

**STATE OF CALIFORNIA
DEPARTMENT OF INDUSTRIAL RELATIONS
Division of Workers' Compensation**

NOTICE OF PROPOSED RULEMAKING

**Subject Matter of Proposed Amendment to Regulations:
Workers' Compensation – Audit Regulations**

TITLE 8, CALIFORNIA CODE OF REGULATIONS SECTIONS 10100.2, ET SEQ.

NOTICE IS HEREBY GIVEN that the Administrative Director of the Division of Workers' Compensation, pursuant to the authority vested in him by Labor Code Sections 59, 129, 129.5, 133 and 5307.3, proposes to adopt the amended and proposed regulations described below after considering all comments, objections, and recommendations regarding the proposed action.

PROPOSED REGULATORY ACTION

The Department of Industrial Relations, Division of Workers' Compensation, proposes to adopt:

Proposed section 10100.2	Definitions
Proposed section 10103.2	Claim Log – Contents and Maintenance
Amended section 10104	Annual Report of Inventory
Amended section 10105	Auditing, Discretion of the Administrative Director
Proposed section 10106.1	Routine and Targeted Audit Subject Selection; Complaint Tracking; Appeal of Targeted Audit Selection
Proposed section 10107.1	Notice of Audit; Claim File Selection; Production of Claims Files; Auditing Procedure
Amended section 10108	Audit Violations – General Rules
Amended section 10109	Duty to Conduct Investigation; Duty of Good Faith
Proposed section 10111.2	Full Compliance Audit Penalty Schedule; Target Audit Penalty Schedule
Amended section 10113	Order to Show Cause Re: Assessment of Civil Penalty and Notice of Hearing
Proposed section 10113.1	Answer to Order to Show Cause
Proposed section 10113.2	Amended Complaint or Supplemental Order to Show Cause Before Submission of Case
Proposed section 10113.3	Administrative Director's Designation of Hearing Officer
Proposed section 10113.4	Written Statement and Supporting Evidence
Proposed section 10113.5	Prehearing Conference; Subject Matter; Prehearing Order
Proposed section 10113.6	Subpoenas
Amended section 10114	Hearing
Proposed section 10114.1	Evidence; Examination of Witnesses
Proposed section 10114.2	Affidavits

Proposed section 10114.3	Oaths
Proposed section 10114.4	Determination
Amended section 10115.1	Appeal of Notice of Penalty Assessment – Filing and Contents
Repealed section 10115.3	Appeal of Civil Penalty

PUBLIC HEARING

A public hearing has been scheduled to permit all interested persons the opportunity to present statements or arguments, oral or in writing, with respect to the subjects noted above, on the following dates:

Date: September 13, 2002
Time: 10:00 am to 5:00 PM or conclusion of business
Place: Gov. Hiram W. Johnson State Office Building, Auditorium
455 Golden Gate Avenue
San Francisco, California 94102

The public hearing room is wheelchair accessible. Persons requiring additional accommodation of a disability are requested to alert the contact person identified below.

Please note that public comment will begin promptly at 10:00 a.m. and will conclude when the last speaker has finished his or her presentation. If public comment concludes before the noon recess, no afternoon session will be held. The Administrative Director requests, but does not require, that any persons who make oral comments at the hearing also provide a written copy of their comments. Equal weight will be accorded to oral comments and written materials.

AUTHORITY AND REFERENCE

Labor Codes sections 59, 133 and 5307.3 authorize the Administrative Director to adopt or amend regulations and to enforce the laws. Labor Code sections 129 and 129.5 authorize the Administrative Director to audit and impose penalties against claims administrators who fail to meet their obligations to promptly and accurately provide injured workers with the compensation to which they are entitled. The proposed regulations will further implement, interpret or make specific Labor Code sections 129 and 129.5.

INFORMATIVE DIGEST AND POLICY OVERVIEW

The Administrative Director of the Division of Workers’ Compensation proposes the following new or amended regulations concerning the audit of workers’ compensation claims.

