016 Period. Appellant contends the premium discount modifier was incorrectly calculated for all three periods at issue. The Commissioner disagrees.

1. Direct Placement Modifier

A SCIF rate filing applicable to both the 2015 Period and 2016 Period states SCIF "will provide a 3% credit to employers who obtain their policy without engaging a broker."¹⁰³ Appellant did not engage a broker but instead dealt directly with SCIF to procure coverage for those periods. SCIF therefore correctly included the three percent credit (i.e., a modifier of 0.97)

⁹⁹ Exh. 1 at 1-4; Exh. 2 at 2-1.

¹⁰⁰ Exh. 206 at 206-3; Exh. 208 at 208-2.

¹⁰¹ Exh. 215 at 215-3; Exh. 218 at 218-2.

¹⁰² Tr. 65:8-9; Exh. 201 at 201-1.

¹⁰³ Exh. 1 at 1-1; Exh. 2 at 2-2.

within the rating plan modifier it applied to the Policy for both the 2015 Period and 2016 Period.¹⁰⁴

2. Territory Modifier

SCIF's rate filings applicable to the 2015 Period and 2016 Period required it to apply a territory modifier of 1.15 to customers in Los Angeles County.¹⁰⁵ Appellant is located in that county. Therefore, SCIF correctly included that territory modifier within the Policy's rating plan modifier during both the 2015 Period and the 2016 Period.¹⁰⁶

3. Premium Discount Modifier

SCIF's rate filings require a premium discount of 11.3 percent for all modified premium over \$5,000 and no discount for the first \$5,000.¹⁰⁷ SCIF correctly applied the discount to Appellant's actual modified premium for the 2015 Period, and to Appellant's estimated modified premiums for the 2016 Period and 2017 Period.¹⁰⁸ However, because Appellant's modified premiums must be recalculated using the correct rating plan modifier in accordance with part V (B) above, SCIF must re-compute the premium discount calculations using the revised modified premiums.¹⁰⁹

¹⁰⁴ Exh. 206 at 206-3; Exh. 208 at 208-2; Exh. 215 at 215-3; Exh. 218 at 218-2.

¹⁰⁵ Exh. 1 at 1-9, 1-27 [effective April 1, 2015]; Exh. 2 [no changes to territory modifiers from prior year].

¹⁰⁶ Exh. 206 at 206-3; Exh. 215 at 215-3.

¹⁰⁷ Exh 1 at 1-2, 1-3.

¹⁰⁸ Tr. 71:6-72:6; Exh. 210 at 210-1; Exh. 218 at 218-2.

¹⁰⁹ For example, Appellant's actual base premium for the 2015 Period was \$13,942.87. (Exh. 212 at 212-1.) The correct rating plan modifier in accordance with part V(B) above is 1.00395 (i.e., 1.15 territory modifier x 0.90 claims free modifier x 0.97 direct placement modifier). Multiplying the base premium by that rating plan modifier yields a modified premium of \$13,997.94 (i.e., 1.00395 x \$13,942.87). Thus, the premium discount modifier for the 2015 Period is: $1 - ((\$13,997.94 - \$5,000) \times 0.113) \div \$13,997.94 = 0.927363$.

E. Appellant Failed to Demonstrate SCIF Miscalculated Appellant's 2015 Period Payroll.

Appellant asserts SCIF miscalculated Appellant's 2015 Period payroll. The Commissioner finds Appellant has failed to meet its burden of proof on this issue.

1. Applicable Law

Under California Code of Regulations, title 10, section 2509.61, "[a] party has the burden of proof as to each fact the existence or non-existence of which is essential to the claim for relief or defense that he or she is asserting." As in an ordinary civil court action, that burden includes both the initial burden of going forward and the burden of persuasion by a preponderance of the evidence.¹¹⁰

2. Analysis

SCIF produced a final payroll audit report for the 2015 Period, indicating Appellant's workers' compensation payroll for the entire period was \$188,995.¹¹¹ Appellant contests the accuracy of the report and produced its own payroll summary for that period, asserting a total workers' compensation payroll of \$180,890.44.¹¹² Appellant thereby met its initial burden of going forward.

However, Appellant's payroll summary contains inaccuracies. Specifically, it does not entirely coincide with the 2015 Period, which began on December 2, 2015 and ended on December 2, 2016. The workers' compensation payroll for that period should cover the work performed by Appellant's employees between those dates.¹¹³ But Appellant's payroll summary sets forth the payments made during that period, rather than the amounts earned. The

¹¹⁰ *McCoy v. Board of Retirement* (1986) 183 Cal.App.3d 1044, 1051 fn. 5.

