RETROSPECTIVE RATINGS

Relief from retrospective rating assessment

The Department is under no duty to investigate or inform a retrospective rating group of possible consequences related to the group's plan, membership, or other decisions. The Department is not a guarantor of automatic refunds to a retrospective rating group. The participation in the retro group is voluntary and involves risk. ….In re Northwest Wall & Ceiling Contractors Ass'n, BIIA Dec., 09 14561 (2010) [Editor's Note: The Board's decision was appealed to superior court under Thurston County Cause No. 08-2-00959-6.]
BEFORE THE BOARD OF INDUSTRIAL INSURANCE APPEALS
STATE OF WASHINGTON

IN RE: NORTHWEST WALL & CEILING CONTRACTORS ASSOCIATION ) DOCKET NO. 09 14561
) )
FIRM NO. 49 ) DECISION AND ORDER

APPEARANCES:

Retrospective Rating Group, Northwest Wall & Ceiling Contractors Association, by
Stafford Frey Cooper, per
James T. Yand and Peter J. Mullinix

Department of Labor and Industries, by
The Office of the Attorney General, per
James S. Johnson, Assistant

The Retrospective Rating Group, Northwest Wall and Ceiling Contractors Association
(hereafter NWCCA), filed an appeal with the Board of Industrial Insurance Appeals on May 4, 2009,
from an order of the Department of Labor and Industries dated April 9, 2009. In this order, the
Department affirmed a Department order dated March 4, 2009, in which the Department denied the
Retrospective Rating Group's request for relief for the final adjustment for plan years beginning
July 1, 1998; July 1, 1999; and July 1, 2000. The Department order is AFFIRMED.

DECISION

As provided by RCW 51.52.104 and RCW 51.52.106, this matter is before the Board for
review and decision. The Department filed a timely Petition for Review of a Proposed Decision and
Order issued on March 8, 2010, in which the industrial appeals judge reversed and remanded the
Department order dated April 9, 2009. All contested issues are addressed in this order.

The Board has reviewed the procedural and evidentiary rulings in the record of proceedings
and finds that no prejudicial error was committed. The rulings are incorporated by reference and
are affirmed.

We have granted review to specifically address NWCCA's request for relief from
retrospective rating assessments based on allegations that the Department of Labor and Industries
breached statutory, contractual, or other recognized duties so as to justify relief from rating
assessments for Plan Years 1998, 1999, and 2000. We do not find that NWCCA is entitled to such
relief from this Board and affirm the Department order of April 9, 2009.
Our industrial appeals judge has summarized the evidence relevant to this appeal in the Proposed Decision and Order. We expand on that summary only to the extent necessary to explain our decision.

As this Board has observed, retrospective ratings groups are authorized and governed by the provisions of Chapter 51.18 RCW and by the provisions of Chapter 296-17 WAC, beginning with WAC 296-17-90401. In general, retrospective rating is an incentive program, voluntarily joined by individual qualified employers and qualified groups of employers. Retrospective rating groups must be made up of employer members engaged in substantially similar business operations, considering the nature of the services or work activities performed. Retrospective rating groups select options with varying caps on the amount of risk they are willing and able to take. The terms of the relationship among the participants within a retrospective rating group are determined by the rating group, not the Department.

Retrospective rating involves a process wherein the Department of Labor and Industries retrospectively examines premiums paid by the participating employer or employer group for three past rating years at issue, comparing premiums paid with losses incurred and anticipated due to industrial injury and occupational disease claims arising and assigned to participating employer accounts in the rating years at issue. Liability for a given fiscal year is not fully determined until the third and final adjustment relative to and following the year in which the industrial injury occurred or in which the occupational disease was diagnosed. Based on formulas applied, a premium rebate (refund) may be provided, or an additional assessment (penalty) may be assessed. Whether a retrospective rated employer or group receives a rebate or incurs an additional assessment depends substantially upon the premium:loss ratio for the three rating years in question. Retrospective rating groups thus assume a significant level of risk, up to the plan cap, or stop loss level, which reflects the level of risk that the group is willing to accept.

The premium side of a retrospective rating group's ratio is comprised by the group membership in terms of the totality of premiums paid by the group's employer members for hours in the respective risk/rate job classifications. To reduce losses, a retrospective rating group can promote safety, monitor and intervene in claims at the Department, and promote early return to work and other programs that minimize claim costs.

