STATE OF ARIZONA
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DEPT. OF INSURANCE
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STATE OF ARIZONA

DEPARTMENT OF INSURANCE

In the Matter of:	**Docket No. 98A-004-INS**
DAYSTAR CONTRACT STAFFING, INC.	**ORDER**
Petitioner.	

On February 24, 1998, the Office of Administrative Hearings, through Administrative Law Judge Casey J. Newcomb submitted "Recommended Decision of Administrative Law Judge" (the "Recommended Decision"), a copy of which is attached and incorporated by this reference. The Director of the Arizona Department of Insurance (the "Director") has reviewed the recommendation and the record in this matter, and enters the following order:

a. Except as noted below, the recommended findings of fact and conclusions of law and proposed order are accepted.

b. For the reasons stated below, the Director substitutes the following findings of fact, conclusions of law and order in lieu of the Recommended Decision of Administrative Law Judge.

FINDINGS OF FACT

A. Parties, Definitions and the Rule

The director amends finding of fact ¶1 as follows:

1. DayStar Contract Staffing, Inc. is a Professional Employer Organization ("PEO") that operates in Arizona and in other western states. Mr. Gary Mecham is the Petitioner's owner and president. The Petitioner has approximately 100 clients and 3,000 employees.

Explanation for change: This change is made to correct a clerical error.

2. PEOs are in the business of creating employee leasing arrangements for profit. An employee leasing arrangement exists when an entity (client) utilizes the services of a third party (the PEO or labor contractor) to provide employees to the client for a fee or other compensation. For example, an employee leasing arrangement is created when a client transfers all or most of its employees to the PEO (or labor contractor) and those employees are then leased back to the client. Employee leasing arrangements are usually of a long-term or permanent nature and should not be confused with temporary labor service contractors providing services on a short-term or temporary basis.

3. The NCCI is a non-profit workers' compensation insurance rating organization licensed in over 30 states. The NCCI collects and disseminates loss and premium information, calculates rates, and develops classifications and statistical reporting mechanisms for use by insurance carriers, employers and insurance departments. This information is used for the purpose of providing equitable workers' compensation insurance to insure employers' business operations.

4. A client's "experience modifier" or E-mod is a term that reflects the workers' compensation claims history of the individual company. For example, a PEO will have an experience modifier of 1.0 if it has an average or normal history (i.e. an average number of workplace injuries and claims) in comparison to other companies in this industry. If a company has a very poor history, then it will have a negative or debit experience modifier that is higher than 1.0 (i.e. 1.5). If a company has a better than average history, then it will have a positive or credit experience modifier that is below 1.0 (i.e. .5). The Petitioner has a positive experience modifier of .77.

The director modifies proposed finding of fact ¶5 as follows:

5. Only those companies with premiums in excess of a certain amount receive experience modifiers. Consequently, smaller companies do not have an experience modifier, regardless of their

claims history. Many of the clients traditionally served by an employee leasing firm will not have sufficient experience or insurance premiums to qualify for an experience modifier. If a company does not have an experience modifier, then it is in essence assigned an experience modifier of 1.0.

Explanation for Change: Evidence presented at the hearing demonstrated that far less than half of the clients of a PEO will generate an experience modifier. This evidence is significant when considering the arguments that the PEO's experience should apply to the business of the client. Thus, DayStar asks for the application of an experience modifier under circumstances not permitted by the NCCI's filings. As such, the argument that DayStar has been discriminated against because it cannot apply its experience modifier to the experience of its clients must be rejected. Instead, consideration must be given to whether DayStar seeks to have the system discriminate in its favor and in favor of its clients by requiring the application of an experience modifier to calculate the cost for workers compensation coverage for the client, when the client could not independently qualify for an experience modifier under the NCCI's filings. In other words, DayStar seeks to have worker's compensation premiums calculated differently for two otherwise identical employers, one of which contracts with a PEO and the other of which does not, even when the sole distinguishing factor between the two employers is the use of a PEO.

6. The NCCI determines a company's "experience modifier" on an annual basis. The experience modifier is calculated using data from the preceding three years. Consequently, a company with a negative experience modifier may have to wait three years before a bad year (i.e. a year with above average workplace accidents and claims) falls out of the equation. However, a company that implements a successful safety program (thereby reducing the number of workplace injuries and claims in a given year) should see some improvement in its negative experience modifier during the subsequent rating period.

7. Prior to the adoption of the Rule, the National Association of Insurance Commissioners ("NAIC") recommended a model rule that was used as a basis for the NCCI's Rule B1276 which was circulated as a national filing in March of 1992. The Department rejected Rule B1276 because it only applied to assigned risk plans and did not cover the voluntary market.

8. The Department drafted a similar rule that would apply to both the assigned risk market and the voluntary market. On November 6, 1995, Bernard Hill, the Department's Property and Casualty Analyst, sent a letter to Thomas W. Cleary of the NCCI requesting that the NCCI review a draft proposal of this rule. See NCCI's Exhibit # 16. On February 20, 1996, the NCCI responded by sending a proposed draft of this rule to the Department. See NCCI's Exhibit 21. The Department subsequently requested that the NCCI formally file the proposed Rule. See NCCI's Exhibit #22.

9. On or about September 25, 1996, the Arizona Department of Insurance (the "Department") approved Arizona State Special Rule IX.F of the Workers' Compensation and Employee Liability Insurance Manual (the "Basic Manual") and Rule C.11 of the Experience Rating Plan Manual, Part 2. This Rule (also referred to as the Arizona Employee Leasing Arrangements Rule) provides in part:

> 2.b. The services of the leased workers provided to a client by a labor contractor must be written under a separate workers' compensation insurance policy. The experience reported in conjunction with the separate policy shall be used to calculate the experience modification of the client.
>
> 3.c The experience modification, classification, rates, and rules applicable to the client entity shall be applied to the premium developed for the workers leased to the client.

Basic Manual, Rule IX.F

The director modifies proposed finding of fact ¶10 as follows:

10. The relevant section in the Experience Rating Plan Manual, Part Two provides in part:

If an experience rated client enters into an employee leasing arrangement, then the experience modification of the client will apply to the coverage for the labor contractor's liability to provide workers' compensation benefits for the workers leased to the client.

Experience Rating Plan Manual, Part Two, §C.11.b.

Explanation for Change: This change is made to correct a clerical error.

11. The primary purpose of the Rule is to prevent companies with negative experience modifiers from joining PEOs (with positive experience modifiers) in order to avoid or wash out the negative financial consequences of their negative experience modifiers. In other words, a company with a poor safety record (and a negative experience modifier) normally would have to pay higher workers' compensation rates. However, this company could possibly avoid these higher rates by joining a PEO with a positive experience modifier.