¹¹¹ Exh. 211 at 211-5.

¹¹² Exh. 3 at 3-47 through 3-51.

¹¹³ Cal. Code Regs., tit. 10, § 2318.6, Part 3, Section V, Rule 1 [payroll includes amounts "earned during the policy period"].

summary does not include any activity after the payments on November 25, 2016,¹¹⁴ which were for the work period ending November 20, 2016.¹¹⁵ Appellant's summary therefore failed to include payroll earned during the last 11 days of the 2015 Period. If Appellant had included those days, its payroll total would likely have closely matched SCIF's.¹¹⁶

Because Appellant's payroll summary is inaccurate and incomplete, Appellant failed to meet its burden of persuasion to establish SCIF incorrectly calculated the 2015 Period payroll.

F. Conclusions of Law

Based on the foregoing facts and analysis, the Commissioner concludes as follows:

1. SCIF failed to apply the correct rating plan modifier to the Policy during the 2015 Period and 2016 Period, in accordance with SCIF's filings with the Commissioner and applicable law. The rating plan modifier is incorrect for two reasons. First, SCIF included an unlawful and unenforceable rating tier modifier component during both the 2015 Period and 2016 Period. Second, SCIF failed to properly include a claims free modifier component for the 2016 Period.

2. SCIF correctly included a territory modifier component and direct placement modifier component in the rating plan modifier during both the 2015 Period and 2016 Period, in accordance with SCIF's rate filings.

3. The correct rating plan modifier for both the 2015 Period and 2016 Period comprises three components: a territory modifier of 1.15, a claims free modifier of 0.90, and a

¹¹⁴ Exh. 3 at 3-47 through 3-50.

¹¹⁵ See, e.g., Exh. 102 at 102-88.

¹¹⁶ Using Appellant's payroll total and assuming relatively steady work periods, one would expect the payroll for the full year to be approximately as follows: $\$180,890.44 \div [(365 \text{ days} - 11 \text{ days}) \div 365 \text{ days}] = \$186,511.33$. That figure is much closer to the audit total, suggesting SCIF's payroll calculation is more accurate than Appellant's.

direct placement modifier of 0.97. Accordingly, SCIF must apply the following rating plan modifier to each of those periods: $1.15 \times 0.90 \times 0.97 = 1.00395$.

4. SCIF used the correct premium discounts to the Policy for the 2015 Period, the 2016 Period, and the 2017 Period, in accordance with SCIF's filings with the Commissioner and applicable law. SCIF applied premium discount modifiers to each of those policy periods at the rate of 11.3 percent on all modified premium over \$5,000, which was consistent with SCIF's rate filings with the Commissioner under Insurance Code section 11735, subdivision (a). However, SCIF must recalculate the premium discount modifier to reflect the correct rating plan modifier's effect on modified premium.

5. Appellant failed to meet its burden of proof to establish SCIF miscalculated Appellant's payroll for the purposes of determining premium for the 2015 Period.

ORDER

1. SCIF shall recalculate Appellant's premium for the 2015 Policy Period and 2016 Policy Period in accordance with this decision and submit a revised premium calculation and statement of account for those periods to Appellant within 30 days after the date this decision is adopted.

2. It is further ordered that the entirety of this Decision is designated precedential pursuant to Government Code section 11425.60, subdivision (b).

Dated: November 16, 2018


DAVE JONES
Insurance Commissioner

02/22/2019

02/22/2019

EXHIBIT B



WORKERS' COMPENSATION AND EMPLOYER'S LIABILITY INSURANCE POLICY

INTRODUCTION

In return for the payment of the premium and subject to all terms and conditions of this policy, we (the State Compensation Insurance Fund) agree with you (the employer named in the Declarations) as follows:

GENERAL SECTION

A. The Policy

This policy includes the Declarations and all endorsements and schedules issued by us to be part of this policy and constitutes the entire contract of insurance. It is a contract of insurance between you and us. It is non-transferable. The only agreements relating to this insurance are stated in this policy.

The terms of this policy may not be changed or waived except by endorsement issued by us to be part of this policy. You are responsible for telling us at once when the information contained in this policy is no longer accurate for your operations.

No condition, provision, agreement or understanding not stated in this policy contract will affect any rights, duties or privileges in connection with this policy contract.

