GILBERT Law Offices, P.A.	]	
	]	
v.	]	
	]	**Decision and Order**
National Council on Compensation Insurance, *et al.*	]	
	]	
Docket NO. INS-99-2	]	

The Petitioner, Gilbert Law Offices, P.A., has filed a petition with the Superintendent pursuant to 24-A M.R.S.A. §§ 229, 2319(1) and 2320(3), contending that the provisions of the workers' compensation insurance rating plan which calculate premium as a percentage of annual payroll, as they are currently structured, discriminate unfairly against high-wage employers because the employer's premium continues to increase as the employee's weekly wage increases, even when there is no corresponding increase in the available total incapacity benefit because of the statutory benefit cap established by 39-A M.R.S.A. § 211. The Petitioner contends that the National Council on Compensation Insurance ("NCCI"), the advisory organization designated by the Superintendent to file rating plans pursuant to 24-A M.R.S.A. § 2382-C(5), should modify the uniform workers' compensation rating plan, either to rate on some basis other than payroll, or to cap the premium base so that annual wages paid to any single employee in excess of some ceiling such as $40,000 or $45,000 are not counted in the employer's premium calculation.

Pursuant to 24-A M.R.S.A. §§ 229 and 2319(2), the Superintendent convened an adjudicatory proceeding. After cross-motions for summary judgment were denied in relevant part, a public hearing was held on November 17, 1999.

For the reasons discussed below, the Petition is denied. The Petitioner has not shown that the current rating plan is unfairly discriminatory nor that it is an unreasonable approach to the measurement of workers' compensation risk. Workers' compensation risk clearly increases with total payroll, and NCCI has adequately justified its conclusion that it continues to increase even when employees' wages are above the threshold suggested by the Petitioner. However, there remains enough uncertainty over the nature and extent of that increase that NCCI is urged to continue to explore the feasibility of alternatives to the current system, in particular as regards the present distinction between executive officers of corporations and other employees.

The Relation Between Payroll and Premium

Payroll cap proposals such as the Petitioner's have been a matter of controversy, both in Maine and in other states, for almost as long as workers' compensation insurance has been in existence.

Workers' compensation risk involves three significant factors: frequency of injuries, average severity of injuries, and the cost of paying benefits for an injury of given

severity. The formula for calculating premium under the uniform rating plan also involves three significant factors: the employer's total payroll, the employer's line of business, and the employer's loss history.

It is essential to realize, however, that the rating factors do not match up on a 1–to–1 basis with the risk factors. In particular, although there is an obvious connection between wages per employee and cost per injury, the connection is not as simple as the Petitioner portrays it. On the one hand, a significant part of the average cost per injury consists of medical payments, which do not have any natural correlation with wages per employee. On the other hand, NCCI has observed that wages per employee do have a natural correlation not only with cost per injury, but also with frequency of injury, since they vary directly with amount of work done. Furthermore, this correlation becomes even stronger when comparing within a given business classification code rather than across the entire universe of employers.

The illustrations used by the Petitioner do not refute NCCI's analysis – they are not typical injuries, and they are chosen to isolate one of the risk variables, cost per injury, while leaving the others fixed. Although the Petitioner notes that measuring hours worked directly rather than indirectly would likely have a stronger correlation with frequency of injuries, NCCI has persuasively explained why collecting accurate information on hours worked is difficult, and why it is unlikely that even if such information were available, adding hours worked as an additional rating variable would greatly increase the complexity of the formula, and there is no reason to be confident of enough improvement in predictive power to justify the cost of designing, testing, and implementing such a formula or collecting, verifying, and managing the additional data.

Furthermore, as NCCI points out, the maximum weekly benefit under 39-A M.R.S.A. § 211 is just as high for partial incapacity benefits as it is for total incapacity benefits. This means that even though total incapacity benefits do stop increasing once wages reach the ceiling proposed by the Petitioner, partial incapacity benefits continue to increase along with wages significantly beyond that level – exactly how far will depend on the claimant's level of impairment.

In summary, NCCI has adequately demonstrated that variations in wages per employee – even above the levels that trigger the statutory cap on total incapacity benefits – appear to be sufficiently related to workers' compensation risk to justify their continued use in the rating formula, especially since the manual rate per $100 of payroll is only the beginning of the rating process. Even if that calculation tends to overstate a particular employer's actual loss exposure, the experience rating plan is designed to reduce the danger of an unfairly high premium charge. Furthermore, in a competitive market, employers that are better risks than the formula calculations would indicate have the opportunity to participate in schedule rating and other premium credit plans and to seek coverage from carriers with more selective underwriting practices and commensurately lower rates.