12. The Rule serves the aforementioned purpose by insuring that the client's experience modifier will follow that client even if it enters into employee leasing arrangements. Pursuant to the Rule, a PEO must provide a separate workers' compensation insurance policy for each client. Each separate insurance policy would name the PEO as the named insured but would also reference the name of the client. This assures that the experience of that client will be used to develop an experience modifier for that client. Furthermore, if the client leaves the PEO, the experience of that client can be easily identified and retained in the client's modifier. Accordingly, by requiring the PEO to enter into separate policies with each client, the NCCI will be more effective and efficient in tracking the experience modification factors of each client.

13. On October 17, 1996, the NCCI distributed the Rule to all of its members and subscribers. See NCCI's Exhibit #27. The Rule became effective on January 1, 1997. Prior to its adoption, this Rule received the endorsement of Lanny L. Hair, the Executive Vice President of the Independent Insurance Agents and Brokers of Arizona, Inc. See NCCI's Exhibit #25.

The director modifies proposed finding of fact ¶14 as follows:

14. The Rule serves the purpose of allowing the NCCI to effectively and efficiently track the experience modification factors of each client that joins a PEO.

Explanation for Change: This change reflects the Director's adoption of this finding.

B. DayStar's Argument

The director modifies proposed finding of fact ¶15 as follows:

15. On or about July 31, 1997, the Petitioner filed an appeal with the Arizona Workers Compensation Appeals Board (the "Board") pursuant to A.R.S. §20-367(B) alleging that the Rule unfairly discriminated against the Petitioner and other small PEOs in violation of A.R.S. §20-341(A), which provides that:

> The purpose of this article is to promote the public welfare by regulating insurance rates to the end that they shall not be excessive, inadequate or unfairly discriminatory, and to authorize and regulate cooperative action among insurers in rate making and in other matters within the scope of this article. Nothing in this article is intended to prohibit or discourage reasonable competition, or to prohibit encourage, except to the extent necessary to accomplish the purpose stated in this section, uniformity in insurance rates, rating systems, rating plans or practices. This article shall be liberally interpreted to carry into effect the provision of this section.

Explanation for Change: This change is made to correct a clerical error and to include the full text of A.R.S. §20-341(A) within the body of the order.

16. On November 14, 1997, a hearing was held before the Board. The purpose of the hearing was to determine if the Rule was fair and reasonable as it applied to the Petitioner and other smaller PEOs. Attorney Scott Gibson represented the Petitioner at this hearing. Mr. Gibson argued that the Rule was unfair to the Petitioner for the following four reasons:

1. Requiring separate policies reduces the premium discount. When all of the clients are insured under a single jumbo policy, the premium discount is larger. In addition, writing individual policies requires a higher deposit premium than if all the clients are insured under a single jumbo policy.

2. The Rule disregards the fact that leased employees are employees of the PEO. The Rule erroneously treats the leased employees as employees of the clients.

3. The Rule requires the PEO to pay premiums based on the client's modifier rather than the modifier developed for the PEO. This reduces the benefits of the loss safety program implemented by the PEO.

4. The Rule establishes a precedent that could lead to the elimination of smaller leasing operations.

17. In an executive session, the Board discussed the purpose of the Rule and Mr. Gibson's arguments. The Board upheld the Rule. See NCCI's Exhibit 11.

1. Premium Discount

18. Mr. Mecham testified that the Petitioner's workers' compensation insurance was up for renewal on August 1, 1997. Mr. Mecham testified that prior to the renewal date, he had contacted and made arrangements with Capital General (an insurance carrier) to write a jumbo policy that would cover the Petitioner's 100 clients and 3,000 employees. However, Mr. Mecham testified that Capital General refused to write the jumbo policy because of the Rule.

19. Mr. Mecham testified that General Capital would only write a separate policy for each of the Petitioner's clients (because of the Rule). Mr. Mecham testified that with so many small policies, the Petitioner could not qualify for the a substantial discount given for large jumbo policies.

20. Mr. Mecham testified that the Arizona State Compensation Fund also required an individual policy for each client because of the Rule. Mr. Mecham testified that he also could not qualify with the Arizona State Compensation Fund for the substantial discount for one large jumbo policy.

21. Mr. Tim Hughes is the Appeals Manager for the NCCI. Mr. Hughes testified that the Rule states that each separate policy shall contain the name of the labor contractor (i.e. the Petitioner) as the named insured with an additional reference identifying the name of the client. Mr. Hughes testified that pursuant to Rule VII.F.1 of the Basic Manual, the Petitioner may combine the 100 single policies to calculate the applicable premium discount. Consequently, the Rule should not have an unfair impact on the Petitioner's premium discount.

22. Mr. Mecham testified that many carriers are not following Rule VII.F.1 of the Basic Manual. Mr. Mecham testified that one insurance carrier at the November 14, 1997 Arizona Workers Compensation Appeals Board Meeting advised the Board that it would not follow Rule VII.F.1 of the Basic Manual. See NCCI's Exhibit 11, page 3. However, another insurance carrier implied that it would. Id.

The director rejects proposed finding of fact ¶23 and in its place substitutes the following finding of fact:

23. The Rule does not preclude the Petitioner from obtaining a substantial premium discount from carriers. In fact, Rule VII.F.1 of the Basic Manual provides in relevant part that:

> Two or more policies issued to the same insured by one or more insurance carriers . . . shall, unless the insured instructs the carrier otherwise, be combined for the purpose of computing the premium discount for that insured.

Explanation for Change: DayStar has not been adversely affected by the Rule VII.F.1 of the Basic Manual. This rule permits a PEO to combine its policies and to have them treated as a single policy for purposes of calculating the premium discount available to the insured. With respect to this and other

provisions of the Basic Manual, compliance is not an option. Any failure of any insurer to enforce these or other provisions of the Basic Manual, and any failure of the NCCI to monitor or audit its member insurers' enforcement and compliance with these provisions is of regulatory concern to the Department. To the extent that DayStar has requested that its policies be combined to calculate the premium discount to which it is entitled under this Rule and other provisions of filings made by the NCCI, DayStar's request should be granted. To the extent that insurers may have failed to provide DayStar with the premium discount established in Rule VII.F.1 of the Basic Manual, other regulatory concerns outside the scope of this hearing may remain to be addressed in separate proceedings.

2. Premium Deposit

24. Mr. Mecham also testified that the Petitioner will have to post a greater premium deposit (because of the Rule) if it has to enter into 100 separate policies as opposed to a jumbo policy. Mr. Mecham testified that the posted premium deposit would be less by about $70,000.00 if the Petitioner could enter into only one jumbo policy (much like the premium discount is greater for a jumbo policy than it is for 100 individual policies).