Proposed section 10100.2 Definitions

The proposed regulation will apply only for injuries occurring on or after January 1, 2003 and concerns definitions which apply to regulations sections 10101 through 10115.3. The current regulation (section 10100.1) does not include definitions for the terms “general business practice,” and “knowingly committed,” which have been added to proposed section

10100.2. The proposed regulation includes definitions previously listed in section 10100.1 and also contains amended definitions of the terms “adjusting location,” “audit subject,” “claim,” “claim file,” “indemnity claim,” “insurer,” “investigation,” and “third party administrator.” These terms are used in Labor Code section 129 and 129.5 and the audit regulations. Clear definitions will help prevent disputes.

Proposed section 10103.2 Claim Log – Contents and Maintenance

Current regulations require a claims administrator to maintain a claim log that lists information pertaining to all work injury claims. Proposed Section 10103.2 will apply to claim log maintenance on or after January 1, 2003. In addition to the requirements that were contained in the current regulation, if a claim has been transferred to another location, the section will now require the claims administrator to indicate the new location on the log. Additionally, the new location’s claim log must list the claim for the year that the claim was initially reported, not the year the claim was transferred. Labor Code section 129 requires the Administrative Director to audit insurers, and a claim log is needed in order to determine which claims to audit.

Amended section 10104 Annual Report of Inventory

Section 10104 is amended to provide that the Annual Report of Inventory filed on or after April 1, 2003 shall report, as of the preceding January 1, the numbers of indemnity, denied, and medical-only claims. This change is needed to help the Audit Unit plan audits so that each audit subject can be audited at least once every five years as required by Labor Code Section 129 (effective 1/1/03), to help the Audit Unit evaluate possible target audit subject selections pursuant to the proposed Section 10106.1(c)(2) and (c)(3) of these regulations, and to determine penalty amounts based on the size of the adjusting location pursuant to Labor Code Section 129.5(b)(7) (effective 1/1/03).

Amended section 10105 Auditing, Discretion of the Administrative Director

Section 10105 is amended to provide that the Administrative Director may utilize the provisions of Government Code sections 11180 through 11191. These sections confer onto the head of an agency the power to conduct investigations and hearing, including issuing subpoenas, oaths, and delegating authority. Labor Code section 133 provides that the Administrative Director shall have the power and jurisdiction to do all things necessary required by the Labor Code, which includes conducting investigation and hearings.

Proposed section 10106.1 Routine and Targeted Audit Subject Selection; Complaint Tracking; Appeal of Targeted Audit Selection

This proposed section describes the process for selecting a subject for an audit on or after January 1, 2003, in order to comply with the legislative changes made to Labor Code sections 129 and 129.5 effective January 1, 2003. All adjusting locations will be subject to a routine audit once every five years.

The Audit Unit will select a subject for a target audit when its performance rating is among the worst 10% based on performance ratings for audits conducted in the three years before the year the audit subject was audited.

The Audit Unit will also select a subject for a target audit based on decisions or findings from the WCAB and/or Rehabilitation Unit, or based on complaints or information that indicate possible claims handling violations. The Audit Unit may also select targeted audit subjects based on data from the Workers' Compensation Information System, or for an audit subject's failure to produce a claim for the Audit Unit within 30 days of request, or failure to pay or appeal a Notice of Compensation due issued by the Audit Unit. The notice of a targeted audit may be appealed as set forth in the section.

Proposed section 10107.1 Notice of Audit; Claim File Selection; Production of Claims Files; Auditing Procedure

This proposed section describes the process for conducting audits on or after January 1, 2003, in order to comply with the legislative changes made to Labor Code sections 129 and 129.5 effective January 1, 2003. It sets forth the procedure for noticing an audit and the sampling methodology for selecting the claims that will be audited. The section sets forth the procedure for calculating the audit subject's profile audit review performance rating. The section provides the method to determine the profile audit review performance rating of each audit and to establish a profile review audit performance standard each year. Those who meet or exceed the performance standard will not be assessed any administrative penalties; however, they will be issued Notices of Compensation Due pursuant to section 10110.