In the early 1990s, the drywall industry in Washington was in a state of turmoil with respect to ever-increasing industrial insurance premiums. The turmoil was widely believed to be due to the failure of many drywall contractors to accurately report the number of hours being worked by
employees, a failure that allowed dishonest contractors to pay less in premiums than honest
contractors and for the dishonest contractors to have a considerable competitive advantage in
bidding new jobs. Although some hyperbole may have been involved, anecdotal reports suggested
that one-half to two-thirds of all drywall work was either under-reported or not reported at all.
Honest contractors, who were indirectly paying the claim costs for dishonest contractors, demanded
change.

In response, the Department of Labor and Industries met with industry representatives in a
program that came to be known as The Drywall Initiative. NWCCA was represented in the Drywall
Initiative by the Drywall Technical Advisory Committee. After much discussion and a lengthy
comment period, new rules were adopted that abandoned the hourly basis for reporting industrial
insurance premiums, focusing instead on the number of square feet of drywall that went into a
given job. Essentially, the more drywall that was installed on a job, the greater the total industrial
insurance premium that would be owed by the contractor, regardless of how many employee hours
were allegedly involved with the installation. One advantage to using the square foot method was
that drywall suppliers were a fairly reliable source as to how much drywall was being installed, the
implication being that suppliers prepared an invoice or similar documentation as to how much
drywall was delivered to a particular job for a particular contractor. The change in rules went into
effect on January 1, 1997.

The problem with converting to the square foot method of reporting is that there was no way
to precisely convert hours-worked to square-feet-of-drywall. Because of this problem, the
Department was necessarily forced to engage in a bit of educated guessing. The Department
estimated the amount of reportable drywall that had been sold in the state the previous year and
divided by the total premium amount the Department anticipated would be needed to cover claims,
yielding a premium/square-foot for the future year that was thought to be adequate. Given that the
Department was estimating, two related points deserve consideration. First, it was difficult for the
Department’s estimate to be informed by its actuaries. Actuaries look back in time, using three to
five years of data to mathematically predict the future. Given that a new measuring standard had
been adopted, no such data was available. Second, the Department’s estimate may have
influenced, however subtly, by industry representatives who were interested in seeing that
premiums were kept as low as reasonably possible. Ultimately, the Department decided to adopt a
conversion factor of 1-hour’s-work = 125 sq. ft-of-installed-drywall.
In addition to estimating future drywall premiums, the Department and industry representatives made three assumptions that no one seemed to question. It was believed that the newly adopted rules would result in dramatically increased industrial insurance reporting by drywall contractors. Given the difficulty that a contractor would have in denying that a certain amount of work had been performed, it was assumed that (1) there would be full compliance from drywall employers; (2) the reporting would be accurate; and (3) a larger pool of premium dollars would be collected.

Acting on the assumption that more premium dollars would be forthcoming, the Department established a base rate paid by all contractors and went a step further, offering employers discounts if they met new, more rigorous reporting requirements. It appeared that contractors who had previously failed to report hours would finally be held accountable.

Unfortunately, the assumptions proved to be overly optimistic. Over a period of several years, and with the benefit of experience, it was learned that reporting improved, but only incrementally. Apparently, disreputable contractors found new ways to avoid premium obligations and it gradually became apparent that there may not have been as many dishonest contractors as first thought. Perhaps anecdotal reports of widespread abuse by non-compliant drywall employers were overstated. Whatever the reason, the premium pool did not dramatically increase. At the same time, claims costs continued to rise. The premiums paid by NWCCA members for the plan years of 1998 and 2000 proved to be too low when compared with claim costs. Ultimately, this imbalance gave rise to the retrospective assessments at issue here.

NWCCA alleges that the Department knew, or should have known, to charge higher premiums in 1998 and 2000 such that retrospective assessments would not have been necessary. Obviously, this allegation benefits from a decade of hindsight and ignores both the purpose of the Drywall Initiative and the fact that employers impact claim costs positively and negatively by their behavior. Employers who are lax with respect to monitoring workplace safety, efficient claims administration, and early return to work opportunities can reasonably expect higher claims costs. Similarly, it can be difficult for the Department to predict how vigorously drywall employers will pursue safety and efficiency. As Robert Malooly, assistant director of insurance services for the Department, testified, determining rate adequacy is like predicting the outcome of the Kentucky Derby in advance.

NWCCA argues that the Department failed to warn drywall employers that participation in the Drywall Initiative would make participation in a retrospective rating program more risky. This
assumes that the Department knew from inception that the Drywall Initiative was ill-considered. There is no evidence to that effect. To the contrary, the Drywall Initiative appears to have been a reasonable and prudent response to industry complaints of significant non-compliance by many drywall employers.