25. Mr. Hughes testified that the Rule does not affect the total amount of the premium that the Petitioner must pay. Rather, it may only affect the deposit or down payment posted on the premium. However, Mr. Hughes also testified that the Basic Manual does not currently have a rule addressing this premium deposit issue. Consequently, Mr. Hughes testified that the Rule could negatively affect the PEO's premium deposit. Mr. Hughes further testified that the NCCI would certainly consider amending Rule VII.F of the Basic Manual to allow the grouping of single policies to determine the overall premium deposit.

The director rejects proposed finding of fact ¶26 and in its place substitutes the following finding of fact:

26. The premium deposit rule does not adversely affect the Petitioner. The premium deposit rule does not impact the total amount of the premium paid by the Petitioner. While the premium deposit rule may prevent the Petitioner from being eligible for a smaller premium deposit, the premium ultimately to be paid by an insured for workers compensation coverage would be calculated after the end of the policy term with the deposit applied against any outstanding balance determined to be due under the policy. Thus, the premium deposit rule addresses the insurance contract's payment terms and not a rating issue. Therefore, the premium deposit rule does not unfairly discriminate against DayStar in violation of the directive that "insurance rates . . . shall not be excessive, inadequate or unfairly discriminatory . . . ." A.R.S. §20-341(A).

Explanation for change: The absence of a rule regarding the ability of purchasers of multiple policies to have the policies combined to calculate the applicable premium deposit required for the coverages does not support the conclusion that DayStar has been unfairly discriminated against in the context of the directive in A.R.S. §20-341(A) that "insurance rates . . . shall not be excessive, inadequate or unfairly discriminatory . . . ." The premium deposit rule does not impact the rates applicable to the coverage bought by DayStar. Instead, the premium deposit rule represents a timing issue with respect to how much an insured must pay up front for coverage, and how much will remain due the insurer at the end of the policy period. Neither the papers filed with DayStar, the transcript, nor the recommended decision demonstrated that DayStar had made any showing, let alone a showing by the preponderance of the evidence, that DayStar has been unfairly discriminated against within the meaning of A.R.S. §20-341(A). Nevertheless, nothing in the law would prevent the NCCI from filing a revision to the Basic Manual to permit premium deposits similar to that allowed already under Rule VII.F.1 of the Basic Manual for premium discounts, a decision that would presumably be made by the NCCI in consideration of the business consequences of a rule of this sort.

Significantly, as noted above as part of the explanation for the modification of finding of fact ¶5, consideration must be given to whether DayStar seeks to have the system discriminate in its favor and in favor of its clients by requiring the application of a premium deposit rule to calculate the premium deposit due for workers compensation coverage for the client, when the client could not independently qualify for a smaller deposit under the NCCI's filings. In other words, DayStar seeks to have worker's compensation premium deposits calculated differently for two otherwise identical employers, one of which contracts with a PEO and the other of which does not, even when the sole distinguishing factor between the two employers is the use of a PEO.

3. Safety Programs

27. Mr. Mecham testified that the Rule unfairly requires the Petitioner to pay premiums based on the experience modifiers of its clients. Some of these clients have poor experience modifiers because they lack an effective safety program. Mr. Mecham testified that the Petitioner has implemented a highly successful safety program that has greatly improved the safety record of its clients. Consequently, Mr. Mecham argued that the Petitioner should pay premiums based upon its own rating experience. Mr. Mecham testified that the Petitioner should not have to pay a premium based on the poor history of a client (which now has an effective safety program implemented by the Petitioner).

28. Mr. Mecham further testified that the PEO's employees (including the employees leased to the clients) will benefit from the PEO's safety programs because the clients' work environments will be safer. However, if the PEO has no incentive to provide the safety program (because of the Rule), then these safety programs will be eliminated causing workplace injuries to increase. Mr. Mecham conceded that not all of the PEOs have effective safety programs.

The director modifies proposed finding of fact ¶ 29 as follows:

29. The Rule will not eliminate the benefits associated with a PEO's safety program because the Rule will not reduce the Petitioner's incentive to provide such safety programs. The Petitioner will always have an incentive to provide safety programs (even under the Rule) because it is constantly striving to reduce workplace injuries which will improve the client's experience modifier as well as the Petitioner's experience modifier. An improved experience modifier will generally translate to lower insurance rates for the Petitioner.

Explanation for Change: This change reflects the Director's adoption of this finding.

4. Employer/Employee Relationship

30. Mr. Mecham testified that the Rule unfairly disregards the Petitioner's employer/employee relationship with its employees. Mr. Mecham testified that under the workers' compensation laws, employers are required to provide insurance for their employees. Mr. Mecham testified that the clients' employees are really the Petitioner's employees. Therefore, the Petitioner should be able to write one jumbo policy to cover all of its employees (including the leased employees of the clients). Mr. Mecham testified that the Rule treats the Petitioner as something other than an employer by requiring separate policies for each client.

The director rejects proposed finding of fact ¶31 and in its place substitutes the following finding of fact:

31. The Rule's treatment of DayStar's employees as also being employees of a client of DayStar for which the employees work does not constitute a rating issue within the meaning of Title 20. Instead, the determination that DayStar's employees also constitute employees of DayStar's client for purposes of the workers compensation statutes represents a judgment mandated by law about who bears the ultimate responsibility (and the risk) for the actual work activities of DayStar's leased employees. Additionally, even if Petitioner could cite applicable law, insufficient evidence exists to demonstrate that

the Petitioner has been unfairly discriminated against. Therefore, the Rule's treatment of DayStar's employees as also being employees of the DayStar client for which the employee worked does not violate the directive that "insurance rates . . . shall not be excessive, inadequate or unfairly discriminatory . . . ." A.R.S. §20-341(A).

Explanation for Change: DayStar has not been discriminated against, within the meaning of A.R.S. §20-341(A) by the application of filings made by the NCCI that treat employees of the PEO as employees of the client too. These filings are consistent with Arizona law on this point. *See, e.g., McDaniel v. Troy Design Services Co.*, 186 Ariz. 552, 555-556, 925 P.2d 693, 696-697 (App. 1996); *Avila v. Northrup King Co.*, 179 Ariz. 497, 502-503, 880 P.2d 417, 722-723 (App. 1994). These and other cases make clear that within the field of workers compensation insurance, special rules apply to ensure that the system fairly accounts for the varying interests and concerns faced by insurers, employers, and employees. Under DayStar's approach, its employees would not be considered employees of its client. This simplistic approach could have deleterious consequences. For example, this result would permit any DayStar employee who suffered a work injury while fulfilling DayStar's contractual obligation to supply labor to the client to sue the client in tort rather than the seek relief pursuant to the exclusive remedy established by Arizona's workers compensation laws. Whether DayStar's clients would welcome this prospect seems unlikely. Nevertheless, the cases cited above make clear that both the client and the PEO may each be the "employer" of the injured worker for purposes of Arizona's workers compensation laws, the laws central to the evaluation of risks and the development of rates for workers compensation insurance.