This section also provides the procedure for conducting Full Compliance Audits and the sampling methodology for selecting the claims that will be audited. The section sets forth the procedure for calculating the audit subject's full compliance audit performance rating and determining the full compliance audit performance standard each year.

Amended section 10108 Audit Violations – General Rules

This section provides the general rules that apply to all audits. It is amended to clarify: (1) that audit penalties will be based on an audited claim's status when the claim is audited; (2) that the mileage rate is thirty four cents (increased from twenty one cents) in compliance with the current law; (3) that the audit unit will not assess penalties for violations for failure to make payment of indemnity due if the total is less than ten dollars aggregate per file; (4) that nothing in the regulations bars the assessment of a civil penalty under Labor Code section 129.5; (5) that the Audit Unit may audit a companion or master claim to a randomly selected claim and consider that claim as randomly selected for purposes of determining whether or not the audit subject meets or exceeds performance standards; (6) that penalties may be assessed for failure to timely submit an accurate Annual Report of Inventory; (7) that penalties for late performance of an act may not exceed the penalty for failure to perform an act; (8) that if more than one claims administrator has adjusted a claim file, penalties will not be assessed for violations which occurred before the audit subjects began adjusting the claim, except with regard to failure to pay compensation due; and (9) that successor liability will be imposed on subsequent claims administrators if there has been a substantial continuity of business and/or the successor business uses substantially the same work force.

Amended section 10109 Duty to Conduct Investigation in Good Faith

The current section requires claims administrators to conduct investigations upon receiving notice of an injury or notice of a claim, and to act in good faith. The amended section defines “acting in good faith.”

Proposed section 10111.2 Full Compliance Audit Penalty Schedules; Target Audit Penalty Schedule

Effective 1/1/03, Labor Code section 129.5 requires audit penalties to be based on additional factors, including whether the audit subject has met or exceeded the profile audit review performance standard; whether a full compliance audit subject has met or exceeded the full compliance audit performance standard; and the size of the audit subject location. For full compliance audit penalties, Labor Code section 129.5 will allow the imposition of penalties up to \$40,000. No administrative penalties are to be imposed on audit subjects that pass the performance audit review. If an audit subject failed the performance audit review, but passes the full compliance audit, only penalties for unpaid or late paid compensation will be imposed.

Proposed section 10111.2 sets forth the audit penalty schedules in compliance with the new requirements of Labor Code section 129.5. This section will apply to audits conducted on or after January 1, 2003. However, for violations in claims with dates of injury between January 1, 1990 and December 31, 1993, penalty amounts may not exceed the amounts that would be assessed pursuant to section 10111. For violations in claims with dates of injuries between January 1, 1994 and December 31, 2002, penalty amounts may not exceed the amounts that would be assessed pursuant to section 10111.1. The penalty amounts in proposed section 10111.2 are based on the type of violation, taking into consideration the lateness of an act or the monetary value of the failure to act. The section sets forth when and how mitigation of penalties will be determined and applied. The section also provides how consideration of penalty amounts based on the size of the audit subject will be determined.

Amended section 10113 Order to Show Cause re Assessment of Civil Penalty and Notice of Hearing

Current section 10113 sets out the procedure regarding the issuance of an Order to Show Cause for an assessment of a civil penalty of up to \$100,000. In compliance with Labor Code section 129.5, amended section 10113 provides that the Audit Unit shall file a complaint requesting the Administrator Director to issue an Order to Show Cause for the possible assessment of a civil penalty if a claims administrator fails to meet the full compliance audit performance standards in two consecutive full compliance audits. Also in compliance with the amended language of Labor Code section 129.5, section 10113 provides that the Administrative Director shall issue the Order to Show cause if he or she has reason to believe that an employer, insurer or third party claims administrator has knowingly committed or performed any of the practices set forth in Labor Code 129.5(e). Finally, the language requiring the hearing to be held not less than 60 days from the date the Order to Show Cause was served and mailed has been deleted.