NWCCA suggests liability for the assessment lies with the Department and that NWCCA had no responsibility for reasoning through its decision to participate in a retrospective rating plan. This is largely unpersuasive. The Department was not and is not a guarantor of automatic annual refunds to a retrospective rating group. Participation in a retrospective rating program is voluntary. RCW 51.18.010(1)(a). It involves risk. Participating employers choose the amount of risk they are willing to assume. More to the point, an employer may protect itself from liability by declining to join a retrospective rating group altogether, thereby placing the risk for industrial insurance losses in the hands of the Department of Labor and Industries.

Nothing in the evidence before us convinces us that the change in the basic reporting unit (from hourly to square foot) was unknown or unexpected by NWCCA and its constituent members. Had NWCCA applied sufficient interest and resources, it could have predicted the impact upon the group and its members. Collectively, NWCCA members contributed millions of dollars in premiums during the years in question and contemplated hundreds of thousands of dollars in potential refunds or assessments. Through its own efforts, it could have forecast the consequences of the change for its members and the group's success or liability.

NWCCA suggests that the Board should apply equitable principles used in the law of contracts, including insurance contracts, in order to provide relief here, arguing that the Department had superior ability to forecast the adequacy of premiums for plan years 1998 and 2000. Because it did not advise NWCCA members of the potential of increased risk, the Department was negligent in meeting its contractual obligations and the retrospective rating agreement should be reformed or rescinded under equitable principles. It is questionable, however, whether contract law appropriately applies in the manner suggested by NWCCA. As we noted in In re Contractors' Alliance, Docket No. 05 22737 (September 26, 2007), the retrospective rating program is governed by statute and by adopted Washington Administrative Code provisions. Although it is true that an agreement is made by the retrospective rating group to do certain things as a condition of retrospective program participation, the terms of the program are governed by the statute and code provisions. This Board declines to invalidate those provisions. In light of the fact that the code
provisions, when applied to the facts of this case, direct the retrospective rating results, NWCCA has failed to show how the Board may provide relief without invalidating the code provisions.

Finally, NWCCA argues that the Department of Labor and Industries failed to follow recognized insurance principles as mandated by RCW 51.18.010(2), claiming the Department failed to set rates based on the best data available at the time it set those rates. In making this argument, however, NWCCA ignores the point that actuarial data requires a period of at least three years of experience, and preferably five, to be sufficiently mature to be reliable. Had there been no change in the basic reporting unit, NWCCA's argument would have considerable weight, but that is not the case. It also bears mentioning that liability for a given plan year is not fully determined until the third and final adjustment following the year in which the industrial injury occurred or in which the occupational disease was diagnosed.

In sum, NWCCA has not identified, in statutory or regulatory law, any Department duty to investigate and inform NWCCA or its members of the possible consequences of properly adopted rules relative to NWCCA's plan choices, membership choices, or other NWCCA decisions. It has not shown how the Department's action, or lack of action, rose to the level of breaching any duty. In short, it has not shown why NWCCA members should be relieved of retrospective assessments that are otherwise authorized by law. The Department order under appeal is affirmed.

FINDINGS OF FACT

1. The Department of Labor and Industries issued a rate notice to the Retrospective Rating Group, Northwest Wall and Ceiling Contractors Association (NWCCA). On February 27, 2006, NWCCA protested the Department's rate notice and requested relief from the Department's final adjustment for the Retrospective Rating Program plan years beginning on July 1, 1998; July 1, 1999; and July 1, 2000.

On June 13, 2006, the Department issued an order in which it determined that it could not reconsider plan years beginning on July 1, 1998, 1999, and 2000 because a protest was not received within the 30-day time limitation, and therefore those determinations regarding the Retrospective Rating Program plan years were final and binding. On July 14, 2006, NWCCA appealed the Department's June 13, 2006 order. On July 26, 2006, the Board granted NWCCA's appeal and assigned it Docket No. 06 17036.

Following a formal hearing, a Proposed Decision and Order was issued on March 22, 2007, in which the industrial appeals judge determined that NWCCA's protest was not timely filed. On January 8, 2008, the Proposed Decision and Order was reissued to NWCCA upon the Retrospective Rating Group's showing that it did not receive the Board's March 22, 2007 Proposed Decision and Order. On April 1, 2008, the
Board issued a Decision and Order in which it determined that NWCCA's protest was not timely filed. On April 23, 2008, NWCCA appealed the Board's April 1, 2008 Decision and Order in Thurston County Superior Court. On November 21, 2008, the Superior Court issued an order in which it reversed the Board's April 1, 2008 Decision and Order and remanded the matter to the Department for consideration on the merits.