5. Excessive Costs/ Unfair Competition

The director modifies proposed finding of fact ¶32 as follows:

32. Mr. Mecham testified that the Rule requires the Petitioner to incur excessive costs because of the paperwork associated with 100 separate insurance policies (as opposed to one jumbo policy). Mr. Mecham testified that the Petitioner had to hire one additional staff employee at $30,000.00 a year just to handle the additional paperwork. Mr. Mecham further testified that one additional employee is an extreme financial burden for a company with only 11 staff employees. Nevertheless, this testimony did not demonstrate that the costs associated with the administration of 100 policies would differ substantially from the costs associated with the administration of one policy divided into 100 "subaccounts" with each account maintained to track the applicable variables, including each client's loss experience and the application of any applicable experience modifier to the business of each client.

Explanation for Change: DayStar's central argument to have all of its policies combined into a single "jumbo" policy, and the logic and force underlying its economies of scale argument in support of the administrative ease of administering a single policy rested on its desire to apply its experience modifier to all of the workers compensation insurance it purchased in connection with its PEO operations. As discussed above, this argument has been rejected. See Findings of Fact ¶¶ 11, 12, and 14 (including the *Explanation for Change*). Because DayStar must account separately for the experience of each client, DayStar has not shown itself to be adversely impacted by the Rule within the meaning of A.R.S. §20-341(A).

Further, the administrative costs associated with the operation of a PEO business have nothing to do with insurance rates. Therefore, DayStar has not stated a rate discrimination issue to which A.R.S. §20-341(A) has any application.

The Rule requires what the law requires: That the applicable experience be matched to the appropriate risk when calculating the premium. This, of course, means at the client level. Therefore, the

same calculations will have to be made under both a single jumbo policy with 100 separate subaccounts and 100 separate polices.

Moreover, as noted above as part of the explanation for the modification of recommended findings of fact ¶¶ 5 and 26, consideration must be given to whether DayStar seeks to have the system discriminate in its favor and in favor of its clients by requiring the elimination of a paperwork requirement generally applicable to policyholders. Each client would have to separately maintain records necessary for the insurer and the NCCI to audit the periodically audit the policy. Nevertheless, DayStar appears to argue that because of its status as a PEO, its expenses would be lower if it did not have to bear this administrative cost, even though its client could not independently qualify for relief from the administrative requirements associated with workers compensation insurance subject to the filings of the NCCI. In other words, DayStar seeks to have a separate rule for the administration of records related to worker's compensation insurance for those employers associated with a PEO and those that are not, even when the sole distinguishing factor between the two employers is the use of a PEO.

The director modifies proposed finding of fact ¶ 33 as follows:

33. Mr. Mecham also testified that the Rule will cost the Petitioner an additional $200,000.00 per year to obtain workers' compensation insurance. Nevertheless, this testimony did not demonstrate that the costs associated with the administration of 100 policies would differ substantially from the costs associated with the administration of one policy divided into 100 "subaccounts" with each account maintained to track the applicable variables, including each client's loss experience and the application of any applicable experience modifier to the business of each client.

Explanation for Change: See Finding of Fact ¶ 32 (including the *Explanation for Change*).

The director modifies proposed finding of fact ¶ 34 as follows:

34. Mr. Mecham testified that larger PEOs and self-insured PEOs can absorb the additional costs associated with the Rule. However, Mr. Mecham testified that the Petitioner and other smaller PEOs cannot absorb these additional costs and still remain competitive with the larger PEOs. No evidence presented at the hearing demonstrated what constitutes a "larger PEO" from a "smaller PEO". No evidence presented at the hearing demonstrated that the Rule causes insured PEOs, regardless of size, to be treated any differently than a PEO of the size of DayStar. Further, nothing in the record suggests that comparisons may permissibly be made between the rules governing the administration of insured plans subject to the provisions of both Title 20 and the filings made by the NCCI with the separate body of laws governing self-insured plans.

Explanation for Change: The argument presented by DayStar rested largely upon its contention that the Rule causes smaller PEOs to be treated differently than all other PEOs. For a number of reasons, nothing in the record supports this contention. First, the records contains no suggestion about how to distinguish a "larger PEO" from a "smaller PEO". DayStar offered only the conclusion without accompanying proof that it constitutes a "smaller PEO" according to any recognized standard. Second, even if DayStar constitutes a "smaller PEO", for the reasons outlined above in the explanation for change following Finding of Fact ¶ 32, in light of the need for DayStar to separately account for the distinct variables of each client, including each client's experience, DayStar, like all other PEOs and employers must maintain specific detailed records relating to workers compensation insurance. Third, if the reference to self-insured PEOs was to those that lawfully provide for workers compensation outside of the insurance system to which the NCCI filings have applicability, those programs are not, under Arizona law, "insurance" within the meaning of Title 20. Therefore, any comparison between the administration of self-insured (i.e., self-funded, non-insured) plans and insured plans would not be

relevant to the determination of whether the Rule violates A.R.S. §20-341(A) because this law does not govern the administration of self insured plans.

The director rejects proposed finding of fact ¶35 and in its place substitutes the following finding of fact:

35. The Rule does not violate the directive that "insurance rates . . . shall not be excessive, inadequate or unfairly discriminatory . . . ." within the meaning of A.R.S. §20-341(A) and thus does not impose an unfair financial hardship on PEOs. The record does not support the conclusion that the Rule compels (1) PEOs to hire additional staff, which is not a insurance rating issue; (2) creates more time consuming paperwork for DayStar, which is not an insurance rating issue; and (3) the possible loss of the premium discount, which Rule VII.F.1 of the Basic Manual expressly permits, and therefore does not result in the effectuation of insurance rates that are excessive, inadequate or unfairly discriminatory.

Explanation for Change: See Findings of Fact ¶¶ 23, 32-34 (including the *Explanation for Change*). In sum, the record does not support the finding that an identifiable distinction exists between "smaller PEOs" and "larger PEOs." Even assuming A.R.S. §20-341(A) applied to Petitioner's claims, the record does not support the conclusion that DayStar bears an unfairly discriminatory burden with respect to the records that it must separately maintain or the staff that it must hire to ensure that the files for its clients may be audited as necessary by its insurer and the NCCI. Finally, the record supports the conclusion that DayStar may request that its policies be combined for the purpose of computing any applicable premium discount.

6. Carrier Audits

36. Mr. Mecham testified that the new Rule also imposes additional hardships on the insurance carriers because it is easier to audit one PEO with one jumbo policy than it is to audit one PEO with 100 separate policies.

Explanation for Change: This change reflects the Director's adoption of this finding.