Proposed section 10113.1 Answer to Order to Show Cause

Labor Code section 129.5(e) authorizes the Administrative Director to conduct a civil penalty hearing. This proposed section provides the procedure for answering the Order to Show Cause re Assessment of Civil Penalty.

Proposed section 10113.2 Amended Complaint or Supplemental Order to Show Cause Before Submission of Case

Labor Code section 129.5(e) authorizes the Administrative Director to conduct a civil penalty hearing. This proposed section provides that an amended Complaint or Order to Show Cause may be filed, and if new charges are presented, the claims administrator may file an amended answer.

Proposed section 10113.3 Administrative Director's Designation of Hearing Officer

Labor Code section 129.5(e) authorizes the Administrative Director to conduct a civil penalty hearing. This proposed section authorizes the Administrative Director to delegate authority to a hearing officer. It also sets forth the authority that can be delegated.

Proposed section 10113.4 Written Statement and Supporting Evidence

Labor Code section 129.5(e) authorizes the Administrative Director to conduct a civil penalty hearing. This proposed section sets forth the procedure concerning the filing of a written statement which must specify the legal and factual bases for the Answer. The written statement shall also contain a list of all witness and copies of all documents that the claims administrator intends on introducing into evidence at the hearing.

Proposed section 10113.5 Prehearing Conference; Subject Matter; Prehearing Order

Labor Code section 129.5(e) authorizes the Administrative Director to conduct a civil penalty hearing. This section sets forth the procedures regarding the prehearing conference.

Proposed section 10113.6 Subpoenas

Labor Code section 129.5(e) authorizes the Administrative Director to conduct a civil penalty hearing. This section provides that the Administrative Director may issue subpoenas for the attendance of persons and the production of documents.

Amended section 10114 Hearing

Labor Code section 129.5(e) authorizes the Administrative Director to conduct a civil penalty hearing. This section sets forth the procedure for the civil penalty hearing. In compliance with Labor Code section 129.5 (effective 1/1/03), it also sets forth that any claims administrator that fails to meet the full compliance audit performance standards in two consecutive full compliance audits shall be rebuttably presumed to have engaged in a general

business practice of discharging and administering its compensation obligations in a manner causing injury to those dealing with it.

Proposed section 10114.1 Evidence; Examination of Witnesses

Labor Code section 129.5(e) authorizes the Administrative Director to conduct a civil penalty hearing. This section provides the rules pertaining to the introduction of evidence at a hearing.

Proposed section 10114.2 Affidavits

Labor Code section 129.5(e) authorizes the Administrative Director to conduct a civil penalty hearing. This section allows for a witness' declaration to be introduced into evidence provided that the witness was listed on the written statement, the declaration is made under penalty of perjury, copies of the declaration are provided to the parties at least twenty days before the hearing, and the opposing party has not demanded that the witness appear in person.

Proposed section 10114.3 Oaths

Labor Code section 129.5(e) authorizes the Administrative Director to conduct a civil penalty hearing. This section authorizes the Administrative Director or designated hearing officer to administer oaths.

Proposed section 10114.4 Determination

Labor Code section 129.5(e) authorizes the Administrative Director to conduct a civil penalty hearing. This proposed section requires the Administrative Director to issue a written Determination setting forth the basis for the Determination. It also sets forth the procedure for service of the Determination and when the Determination will become final.

Amended section 10115.1 Appeal of Notice of Penalty Assessment – Filing and Contents

Labor Code section 129.5(d) authorizes the Administrative Director to issue a penalty assessment. This section sets forth the procedure for appealing a Notice of Penalty Assessment. The proposed amendments are grammatical changes only, proposed in order to clarify the section.

Repealed section 10115.3 Appeal of Civil Penalty

Section 10115.3, which set forth the procedure for appealing an assessment of a civil penalty no longer complies with Labor Code section 129.5(g) (effective 1/1/03). The procedure to appeal an assessment of a civil penalty will be found in regulation section 10953.