B. Who Is Insured

You are insured for your liability to your employees if you are the employer named in the Declarations, subject to the provisions of this policy.

If the employer is a partnership, and if you are one of its named partners, you are insured but only in your capacity as an employer of the partnership's employees.

This policy does not insure the liability of any employer other than the employer named in the Declarations.

C. Workers' Compensation Law

Workers' compensation law means the Workers' Compensation Laws of the State of California. It includes any amendments to that law which are in effect during the policy period. It does not include the provisions of any law that provide non-occupational disability benefits. It does not include the provision of any federal law.

D. Locations

This policy covers all of your California workplaces listed in the Declarations; and it covers all of your other California workplaces unless you have other insurance or are self-insured for such California workplaces.

E. Who Is Eligible To Receive Workers' Compensation Benefits

Your employees (or in the event of their death, their dependents) are eligible for benefits under this policy, except that:

1. Employees who are covered for California workers' compensation benefits on a policy also affording comprehensive personal liability (CPL) insurance issued to you are not eligible for benefits under this policy.
2. Employees who are excluded under workers' compensation law are not eligible for benefits under this policy, unless they have been included in the Declarations or by endorsement.

If you are named in the Declarations as an Individual Employer or a Husband and Wife Employer, either as individuals or a co-partnership, you are not eligible for benefits under this policy.

PART ONE: WORKERS' COMPENSATION INSURANCE

A. How This Insurance Applies

This workers' compensation insurance applies to bodily injury by accident or bodily injury by disease, including resulting death, subject to the following conditions:

1. Bodily injury by accident must occur during the policy period.
2. Bodily injury by disease must be caused or aggravated by the conditions of your employment. Your employee's exposure to those conditions causing or aggravating such bodily injury by disease must occur during the policy period.

B. We Will Pay

We will pay promptly when due to those eligible under this policy the benefits required of you by the workers' compensation law.

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C. We Will Defend

We have the right and duty to defend at our expense any claim or proceeding instituted against you before the Workers' Compensation Appeals Board for benefits payable by this workers' compensation insurance. We have the right to investigate and settle these claims or proceedings.

We have no duty to defend any claim, proceeding or suit that is not covered by this workers' compensation insurance.

We have no duty to defend any claim against you for the discharge, coercion, or discrimination against any employee in violation of the law.

We may, at your request, defend you using our legal staff against a claim of serious and willful misconduct or for sanctions instituted before the Workers' Compensation Appeals Board.

D. We Will Also Pay

We will also pay the costs enumerated below, in addition to other amounts payable under this workers' compensation insurance, as part of any claim or proceeding we defend before the Workers' Compensation Appeals Board:

1. reasonable expenses incurred at our request, but not loss of earnings;
2. premiums for bonds to release attachments and for appeal bonds in bond amounts up to twice the amount payable under this workers' compensation insurance;
3. litigation costs for which we are responsible;
4. interest on an award as required by law; and
5. expenses we incur.

E. Other Insurance

We will not pay more than our share of benefits and costs covered by this insurance and other insurance or self-insurance. All shares will be equal until the loss is paid. If any insurance or self-insurance is exhausted, the shares of all remaining insurance will be equal until the loss is paid.

F. Payments You Must Make

You are responsible for any payments in excess of the benefits regularly provided by the workers' compensation law including, but not limited to, those required because:

1. of your serious and willful misconduct;
2. you knowingly employ an employee in violation of law;
3. you fail to comply with a health or safety law or regulation;
4. you discharge, coerce or discriminate against any employee in violation of the law;
5. of injury to an employee under the minimum age specified in the workers' compensation law and illegally employed at the time of injury;

6. of an increase in indemnity payments due to your failure to provide us with timely and proper notice required by law. We may seek reimbursement for any of these amounts paid on your behalf; or
7. of sanctions imposed on you by the Workers' Compensation Appeals Board.

G. Recovery From Others

We may enforce your rights, and the rights of persons entitled to the benefits of this insurance, to recover our payments from anyone liable for the injury. You will do everything necessary to protect those rights for us and to help us enforce them.