The director modifies proposed finding of fact ¶ 37 as follows:

37. The evidence is not sufficient to prove that the Rule negatively affects insurance carriers.

Explanation for Change: This change reflects the Director's adoption of this finding.

C. Alternative Rule

38. Mr. Mecham testified that the Rule should be amended to allow a PEO to obtain a master policy. This would allow the PEO to enjoy the premium discount and premium deposit benefit offered to larger jumbo policyholders. Furthermore, Mr. Mecham testified that each client would have a sub-number which would allow the NCCI to track all of the claims made by that client. Consequently, a company with a negative experience modifier could reap the benefits of the PEO's safety program but would not be able to wash away its negative experience modifier.

39. On July 9, 1997, Bernard Hill, the Department's Property and Casualty Analyst, wrote a letter to Mr. Mecham stating that the Department conceptually had no problem with permitting a master policy for employee leasing arrangements. See Petitioner's Exhibit #3. Mr. Hill suggested that the master policy could include a schedule containing the name of each client, the client's address, classification codes, payroll and experience modification factors of the client. Id.

40. The State of Utah passed a rule that allows the PEO to choose between (1) a master policy that covers all the leased employees or (2) separate policies for each client. See NCCI's Exhibit #14. The Utah rule does require (under both options) that the client's experience modifier be used in determining the PEO's premium for the master policy.

41. Mr. Mecham testified that the Utah rule should be adopted in Arizona with the exception that the PEO's experience modifier should be applied in determining the PEO's premium. Mr. Mecham testified that the Petitioner's experience modifier should be based on the claims experience of its client

companies only since the client companies associated with the Petitioner. Mr. Mecham testified that if the client's prior experience modifier is applied, then the client will have no incentive to join the PEO. This is because the PEO would have to charge the client the same cost that the client is already paying (outside of the PEO) plus the cost of doing business with the PEO.

The director modifies proposed finding of fact ¶ 42 as follows:

42. The Petitioner's proposed exception to the Utah rule is unreasonable because it allows a client with a poor experience modifier to join a PEO and thereby avoid the negative cost of higher insurance rates associated with a poor experience modifier. This is unfair to other companies that have not joined a PEO. Furthermore, it defeats the primary purpose for adopting the Rule as discussed in Findings of Fact #11. Finally, the PEO can always pass along the higher premium cost to the client with the poor experience modifier. The client with a poor experience modifier will still have the incentive to join the PEO because of the savings associated with the master policy's substantial premium discount.

Explanation for Change: This change reflects the Director's adoption of this finding.

The director rejects proposed finding of fact ¶43 and in its place substitutes the following finding of fact:

43. DayStar's support for the Utah Rule stemmed from its fundamental misunderstanding of that rule. DayStar incorrectly believed that the Utah Rule permitted it to apply its experience modifier to the workers compensation insurance purchased for its clients.

Explanation for Change: See Findings of Fact ¶¶ 11, 12, 14, 23, 32-35 (including the *Explanation for Change*) DayStar did not establish that the Rule violates the provisions of A.R.S. §20-341(A). Thus, any comparison between this lawful Rule and the laws and rules of another state has no relevance or significance to this proceeding.

CONCLUSIONS OF LAW

1. The Appellant has the burden of proof, and the standard of proof on all issues is by a preponderance of the evidence. Culpepper v. State, 187 Ariz. 431, 930 P.2d 508 (App. 1996). A "preponderance of the evidence is such proof as convinces the trier of fact that the contention is more probably true than not." Morris K. Udall, Arizona Law of Evidence, §5 (1960). It "is evidence which is of greater weight or more convincing than the evidence which is offered in opposition to it; that is, evidence which as a whole shows that the fact sought to be proved is more probable than not." Black's Law Dictionary, 1182 (6th ed. 1990).

The director rejects proposed conclusion of law ¶2 and in its place substitutes the following conclusion of law:

2. The purpose of A.R.S. §20-341(A) is to promote the public welfare by regulating insurance rates so that they are not "excessive, inadequate or unfairly discriminatory." A.R.S. §20-341(A). DayStar failed to prove that Section IX.F.2.b of the Basic Manual unfairly discriminates against the Petitioner and other similarly situated PEOs for the reasons stated in Findings of Fact ¶¶ 23, 26 and 35.

The director rejects proposed conclusion of law ¶3 and in its place substitutes the following conclusion of law:

3. DayStar failed to prove that Section IX.F.2.b of the Basic Manual is inadequate for the reasons set forth in Findings of Fact ¶¶ 23, 26, 35, and 43.

The director modifies proposed conclusion of law ¶4 as follows:

4. Section IX.F.3.c. of the Basic Manual does not violate A.R.S. §20-341(A).

The director modifies proposed conclusion of law ¶5 as follows:

5. Section C.11.b. of the Experience Rating Plan Manual does not violate A.R.S. §20-341(A).

The director rejects the Recommended Decision and in its place substitutes the following in its place:

DECISION

Based upon the foregoing, the Board's decision to uphold Section IX.F.2.b of the Basic Manual is affirmed.

NOTIFICATION OF RIGHTS

The aggrieved party may request a rehearing with respect to this Order by filing a written petition with the Office of Administrative Hearings within 30 days of the date of this Order, setting forth the basis for such relief pursuant to A.A.C. R20-6-114(B).

The final decision of the Director may be appealed to the Superior Court of Maricopa County for judicial review pursuant to A.R.S. § 20-166. A party filing an appeal must notify the Office of Administrative Hearings of the appeal within ten days after filing the complaint commencing the appeal, pursuant to A.R.S. §41-1092.10.

DATED this 13 day of April, 1998.

John A. Greene
Director of Insurance

A copy of the foregoing mailed
this 13th day of April, 1998

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IN THE OFFICE OF ADMINISTRATIVE HEARINGS

IN THE MATTER OF: DAYSTAR CONTRACT STAFFING, INC., Petitioner.	Docket No. 98A-004-INS RECOMMENDED DECISION OF THE ADMINISTRATIVE LAW JUDGE

HEARING: February 23, 1998

APPEARANCES: -Attorneys S. David Childers and Christy A. Chism represented the National Council on Compensation Insurance.
-Attorney Scott Gibson represented the Petitioner.

ADMINISTRATIVE LAW JUDGE: Casey J. Newcomb

On February 24, 1998, a hearing was held to determine if the Arizona Employee Leasing Arrangements Rule (the "Rule") unfairly discriminates against the Petitioner in violation of A.R.S. §20-341(A). Attorneys S. David Childers and Christy A. Chism represented the National Council on Compensation Insurance (NCCI). Attorney Scott Gibson represented Daystar Contract Staffing, Inc. (the "Petitioner"). Evidence and testimony were presented. Based upon a review of the entire record, the following Findings of Fact, Conclusions of Law and Recommended Decision are made.