On March 4, 2009, the Department issued an order in which it denied NWCCA's request for relief on the basis that the plan for years beginning on July 1, 1998, 1999, and 2000, the Retrospective Rating Group's members paid standard premium rates set in accordance with Department rules. The Department used base rates set by rule, and for calendar years 1998 through 2001, the Department set base rates using the best information available at the time. On March 5, 2009, the Department issued an order that was identical to its order dated March 4, 2009.


2. NWCCA was an organization comprised of drywall contractors and was an active participant in the Department's retrospective rating program for several years, including plan years 1998, 1999, and 2000.

3. NWCCA's retrospective rating plan years began July 1 of each year and ended on June 30 of the following year.

4. From 1993 to 1997, industrial insurance premiums for drywall employers in Washington State increased significantly, due in part to non-compliant drywall contractors failing to report worker hours and pay industrial insurance premiums related to those hours.

5. By failing to report hours, non-compliant contractors obtained a significant competitive advantage over compliant contractors who correctly reported.

6. During the mid-1990s, the Department and drywall industry representatives worked to address the problem of non-compliant employers. The program that followed became known as the Drywall Initiative.

7. During the mid-1990s, NWCCA was represented on the Drywall Technical Advisory Committee by Richard Mettler.

8. Prior to January 1, 1997, industrial insurance premiums for drywall contractors were based on the number of hours worked by employees.

9. The Drywall Technical Advisory Committee recommended to the Department that it change its rate structure from one that was based on hours worked to one based on square feet of drywall material installed.
10. Pursuant to its statutory rule-making authority, the Department conducted public hearings to discuss the Drywall Initiative and the proposal to change to square foot reporting.

11. On January 1, 1997, the Department implemented the provisions of the Drywall Initiative, changing the method of calculating drywall premiums from one unit of measurement (hours worked) to another unit of measurement (square feet of drywall). The Drywall Initiative introduced discounts for compliant contractors who completed new, more stringent documentation requirements.

12. Contemporaneous with the change in the unit of measurement, the Department adopted 1 hour of work as being the equivalent of 125 square feet of drywall (1 hour = 125 square feet).

13. Following the change in the reporting unit of measurement, the Department began to develop new actuarial data.

14. The Department requires three to five years of accumulated data to make statistically reliable predictions.

15. Industrial insurance claims may remain open for several years. Liability for a given plan year is not fully determined until the third and final adjustment following the year in which an industrial injury occurred or in which an occupational disease was diagnosed.

16. The employer, not the Department, controls work place safety, the work environment, and the activities of workers at a given job site.

17. Retrospective rating group employers can minimize claim costs by promoting workplace safety, monitoring claims at the Department, and providing early return-to-work opportunities for injured workers, among other things. By minimizing claim costs, retrospective rating group employers can earn refunds.

18. Retrospective rating group employers that fail to promote work place safety, monitor claims, and provide return-to-work opportunities may incur higher claim costs and be assessed additional premiums.

19. NWCCA’s participation in the retrospective rating program was voluntary.

20. NWCCA was aware that the retrospective rating program involved risk.

21. For plan years 1998, 1999, and 2000, NWCCA and its constituent members selected the amount of risk they were willing to undertake.

22. For plan years 1998, 1999, and 2000, NWCCA members paid standard premium rates set in accordance with Department rules. The Department used base rates set by rule, and used the best information available at the time.

23. With respect to plan year 1998, NWCCA’s claims costs exceeded premiums, resulting in a retrospective assessment against NWCCA in the amount of $735,149.
24. With respect to plan year 1999, NWCCA’s claims costs were less than premiums, resulting in a refund of premium to NWCCA in the amount of $433,843.

25. With respect to plan year 2000, NWCCA’s claim costs exceeded premiums, resulting in a retrospective assessment against NWCCA in the amount of $309,528.

CONCLUSIONS OF LAW

1. The Board of Industrial Insurance Appeals has jurisdiction over the parties and subject matter of this appeal.

2. For the plan years beginning July 1, 1998; July 1, 1999; and July 1, 2000, NWCCA members paid standard premiums at rates set in accordance with Department rules. The Department used base rates set by rules in accordance with RCW 51.18.010.

3. For the plan years at issue, the Department set base rates using the best information available at the time in keeping with RCW 51.18.010.

4. The order of the Department of Labor and Industries dated April 9, 2009, is correct and is AFFIRMED.


BOARD OF INDUSTRIAL INSURANCE APPEALS

/s/ DAVID E. THREEDY Chairperson

/s/ FRANK E. FENNERTY, JR. Member

/s/ LARRY DITTMAN Member