H. Statutory Provisions

These statements apply where they are required by law:

1. As between an injured worker and us, we have notice of the injury when you have notice.
2. Your default or the bankruptcy or insolvency of you or your estate will not relieve us of our duties under this insurance for an injury occurring while this policy is in force.
3. We are directly and primarily liable to any person entitled to the benefits payable by this insurance, subject to the provisions, conditions and limitations of this policy.
4. Jurisdiction over you is jurisdiction over us for purposes of the workers' compensation law. We are bound by decisions against you under that law, subject to the provisions of this policy that are not in conflict with that law.
5. Terms of this insurance that conflict with the workers' compensation insurance law in effect during the policy period are changed by this statement to conform to that law.
6. Your employee has a first lien upon any amount which becomes owing to you by us on account of this policy, and in the case of your legal incapacity or inability to receive the money and pay it to the claimant, we will pay it directly to the claimant.

Nothing in these paragraphs relieves you of your duties under this policy.

PART TWO: EMPLOYER'S LIABILITY INSURANCE

A. How This Insurance Applies

This employer's liability insurance applies to bodily injury by accident or bodily injury by disease of an employee. Bodily injury means physical or mental injury, including resulting death. Bodily injury does not include emotional distress, anxiety, discomfort, inconvenience, depression, dissatisfaction or shock to the nervous system, unless caused by either a manifest physical injury or a disease with a physical dysfunction or condition resulting in treatment by a licensed physician or surgeon. Accident is defined as an event that is neither expected nor intended from the

standpoint of the insured.

1. The bodily injury must arise out of and in the course of the injured employee's employment by you.
2. The employment must be necessary or incidental to your work in California.
3. Bodily injury by accident must occur during the policy period.
4. Bodily injury by disease must be caused or aggravated by the conditions of your employment. The employee's last day of last exposure to the conditions causing or aggravating such bodily injury by disease must occur during the policy period.
5. If you are sued, the suit and any related legal actions for damages for bodily injury by accident or by disease must be brought under the laws of the State of California.

B. We Will Pay

We will pay all sums you legally must pay as damages because of bodily injury to your employees eligible for benefits under this policy, provided the bodily injury is covered by this employer's liability insurance.

The damages we will pay, where recovery is permitted by California law, include damages:

1. for which you are liable to a third party by reason of a claim or suit against you by that third party to recover the damages claimed against such third party as a result of injury to your employee;
2. for care and loss of services; and
3. for the consequential bodily injury that is covered by this employer's liability insurance to a spouse, child, parent, brother or sister of the injured employee; provided that these damages are the direct consequence of bodily injury that arises out of and in the course of the injured employee's employment by you; and
4. because of bodily injury to your employee that arises out of and in the course of employment claimed against you in a capacity other than as employer.

C. Exclusions

This insurance does not cover:

1. liability assumed under a contract;
2. punitive or exemplary damages where insurance for such liability is prohibited by law or contrary to public policy;
3. damages or bodily injury to an employee while employed in violation of law with your actual knowledge or the actual knowledge of any of your executive officers;
4. any obligation imposed by a workers' compensation, occupational disease, unemployment compensation or disability benefits law, the provisions of any federal law unless endorsed on this policy or any similar law;
5. damages or bodily injury intentionally caused or aggravated by you;

6. damages or bodily injury arising out of termination of employment;
7. damages or bodily injury arising out of coercion, criticism, demotion, evaluation, reassignment, discipline, defamation, harassment or humiliation of, or discrimination against any employee, or from any personnel practices, policies, acts or omissions; or
8. fines or penalties imposed for violation of any law.

D. We Will Defend

We have the right and duty to defend, at our expense, any claim, proceeding or suit against you for damages payable by this employer's liability insurance. We have the right to investigate and settle these claims, proceedings and suits. We may use counsel of our choice.

We have no duty to defend a claim, proceeding or suit that is not covered by this employer's liability insurance. We have no duty to defend or continue defending after we have paid our limit of liability under this employer's liability insurance.

E. We Will Also Pay

We will also pay the costs enumerated below, in addition to other amounts payable under this employer's liability insurance, as part of any claim, proceeding or suit we defend:

1. reasonable expenses incurred at our request, but not loss of earnings;
2. premiums for bonds to release attachments and for appeal bonds in bond amounts up to twice the limit of our liability under this employer's liability insurance;
3. litigation costs taxed against you;
4. interest on a judgment as required by law, and
5. expenses we incur.

F. Other Insurance

We will not pay more than our share of damages and costs covered by this employer's liability insurance and other insurance or self-insurance. Subject to any limits of liability that apply, all shares will be equal until the loss is paid. If any insurance or self-insurance is exhausted, the shares of all remaining insurance and self-insurance will be equal until the loss is paid.