FINDINGS OF FACT

A. Parties, Definitions and the Rule

1. DayStar Contract Staffing, Inc. is a Professional Employer Organization ("PEO) that operates in Arizona and in other western states. Mr. Gary Mecham is the Petitioner's owner and president. The Petitioner has approximately 100 clients and 3,000 employees.

2. PEOs are in the business of creating employee leasing arrangements for profit. An employee leasing arrangement exists when an entity (client) utilizes the services of a third party (the PEO or labor contractor) to provide employees to the client for a fee or

other compensation. For example, an employee leasing arrangement is created when a client transfers all or most of its employees to the PEO (or labor contractor) and those employees are then leased back to the client. Employee leasing arrangements are usually of a long-term or permanent nature and should not be confused with temporary labor service contractors providing services on a short-term or temporary basis.

3. The NCCI is a non-profit workers' compensation insurance rating organization licensed in over 30 states. The NCCI collects and disseminates loss and premium information, calculates rates, and develops classifications and statistical reporting mechanisms for use by insurance carriers, employers and insurance departments. This information is used for the purpose of providing equitable workers' compensation insurance to insure employers' business operations.

4. A client's "experience modifier" or E-mod is a term that reflects the workers' compensation claims history of the individual company. For example, a PEO will have an experience modifier of 1.0 if it has an average or normal history (i.e. an average number of workplace injuries and claims) in comparison to other companies in this industry. If a company has a very poor history, then it will have a negative or debit experience modifier that is higher than 1.0 (i.e. 1.5). If a company has a better than average history, then it will have a positive or credit experience modifier that is below 1.0 (i.e. .5). The Petitioner has a positive experience modifier of .77.

5. Only those companies with premiums in excess of a certain amount receive experience modifiers. Consequently, smaller companies do not have an experience modifier, regardless of their claims history. If a company does not have an experience modifier, then it is in essence assigned an experience modifier of 1.0.

6. The NCCI determines a company's "experience modifier" on an annual basis. The experience modifier is calculated using data from the preceding three years. Consequently, a company with a negative experience modifier may have to wait three years before a bad year (i.e. a year with above average workplace accidents and claims) falls out of the equation. However, a company that implements a successful safety program (thereby reducing the number of workplace injuries and claims in a given year) should see some improvement in its negative experience modifier during

the subsequent rating period.

7. Prior to the adoption of the Rule, the National Association of Insurance Commissioners ("NAIC") recommended a model rule that was used as a basis for the NCCI's Rule B1276 which was circulated as a national filing in March of 1992. The Department rejected Rule B1276 because it only applied to assigned risk plans and did not cover the voluntary market.

8. The Department drafted a similar rule that would apply to both the assigned risk market and the voluntary market. On November 6, 1995, Bernard Hill, the Department's Property and Casualty Analyst, sent a letter to Thomas W. Cleary of the NCCI requesting that the NCCI review a draft proposal of this rule. See NCCI's Exhibit # 16. On February 20, 1996, the NCCI responded by sending a proposed draft of this rule to the Department. See NCCI's Exhibit 21. The Department subsequently requested that the NCCI formally file the proposed Rule. See NCCI's Exhibit #22.

9. On or about September 25, 1996, the Arizona Department of Insurance (the "Department") approved Arizona State Special Rule IX.F of the *Workers' Compensation and Employee Liability Insurance Manual* (the "Basic Manual") and Rule C.11 of the *Experience Rating Plan Manual*, Part 2. This Rule (also referred to as the Arizona Employee Leasing Arrangements Rule) provides in part:

> 2.b. The services of the leased workers provided to a client by a labor contractor must be written under a separate workers' compensation insurance policy. The experience reported in conjunction with the separate policy shall be used to calculate the experience modification of the client.
>
> . . . .
>
> 3.c The experience modification, classification, rates, and rules applicable to the client entity shall be applied to the premium developed for the workers leased to the client.

Basic Manual, Rule IX.F

10. The relevant section in the Experience Rating Plan Manuel, Part Two provides in part:

> If an experience rated client enters into an employee leasing arrangement, then the experience modification of the client will apply to the coverage for the labor contractor's liability to provide workers' compensation benefits for the workers leased to the client.

Experience Rating Plan Manual, Part Two, §C.11.b.

11. The primary purpose of the Rule is to prevent companies with negative experience modifiers from joining PEOs (with positive experience modifiers) in order to avoid or wash out the negative financial consequences of their negative experience modifiers. In other words, a company with a poor safety record (and a negative experience modifier) normally would have to pay higher workers' compensation rates. However, this company could possibly avoid these higher rates by joining a PEO with a positive experience modifier.

12. The Rule serves the aforementioned purpose by insuring that the client's experience modifier will follow that client even if it enters into employee leasing arrangements. Pursuant to the Rule, a PEO must provide a separate workers' compensation insurance policy for each client. Each separate insurance policy would name the PEO as the named insured but would also reference the name of the client. This assures that the experience of that client will be used to develop an experience modifier for that client. Furthermore, if the client leaves the PEO, the experience of that client can be easily identified and retained in the client's modifier. Accordingly, by requiring the PEO to enter into separate policies with each client, the NCCI will be more effective and efficient in tracking the experience modification factors of each client.

13. On October 17, 1996, the NCCI distributed the Rule to all of its members and subscribers. See NCCI's Exhibit #27. The Rule became effective on January 1, 1997. Prior to its adoption, this Rule received the endorsement of Lanny L. Hair, the Executive Vice President of the Independent Insurance Agents and Brokers of Arizona, Inc. See NCCI's Exhibit #25.

14. The undersigned Administrative Law Judge finds that the Rule does serve the purpose of allowing the NCCI to effectively and efficiently track the experience

modification factors of each client that joins a PEO.

B. Daystar's Argument

15. On or about July 31, 1997, the Petitioner filed an appeal with the Arizona Workers Compensation Appeals Board (the "Board") pursuant to A.R.S. §20-367(b) alleging that the Rule unfairly discriminated against the Petitioner and other small PEOs in violation of A.R.S. §20-341(A).

16. On November 14, 1997, a hearing was held before the Board. The purpose of the hearing was to determine if the Rule was fair and reasonable as it applied to the Petitioner and other smaller PEOs. Attorney Scott Gibson represented the Petitioner at this hearing. Mr. Gibson argued that the Rule was unfair to the Petitioner for the following four reasons:

1. Requiring separate policies reduces the premium discount. When all of the clients are insured under a single jumbo policy, the premium discount is larger. In addition, writing individual policies requires a higher deposit premium than if all the clients are insured under a single jumbo policy.

2. The Rule disregards the fact that leased employees are employees of the PEO. The Rule erroneously treats the leased employees as employees of the clients.