STATE MANDATED LOCAL COSTS; REIMBURSEMENT

The Administrative Director has determined that the proposed regulations will not impose any new mandated program on local agencies and school districts. The California

Supreme Court has determined that an increase in workers' compensation benefit levels does not constitute a new State mandate for the purpose of local mandate claims because the increase does not impose unique requirements on local governments. See County of Los Angeles v. State of California (1987) 43 Cal.3d 46. The requirements imposed on all employers by these proposed regulations, although not a benefit level increase, similarly do not constitute a new State mandate because the regulations apply to all employers, private and public, and not uniquely to local governments.

DETERMINATION OF DISCRETIONARY COSTS ON LOCAL AGENCIES

The proposed regulations may impose discretionary costs on local agencies and school districts. Any such costs, however, will be non-discretionary because the requirement that every employer comply with the requirements of California's workers' compensation laws is a statutory obligation. Furthermore, any such costs are non-reimbursable because the requirement for employers to comply with California's workers' compensation laws is not unique to local agencies or school districts and applies to all employers alike, public and private, including the State of California.

COST OR SAVINGS TO STATE AGENCIES

The proposed regulations may impose costs on State agencies. (State government accounts for about 3% of the occupational injuries and illnesses.) Any such costs are, however, are non-reimbursable since the requirement on an employer to comply with California's workers' compensation laws is not unique to State agencies and applies to all employers alike, public and private. Because the proposed regulations will (1) eliminate penalties for audit subjects that meet or exceed the profile audit review performance standards, and (2) provide for penalties to be assessed only for violations involving late-paid and unpaid compensation against those audit subjects that meet or exceed the full compliance audit performance standards, the proposed regulations may result in possible cost savings.

COST OR SAVINGS IN FEDERAL FUNDING TO STATE

The proposed regulations will not affect any federal funding.

SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT ON BUSINESS

The Administrative Director has concluded that the proposed regulations will not have a significant statewide adverse economic impact on businesses, including the ability of California businesses to compete with businesses in other states.

POTENTIAL COST IMPACT ON REPRESENTATIVE PRIVATE PERSONS OR DIRECTLY AFFECTED BUSINESSES

The Administrative Director has determined that the proposed regulations will not have a significant adverse economic impact on representative private persons or directly affected businesses.

The entities directly affected by the regulations which allow for increase audit penalties are those which administer workers' compensation claims in California. This includes three types of private businesses: (1) employers who are large and financially secure enough to be permitted to self-insure their workers' compensation liability and who administer their own workers' compensation claims; (2) private insurance companies which are authorized to transact workers' compensation insurance in California; and (3) third party administrators which are retained to administer claims on behalf of self-insured employers or insurers.

ECONOMIC IMPACT ON SMALL BUSINESSES

The Administrative Director has determined that small business will not be impacted by the proposed regulations. The businesses that are subject to audit penalties for failure to comply with the workers' compensation regulations are insurers, self-insured employers (who must by regulation have substantial net worth and income) and third party administrators, all of whom do not qualify as "small business."

ASSESSMENT OF EFFECTS ON JOB AND/OR BUSINESS CREATION, ELIMINATION OR EXPANSION

The Administrative Director has determined that the proposed regulations will likely have no net effect on the creation or elimination of existing businesses within California, or affect the expansion of current California businesses.

IMPACT ON HOUSING COSTS

The proposed regulations will have no effect on housing costs.

CONSIDERATION OF ALTERNATIVES

In accordance with Government Code section 11346.5(a)(13), the Administrative Director must determine that no reasonable alternative considered or that has otherwise been identified and brought to the Administrative Director's attention would be more effective in carrying out the purpose for which the actions are proposed or would be as effective and less burdensome to affected private persons than the proposed action.

The Administrative Director invites interested persons to present statement or arguments with respect to alternatives to the proposed regulations at the scheduled hearing or during the written comment period.

AVAILABILITY OF INITIAL STATEMENT OF REASONS, TEXT OF PROPOSED REGULATIONS, RULEMAKING FILE AND DOCUMENTS SUPPORTING THE RULEMAKING FILE / INTERNET ACCESS

An Initial Statement of Reasons and the text of the proposed regulations in plain English have been prepared and are available from the contact person named in this notice. The entire rulemaking file will be made available for inspection and copying at the address indicated below.