Executive Officers and Other Exceptionally High-Wage Employees

Nevertheless, although NCCI has demonstrated to the Superintendent's satisfaction why it should not be required to cap payroll at the levels proposed by the Petitioner, there is a point of diminishing returns beyond which wage levels do lose substantially all their predictive power in measuring workers' compensation risk. Salaries measured in millions per year do not result in a thousand times the exposure of salaries measured in thousands.

NCCI has taken this fact into consideration, and the rating plan does incorporate payroll caps, but at a more limited level than those proposed by the Petitioner. In all classifications, the maximum wage attributable to the executive officer of a corporation is four times the statewide average. For the Petitioner's 1997–98 policy year, the year for which the Petition was initially filed, this was $83,200 on an annualized basis. In certain classifications characterized by unusually wide variations in pay, such as entertainers, this cap also applies to non-executive employees.

Applying a cap here rather than at approximately half this level is justified by three significant distinctions:

- When only a small number of employees are affected by the cap, it is easier to administer and verify, and more difficult for employers to manipulate the data;
- Above this level, there is less of a correlation between increasing wages and a significant increase in partial incapacity exposure; and
- Above this level, in most classifications there is less of a correlation between wage levels and the time worked or the hazardous nature of the work.

However, NCCI has relied until now on an *ad hoc* process for deciding which classifications should be subject to payroll caps for non-executive employees and which ones should not be. Although this sort of evolutionary process is to be expected and does not call into question the validity of the current rating plan, it is time for NCCI to consider, on a prospective basis, a more systematic implementation of the principle set forth in its actuarial testimony that some sort of payroll cap or other alternative premium calculation formula is appropriate when "it is expected that compensation for a small number of individuals will be substantially different from the average for the class as a whole (as in the case of executive officers, or star athletes)."

Therefore, in its next statewide pure premium filing, NCCI shall either (a) make the same imputed maximum wage applicable to both executive officers and other employees, unless characteristics of a particular classification make this process inappropriate for that classification, reversing the current presumption in favor of capping only executive wages; or (b) demonstrate why such a change in the plan would not be appropriate.

The Disabled Principal

The most significant issue relating specifically to the Petitioner rather than to the classification system as a whole arose when one of the firm's principals was stricken by a tragic illness in 1997, resulting in total disability which is now expected to be permanent. During the 1997–98 policy period, her total earnings were $700.

Nevertheless, the Petitioner's premium was calculated as if she had received wages of $10,608, the minimum imputed wage for an executive officer pursuant to the uniform rating plan. Had that amount not been included in the Petitioner's premium base, the 1997–98 premium would have been $99.98 lower.

This attorney, as one of the firm's owners, had the right to waive eligibility for workers' compensation benefits pursuant to 39-A M.R.S.A. § 102(11)(A)(4). Had she done so, her wages would not have been included in the premium calculation. However, it is clear from the testimony of Charles Gilbert, a managing shareholder of the firm, that her prognosis at the time the policy was renewed was uncertain and that the Petitioner made a conscious decision to keep her on the policy, even though the firm's principals knew or should have known that this decision could cost as much as $100 even if her earnings during the policy period were negligible.

On these facts, I find that such a premium charge would be within the range of reasonableness for this exposure. NCCI has explained why the use of an imputed minimum for an employer's executive officers is fair and reasonable. The Petitioner has not challenged the underlying provision of the rating plan, but only its application to the circumstances of this case by its workers' compensation insurer, the Maine Employers' Mutual Insurance Company (MEMIC).

Specifically, the Petitioner contends that MEMIC should have applied Rule V(F)(4) of the NCCI Basic Manual, which provides coverage at no additional charge for nonworking officers and directors for the incidental exposure arising out of attendance at corporate meetings. However, when this claim was made, MEMIC reaffirmed its earlier decision after giving it careful reconsideration in light of the Petitioner's description of the very limited work actually performed by this attorney during the policy period. Based on testimony on behalf of both MEMIC and the Petitioner, I find that MEMIC acted reasonably and that its decision was a valid application of the rating plan to these facts.

Diversity of the Risk Pool

Next, the Petitioner observes that the purpose of the uniform classification system is to divide employers, to the extent feasible, into reasonably homogeneous groups based on the level of risk associated with the type of business they conduct. However, according to the Petitioner, the most significant work-related hazard for a white collar worker such as an attorney is likely to be the risk of a transportation-related injury, and there is substantial variation among law firms in the extent of their travel exposure.