3. The Rule requires the PEO to pay premiums based on the client's modifier rather than the modifier developed for the PEO. This reduces the benefits of the loss safety program implemented by the PEO.

4. The Rule establishes a precedent that could lead to the elimination of smaller leasing operations.

17. In an executive session, the Board discussed the purpose of the Rule and Mr. Gibson's arguments. The Board upheld the Rule. See NCCI's Exhibit 11.

1. Premium Discount

18. Mr. Mecham testified that the Petitioner's workers' compensation insurance was up for renewal on August 1, 1997. Mr. Mecham testified that prior to the renewal date, he had contacted and made arrangements with Capital General (an insurance carrier) to write a jumbo policy that would cover the Petitioner's 100 clients and 3,000 employees. However, Mr. Mecham testified that Capital General refused to write the jumbo policy

because of the Rule.

19. Mr. Mecham testified that General Capital would only write a separate policy for each of the Petitioner's clients (because of the Rule). Mr. Mecham testified that with so many small policies, the Petitioner could not qualify for the a substantial discount given for large jumbo policies.

20. Mr. Mecham testified that the Arizona State Compensation Fund also required an individual policy for each client because of the Rule. Mr. Mecham testified that he also could not qualify with the Arizona State Compensation Fund for the substantial discount for one large jumbo policy.

21. Mr. Tim Hughes is the Appeals Manager for the NCCI. Mr. Hughes testified that the Rule states that each separate policy shall contain the name of the labor contractor (i.e. the Petitioner) as the named insured with an additional reference identifying the name of the client. Mr. Hughes testified that pursuant to Rule VII.F.1 of the Basic Manual, the Petitioner may combine the 100 single policies to calculate the applicable premium discount. Consequently, the Rule should not have an unfair impact on the Petitioner's premium discount.

22. Mr. Mecham testified that many carriers are not following Rule VII.F.1 of the Basic Manual. Mr. Mecham testified that one insurance carrier at the November 14, 1997 Arizona Workers Compensation Appeals Board Meeting advised the Board that it would not follow Rule VII.F.1 of the Basic Manual. See NCCI's Exhibit 11, page 3. However, another insurance carrier implied that it would. Id.

23. The undersigned Administrative Law Judge finds that the Rule adversely affects the Petitioner because the Rule makes it more difficult for the Petitioner to obtain a substantial premium discount. However, the Administrative Law Judge also finds that the Rule does not absolutely preclude the Petitioner from obtaining a substantial premium discount from some carriers.

2. Premium Deposit

24. Mr. Mecham also testified that the Petitioner will have to post a greater premium deposit (because of the Rule) if it has to enter into 100 separate policies as opposed to a jumbo policy. Mr. Mecham testified that the posted premium deposit would be less by

about $70,000.00 if the Petitioner could enter into only one jumbo policy (much like the premium discount is greater for a jumbo policy than it is for 100 individual policies).

25. Mr. Hughes testified that the Rule does not affect the total amount of the premium that the Petitioner must pay. Rather, it may only affect the deposit or down payment posted on the premium. However, Mr. Hughes also testified that the Basic Manual does not currently have a rule addressing this premium deposit issue. Consequently, Mr. Hughes testified that the Rule could negatively affect the PEO's premium deposit. Mr. Hughes further testified that the NCCI would certainly consider amending Rule VII.F of the Basic Manual to allow the grouping of single policies to determine the overall premium deposit.

26 The undersigned Administrative Law Judge finds that the Rule adversely affects the Petitioner because the Rule makes it extremely difficult for the Petitioner to be eligible for the smaller premium deposit. Even though the Rule does not affect the total amount of the premium paid by the Petitioner, it does affect the posted deposit amount which is an important cash flow issue for a small company. Furthermore, it is not entirely clear if or when the Basic Manual will include a rule addressing this issue. Finally, it is also unclear if insurance carriers would even follow an amended rule that addressed this issue.

3. Safety Programs

27. Mr. Mecham testified that the Rule unfairly requires the Petitioner to pay premiums based on the experience modifiers of its clients. Some of these clients have poor experience modifiers because they lack an effective safety program. Mr. Mecham testified that the Petitioner has implemented a highly successful safety program that has greatly improved the safety record of its clients. Consequently, Mr. Mecham argued that the Petitioner should pay premiums based upon its own rating experience. Mr. Mecham testified that the Petitioner should not have to pay a premium based on the poor history of a client (which now has an effective safety program implemented by the Petitioner).

28. Mr. Mecham further testified that the PEO's employees (including the employees leased to the clients) will benefit from the PEO's safety programs because the clients' work environments will be safer. However, if the PEO has no incentive to provide the

safety program (because of the Rule), then these safety programs will be eliminated causing workplace injuries to increase. Mr. Mecham conceded that not all of the PEOs have effective safety programs.

29. The undersigned Administrative Law Judge finds that the Rule will not eliminate the benefits associated with a PEO's safety program because the Rule will not reduce the Petitioner's incentive to provide such safety programs. The Petitioner will always have an incentive to provide safety programs (even under the Rule) because it is constantly striving to reduce workplace injuries which will improve the client's experience modifier as well as the Petitioner's experience modifier. An improved experience modifier will generally translate to lower insurance rates for the Petitioner.

4. Employer/Employee Relationship

30. Mr. Mecham testified that the Rule unfairly disregards the Petitioner's employer/employee relationship with its employees. Mr. Mecham testified that under the workers' compensation laws, employers are required to provide insurance for their employees. Mr. Mecham testified that the clients' employees are really the Petitioner's employees. Therefore, the Petitioner should be able to write one jumbo policy to cover all of its employees (including the leased employees of the clients). Mr. Mecham testified that the Rule treats the Petitioner as something other than an employer by requiring separate policies for each client.

31. The undersigned Administrative Law Judge finds that the Rule does treat the Petitioner as something other than an employer. However, the undersigned Administrative Law Judge also finds that there is insufficient evidence showing that the Petitioner is adversely affected by the Rule for this reason.

5. Excessive Costs/ Unfair Competition

32. Mr. Mecham testified that the Rule requires the Petitioner to incur excessive costs because of the paperwork associated with 100 separate insurance policies (as opposed to one jumbo policy). Mr. Mecham testified that the Petitioner had to hire one additional staff employee at $30,000.00 a year just to handle the additional paperwork. Mr. Mecham further testified that one additional employee is an extreme financial burden for a company with only 11 staff employees.

33. Mr. Mecham also testified that the Rule will cost the Petitioner an additional $200,000.00 per year to obtain workers' compensation insurance.

34. Mr. Mecham testified that larger PEOs and self-insured PEOs can absorb the additional costs associated with the Rule. However, Mr. Mecham testified that the Petitioner and other smaller PEOs cannot absorb these additional costs and still remain competitive with the larger PEOs.