G. Limit Of Liability

Our liability to pay for damages, including defense costs, is limited. Our limit of liability, including defense costs, is shown in the Declarations. It is the most we will pay for all damages covered by this employer's liability insurance because of bodily injury to one or more employees in any one accident or occurrence, or series of accidents or occurrences, arising out of any one event.

We will not pay any claims for damages after we have paid the limit of our liability, including defense costs, under this insurance as explained above.

H. Recovery From Others

We may enforce your rights to recover our payment from anyone liable for an injury covered by this employer's liability insurance. You will do everything necessary to protect those rights for us and to help us enforce them.

I. Actions Against Us

There will be no right of action against us under this employer's liability insurance unless:

1. you have complied with all the terms of this policy; and
2. the amount you owe has been determined with our consent or by actual trial and final judgment.

This insurance does not give anyone the right to add us as a defendant in an action against you to determine your liability.

PART THREE: COVERAGE OUTSIDE OF CALIFORNIA

This coverage is identical to Part One of this policy. It applies to your employees who are hired in California and who are eligible for benefits under this policy while they are temporarily working anywhere outside of California on a specific assignment.

PART FOUR: YOUR DUTIES IF INJURY OCCURS

Tell us at once if an injury occurs that may be covered by this policy. Your other duties are listed here:

1. Provide for immediate medical treatment and other services required by the workers' compensation law.
2. Give us or our representative the names and addresses of the injured persons and of witnesses, and other information we may need as required by California Workers' Compensation Law.
3. Promptly give us all notices, demands and legal papers related to the injury, claim, proceeding or suit.
4. Cooperate with us and assist us, as we may request, in the investigation, settlement or defense of any claim, proceeding or suit.
5. Do nothing after an injury occurs that would interfere with our right to recover from others.
6. Do not voluntarily make payments, assume obligations or incur expenses, except at your own cost.

PART FIVE: PREMIUM

A. Manuals

All premium for this policy will be determined by our manuals of rules, rates, rating plans and classifications. We may change our manuals and apply the changes to this policy if authorized by law or a governmental agency regulating this workers' compensation insurance.

B. Classifications

The Declarations show the rate and premium basis for certain business or work classifications. These classifications were assigned based on an estimate of the exposures you would have during the policy period. If your actual exposures are not properly described by those classifications, we will assign proper classifications, rates and premium basis by endorsement to this policy. You are responsible for telling us at once of any change in classification.

C. Premium Calculation

Premium for each work classification is determined by multiplying a rate times a premium basis. Remuneration is the most common premium basis. This premium basis includes payroll and all other remuneration paid or payable during the policy period for the services of:

1. all your employees eligible for benefits under this policy while engaged in work covered by this policy; and
2. all other persons engaged in work that could make us liable under Part One of this policy. If you do not have payroll records for these persons, the contract price for their services and materials may be used as the premium basis. This paragraph will not apply if you give us proof that the employers of these persons lawfully secured their workers' compensation obligations.

D. Premium Payments

You will pay all premium when due.

E. Final Premium

The premium shown on the Declarations, schedules and endorsements is an estimate. The final premium will be determined after this policy ends by using the actual premium basis and the proper classifications, rates and rating plans that lawfully apply to the business and work covered by this policy. If you do not provide us with the information necessary to determine the actual premium basis, the estimated premium will be used. If the final premium is more than the premium you paid to us, you must pay us the balance. If it is less, we will refund the balance to you. The final premium will not be less than the minimum premium for this policy.

If this policy is cancelled, final premium will be determined in the following way unless our manuals provide otherwise:

1. If we cancel, final premium will be calculated pro rata based on the time this policy was in force. Final premium will not be less than the minimum premium if we cancel because you fail to comply with the terms and conditions of this policy in regard to payroll records or premium payments.

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2. If you cancel, final premium will be more than pro rata: it will be based on the time this policy was in force, and increased by any short rate cancellation table and procedure in our manuals.

F. Records

You will keep records of information needed to compute premium. You will provide us with copies of those records when we ask for them.

G. Audit

You will let us examine and audit all your records that relate to this policy. These records include ledgers, journals, registers, vouchers, contracts, tax reports, payroll and disbursement records and programs for storing and retrieving data. We may conduct the audits during regular business hours during the policy period and within three years after the policy period ends. Information developed by audit will be used to determine final premium. The rating organization designated by the Insurance Commissioner has the same rights we have under this provision.