These observations are quite believable, and they have not been questioned by NCCI or MEMIC. However, although incorporating them into the rating plan would seem to be a good idea in principle, there is no obvious way to do so, nor has the Petitioner suggested anything specific enough to be the basis for any concrete action even on a prospective basis.

Disclosure

Finally, the Petitioner asserts that it was not given adequate information about the rating plan and how the plan affected the Petitioner's premium. According to the Petitioner, its managers might have made a number of business decisions differently had MEMIC or its agents provided a better explanation, which might have included, without limitation, naming one of its high-wage employees as an executive officer, filing a petition challenging the rating plan earlier, or limiting coverage to employees who were ineligible to waive workers' compensation benefits.

However, the evidence shows that the firm's managers were experienced workers' compensation attorneys. Mr. Gilbert testified that in 1995, he became aware of the alleged inconsistency between the premium rating plan and the benefit structure. As he explained on August 24, 1995, in a letter to his insurance agency: "I feel there is a significant overstatement of the premium basis. This stems from the fact that my salary in particular is far in excess of what is allowed under law as a benefit; In other words, under § 211 of the act, if I should become totally disabled, the maximum benefit to which I would be entitled is $441 per week.... [I]t stands to reason that, if such person makes $100,000 per year, but only gets the same benefits as someone making $35,000.00, it is wrong and illegal for the insurer to charge a premium on the excess."

The agency responded by sending him a copy of the relevant provisions of the rating plan. Although that document expresses the imputed maximum wage for executive officers in terms of a weekly wage, the agency added a handwritten notation in the margin explaining that the cap in effect at that time was equivalent to an annual salary of $78,000. They explained that accordingly, they would ask MEMIC to reduce the firm's total payroll to reflect that cap.

In response to a further inquiry by Mr. Gilbert, the agency explained on September 1, 1995: "I understand your frustration with the fact that the wage benefits available to you are much lower than the premium basis used for rating when including an executive officer. Please remember that the wage benefits are only a part of the coverage under a Workers Compensation policy." The Petitioner apparently acquiesced in this recalculation of its premium, since there is no record of any further demand at that time to reduce the payroll further by capping Mr. Gilbert's salary at $35,000 rather than $78,000.

In summary, the record shows that Mr. Gilbert received timely, accurate, and clear responses to his questions about the premium rating process, and there is no evidence on this record that either MEMIC or the agency misrepresented any contract terms or violated any duty to disclose. Although Mr. Gilbert testified that the firm's subsequent treatment of a high-wage non-executive employee (who has subsequently become a shareholder and an executive officer) relied on the assumption that nonexecutive employees were subject to a lower payroll cap than executive officers, such an assumption was not reasonable in light of the information he had been given in response to his inquiries,

The Petitioner's further complaint that the NCCI Basic Manual has not been reviewed for compliance with the Insurance Policy Language Simplification Act has

no merit because that manual is not a "policy form" within the meaning of 24-A M.R.S.A. § 2439(2). Furthermore, the record demonstrates that Mr. Gilbert was not in fact led astray in any material way by any alleged obscurity in the relevant provisions of the manual.

Order and Notice of Appeal Rights

It is therefore *ORDERED:*

1. The Petition is hereby *DENIED.*
2. In its next statewide pure premium filing, NCCI shall either (a) make the same imputed maximum wage applicable to both executive officers and other employees, unless characteristics of a particular classification make this process inappropriate for that classification, reversing the current presumption in favor of capping only executive wages; or (b) demonstrate why such a change in the plan would not be appropriate. If NCCI elects to use a lower aggregate premium base for any classification to adjust for the effect of the payroll caps, it must demonstrate that the adjustments are attributable to employees who are covered by the workers' compensation system and are not currently subject to the existing caps. If supported by experience, an imputed maximum wage established pursuant to this Order may vary from the current standard of four times the average wage, either statewide or by exception for particular classifications.

This Decision and Order is a final agency action of the Superintendent of Insurance within the meaning of the Maine Administrative Procedure Act. It is appealable to the Superior Court in the manner provided in 24A M.R.S.A. § 236 (Supp. 1999) and M.R. Civ. P. 80C. Any party to the hearing may initiate an appeal within thirty days after receiving this notice. Any aggrieved non-party whose interests are substantially and directly affected by this Decision and Order may initiate an appeal on or before February 21, 2000. There is no automatic stay pending appeal; application for stay may be made in the manner provided in 5 M.R.S.A. § 11004.

PER ORDER OF THE SUPERINTENDENT OF INSURANCE

January 10, 2000

NANCY H. JOHNSON
DESIGNATED HEARING OFFICER