35. The undersigned Administrative Law Judge finds that the Rule does impose an unfair financial hardship on the smaller PEOs because (1) the PEOs will have to hire additional staff; (2) the Rule creates more time consuming paperwork; and (3) the Rule may cause the possible loss of the premium discount. These are all additional costs that are far more burdensome to a smaller PEO than to a larger PEO.

6. Carrier Audits

36. Mr. Mecham testified that the new Rule also imposes additional hardships on the insurance carriers because it is easier to audit one PEO with one jumbo policy than it is to audit one PEO with 100 separate policies.

37. The undersigned Administrative Law Judge finds that there is insufficient evidence to conclude that the Rule will negatively affect insurance carriers.

C. Alternative Rule

38. Mr. Mecham testified that the Rule should be amended to allow a PEO to obtain a master policy. This would allow the PEO to enjoy the premium discount and premium deposit benefit offered to larger jumbo policyholders. Furthermore, Mr. Mecham testified that each client would have a sub-number which would allow the NCCI to track all of the claims made by that client. Consequently, a company with a negative experience modifier could reap the benefits of the PEO's safety program but would not be able to wash away its negative experience modifier.

39. On July 9, 1997, Bernard Hill, the Department's Property and Casualty Analyst, wrote a letter to Mr. Mecham stating that the Department conceptually had no problem with permitting a master policy for employee leasing arrangements. See Petitioner's

Exhibit #3. Mr. Hill suggested that the master policy could include a schedule containing the name of each client, the client's address, classification codes, payroll and experience modification factors of the client. Id.

40. The State of Utah passed a rule that allows the PEO to choose between (1) a master policy that covers all the leased employees or (2) separate policies for each client. See NCCI's Exhibit #14. The Utah rule does require (under both options) that the client's experience modifier be used in determining the PEO's premium for the master policy.

41. Mr. Mecham testified that the Utah rule should be adopted in Arizona with the exception that the PEO's experience modifier should be applied in determining the PEO's premium. Mr. Mecham testified that the Petitioner's experience modifier should be based on the claims experience of its client companies only since the client companies associated with the Petitioner. Mr. Mecham testified that if the client's prior experience modifier is applied, then the client will have no incentive to join the PEO. This is because the PEO would have to charge the client the same cost that the client is already paying (outside of the PEO) plus the cost of doing business with the PEO.

42. The undersigned Administrative Law Judge finds that the Petitioner's proposed exception to the Utah rule is unreasonable because it allows a client with a poor experience modifier to join a PEO and thereby avoid the negative cost of higher insurance rates associated with a poor experience modifier. This is unfair to other companies that have not joined a PEO. Furthermore, it defeats the primary purpose for adopting the Rule as discussed in Findings of Fact #11. Finally, the PEO can always pass along the higher premium cost to the client with the poor experience modifier. The client with a poor experience modifier will still have the incentive to join the PEO because of the savings associated with the master policy's substantial premium discount.

43. The undersigned Administrative Law Judge finds that the Utah rule is a reasonable alternative to the current Rule for the following reasons:

A. The Utah rule allows the PEO to receive a substantial premium discount by having one large master policy.

B. The Utah rule allows the PEO to post a lower premium deposit by having one

large master policy.

C. The Utah policy recognizes the employer/employee relationship between the PEO and its leased employees.

D. The Utah rule allows the NCCI to track a company's individual experience modifier when the company joins and leaves a PEO.

E. The Utah rule prohibits a client with a poor experience modifier from avoiding or washing out the negative financial consequences of its poor experience modifier.

F. The Utah rule allows a smaller PEO to be competitive because of the premium discount advantage. Furthermore, the Utah rule allows the PEO to avoid the excessive costs associated with hiring new employees to keep up with the voluminous paperwork associated with hundreds of smaller policies.

H. The Utah rule may possibly allow insurance carriers to more efficiently audit the PEOs.

I. The Utah rule provides the PEO with the incentive to develop effective safety programs.

CONCLUSIONS OF LAW

1. The Appellant has the burden of proof, and the standard of proof on all issues is by a preponderance of the evidence. Culpepper v. State, 187 Ariz. 431, 930 P.2d 508 (App. 1996). A "preponderance of the evidence is such proof as convinces the trier of fact that the contention is more probably true than not." Morris K. Udall, *Arizona Law of Evidence*, §5 (1960). It "is evidence which is of greater weight or more convincing than the evidence which is offered in opposition to it; that is, evidence which as a whole shows that the fact sought to be proved is more probable than not." *Black's Law Dictionary*, 1182 (6th ed. 1990).

2. The purpose of A.R.S. §20-341(A) is to promote the public welfare by regulating insurance rates so that they are not "excessive, inadequate or unfairly discriminatory." A.R.S. §20-341(A). The undersigned Administrative Law Judge finds that Section IX.F.2.b of the Basic Manual unfairly discriminates against the Petitioner and other similarly situated PEOs for the reasons set forth in Findings of Fact # 23, 26 & 35.

3. The undersigned Administrative Law Judge finds that Section IX.F.2.b of the Basic Manual is inadequate for the reasons set forth in Findings of Fact #23, 26, 35 & 43.

4. The undersigned Administrative Law Judge finds that Section IX.F.3.c. of the Basic Manual does not violate A.R.S. §20-341(A).

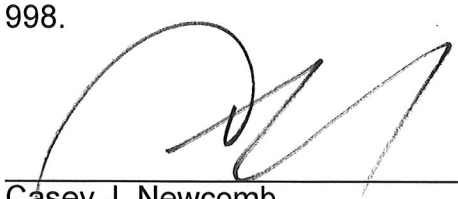
5. The undersigned Administrative Law Judge finds that Section C.11.b. of the Experience Rating Plan Manual does not violate A.R.S. §20-341(A).

RECOMMENDED DECISION

Based upon the foregoing, the undersigned Administrative Law Judge recommends that the Board's decision to uphold Section IX.F.2.b of the Basic Manual be reversed. The undersigned Administrative Law Judge further recommends that PEOs be allowed to obtain a master policy rather than individual policies for each of their clients. The undersigned Administrative Law Judge suggests that the aforementioned Utah Rule serve as a guide for amending Arizona Special Rule IX.F.2.

The undersigned Administrative Law Judge respectfully urges the Director of the Department of Insurance to conduct an investigation and/or hold hearings to determine how to amend the Rule so that (1) the client's experience can be accurately monitored; (2) claims reporting can be correctly matched with the client; and (3) the client's experience will transfer with the client when it leaves the labor contractor. The amended Rule should impose the smallest possible burden on labor contractors and all parties involved. The investigation and hearings should consider the views of the PEOs, the insurance industry, the Department, the NCCI and all others who may be affected by the amended Rule.

Done this day, March 12, 1998.



Casey J. Newcomb
Administrative Law Judge

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