As of the date of this notice, the rulemaking file consists of the notice, the initial statement of reasons, the proposed text of the regulations in strikeout/underline format, and the Form 399. The documents in the pre-notice rulemaking file include the CHSWC report on the DWC Audit Function, the January 30, 1998 memo to the Rulemaking File regarding claim sample sizes, audit worksheets, the minutes from the Audit Advisory Committee Meetings, the Audit Advisory Committee Meeting sign-in sheets, and memo(s) from Audit Advisory Committee member(s).

In addition, the Notice, Initial Statement of Reasons, and proposed text of regulations may be accessed and downloaded from the Division's website at www.dir.ca.gov.

Any interested person may inspect a copy or direct questions about the proposed regulations and any supplemental information contained in the rulemaking file. The rulemaking file will be available for inspection at the Department of Industrial Relations, Division of Workers' Compensation, 455 Golden Gate Avenue, 9th Floor, San Francisco, California, between 9:00 a.m. and 4:30 p.m., Monday through Friday. Copies of the proposed regulations, initial statement of reasons and any information contained in the rulemaking file may be requested in writing to the contact person.

PRESENTATION OF ORAL OR WRITTEN COMMENTS AND DEADLINE FOR SUBMISSION OF WRITTEN COMMENTS

Members of the public are invited to present oral or written statements, arguments or evidence at the public hearings. If you provide a written comment, it will not be necessary to present your comment as oral testimony at the public hearing.

In addition, any person may submit written comments concerning the proposed regulations prior to the close of the public comment period to:

Marcela Reyes
Regulations Coordinator
Department of Industrial Relations
Division of Workers' Compensation
Post Office Box 420603
San Francisco, CA 94142

Written comments may be submitted by facsimile transmission (FAX), addressed to the above-named contact person at (415) 703-4720. Written comments may also be sent electronically (via e-mail) using the following e-mail address: dwcrules@dir.ca.gov.

Unless submitted prior to or at the public hearing, Ms. Reyes must receive all written comments no later than 5:00 p.m. on September 13, 2002.

CONTACT PERSON

Nonsubstantive inquiries concerning this action, such as requests to be added to the mailing list for rulemaking notices, requests for copies of the text of the proposed regulations, the Initial Statement of Reasons, and any supplemental information contained in the rulemaking file may be requested in writing at the same address. The contact person is:

Marcela Reyes
Regulations Coordinator
Department of Industrial Relations
Division of Workers' Compensation
Post Office Box 420603
San Francisco, CA 94142

The telephone number of the contact person is (415) 703-4600.

BACKUP CONTACT/PERSON CONTACT PERSON FOR SUBSTANTIVE QUESTIONS

In the event the contact person is unavailable, or to obtain responses to questions regarding the substance of the proposed regulations, inquiries should be directed to the following backup contact person:

Department of Industrial Relations

Destie Overpeck
Industrial Relations Counsel
Division of Workers' Compensation
Post Office Box 420603
San Francisco, CA 94142

The telephone number of the backup contact person is (415) 703-4600.

AVAILABILITY OF CHANGES FOLLOWING PUBLIC HEARING

If the Administrative Director makes changes to the proposed regulations as a result of the public hearing and public comment received, the modified text with changes clearly indicated will be made available for public comment for at least 15 days prior to the date on which the regulations are adopted.

AVAILABILITY OF THE FINAL STATEMENT OF REASONS

Upon its completion, the Final Statement of Reasons will be available and copies may be requested from the contact person named in this notice or may be accessed on the website: www.dir.ca.gov

AUTOMATIC MAILING

A copy of this Notice, the Initial Statement of Reasons, and the text of the regulations, will automatically be sent to those interested persons on the Administrative Director's mailing list.

If adopted, the regulations as amended will appear in Title 8, California Code of Regulations, Section 10100.2 et seq.