H. Rate Changes

Premium may be subject to midterm adjustment, for the unexpired term of the policy, pursuant to the Insurance Commissioner's power to disapprove rates.

PART SIX: CONDITIONS

A. Inspection

We have the right, but are not obliged, to inspect your workplaces at any reasonable time. Our inspections relate to the insurability of the workplaces and the premiums to be charged. We may give you reports on the conditions we find. We may also recommend changes. While they may help reduce losses, we do not undertake to perform the duty of any person to provide for the health or safety of your employees or the public. We do not warrant that your workplaces are safe or healthful or that they comply with laws, regulations, codes or standards. The rating organization designated by the Insurance Commissioner has the same rights we have under this provision.

B. Long Term Policy

If this policy is written for a period longer than one year, all the provisions of this policy shall apply separately to each consecutive twelve month period. If the first or last consecutive period is less than twelve months, the provisions of this policy shall apply as if a separate policy had been written for each consecutive period. Until your policy terminates, your deposit premium will be transferred to each consecutive policy period to act as a deposit as if a separate policy had been written.

C. Transfer Of Your Rights And Duties

Your rights or duties under this policy may not be transferred without our written consent.

If you die and we receive notice within thirty days after your death, we will cover your legal representative as insured.

D. Cancellation

1. You may cancel this policy. You must mail or deliver advance written notice to us stating when the cancellation is to take effect. If certificates of insurance issued by us are in effect, your advance notice to us must be no less than the maximum number of days notice we have agreed to give any one certificate holder when the policy is cancelled.
2. We may cancel this policy for one or more of the following reasons:
 - a. non-payment of premium;
 - b. failure to report payroll;
 - c. failure to permit us to audit payroll as required by the terms of this policy or of a previous policy issued by us;
 - d. failure to pay any additional premium resulting from an audit of payroll required by the terms of this policy or any previous policy issued by us;
 - e. material misrepresentation made by you or your agent;
 - f. failure to cooperate with us in the investigation of a claim;
 - g. failure to comply with federal or state safety orders;
 - h. failure to comply with written recommendations of our designated loss control representatives;
 - i. the occurrence of a material change in the ownership of your business;
 - j. the occurrence of any change in your business or operations that materially increases the hazard for frequency or severity of loss;
 - k. the occurrence of any change in your business or operations that requires additional or different classification for premium calculation;
 - l. the occurrence of any change in your business or operations which contemplates an activity excluded by our reinsurance treaties.
3. If we cancel your policy for any of the reasons listed in Items (a) through (f), we will give you 10 days advance written notice, stating when the cancellation is to take effect. Mailing that notice to you at your mailing address shown in the Declarations will be sufficient to prove notice.
4. If we cancel your policy for any of the reasons listed in Items (g) through (l), we will give you 30 days advance written notice. Mailing that notice to you at your mailing address shown in the Declarations will

be sufficient to prove notice. In the event of cancellation and reissuance of a policy effective upon a material change in ownership or operations, the notice will not be provided.

5. The policy period will end on the day and hour stated in the cancellation notice.
6. Any of these provisions that conflict with a law that controls the cancellation of the insurance in this policy is changed by this statement to comply with that law.

E. Our Notice To You

Mailing documents to you that relate to this policy at the mailing address shown in the Declarations will be sufficient to prove notice.

F. Participating Provision-Dividends

You will be entitled to participate in any dividend plan applicable to this policy which may be approved for distribution by our Board of Directors, with the following exceptions:

You will not be allowed to participate if:

1. you fail to pay any part of the premium for this policy after we request payment in writing, or allow it to remain unpaid for 90 days after we mail a statement of premium to you at the mailing address shown in the Declarations;
2. you do not keep adequate records of information needed to compute premium, or do not provide them to us when we ask for them; or
3. we must bring suit against you to obtain the records necessary for us to compute premium or to enforce the collection of all or any part of the premium for this policy.

Your participation will be according to the rules adopted by our Board of Directors.

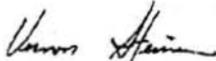
Under California law it is unlawful for an insurer to promise the future payment of dividends under an unexpired workers' compensation policy or to misrepresent the conditions for dividend payment. Dividends are payable only pursuant to conditions determined by our Board of Directors or other governing board following policy expiration.

To be valid this policy must be signed by our President or Executive Vice President and countersigned by our authorized representative.

Countersigned and Issued at San Francisco, California.



Kenneth R. Van Laar
Authorized Representative



Vernon Steiner
President & CEO



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