Audit Advisory Committee – Comments

To: Administrative Director Hoch and James Robbins
From: Michael McClain, General Counsel, CWCI
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Separate and Independent Audits for Sections 5814.6 and 4610

Authority
While it is clear that the Administrative Director has the authority to impose administrative penalties under both section 5814.6 and section 4610, the statutes are silent as to the process for assessing and collecting the penalties. The Audit Unit has proposed separate and independent audits to assess and impose these new penalties.

There is no express statutory authority to enforce the obligations created under sections 5814.6 and 4610 by separate and independent audits. To do so would violate the legislative policy established in Labor Code sections 129 and 129.5 and it is unnecessary to create an independent system to monitor and enforce these new obligations. The pattern of 5814 penalties and poor compliance with the UR timetables were not identified by the Legislature as key indicators of claim administrator performance, and the Legislature has given no indication that it intended to change its enforcement priorities by adding these new administrative penalties. The new elements are simply additional factors to be scrutinized by the AD and included in the regular audits.

Public Policy
The question of the overall effectiveness of the audit process was fully addressed by the Commission on Health, Safety, and Workers' Compensation in its 2001 analysis. Based on this work the Legislature amended the audit system in AB 749. Labor Code sections 129 and 129.5 are a clear statement of legislative policy and they create a complete methodology for allocating the resources of the Audit Unit, reviewing claims practices, and ensuring compliance. These statutes do not provide for separate and independent audits outside the scope of that methodology.

Labor Code section 129 (a) provides a clear statement of the purpose of the audits:

> To make certain that injured workers, and their dependents in the event of their death, receive promptly and accurately the full measure of compensation to which they are entitled, the administrative director shall audit insurers, self-insured employers, and third-party administrators to determine if they have met their obligations under this code.

The system created by AB 749 was based on specific key indicators of claim administrator performance. The structure of the new audit procedures was intended to allow the Audit Unit to review every claim organization in a 5-year

period. The new structure helped the auditors to identify and target the worst performers and to use their resources to ensure effective compliance.

The fact that both of the new statutes provide for administrative penalties but are silent as to the enforcement mechanism allows the AD some flexibility in monitoring compliance. As was suggested at the meeting, there are others ways to track the performance of claim organizations for section 5814 penalty awards and UR.

Resources

The study by the Commission and the statutory requirements of AB 749 focused very closely on the efficient use of the Division's resources. The annual Audit reports demonstrate that the Audit Unit still cannot meet the clearly stated legislative goals of sections 129 and 129.5. The focus of the Audit Unit must be to meet the statutory mandate of ensuring that the key indicators of claim performance are being achieved by all claim organizations. Until that is achieved, these new mandates must remain a secondary focus.

Separate and independent audits are unnecessary, as these new elements can be monitored by other means. As discussed, the number of section 5814 penalties can be tracked with data received from the appeals boards and UR compliance can be reviewed by modifying the current audit structure to include overall UR performance. The Target Audit process is also available to help the AD assess necessary administrative penalties.

Labor Code Section 5814.6

Section 5814.6 authorizes the AD to apply administrative penalties for a knowing violation of section 5814 with a frequency that indicates a general business practice. The new section imposes a single penalty for a different, more serious, form of misconduct – a pattern and practice of knowingly violating section 5814. The application of this penalty also requires a different method of assessment.

5814.6 Assessment Process

To determine whether an audit subject has consistently, knowingly violating section 5814, the auditor must review each 5814 penalty awarded by the Board. Only 5814 penalties that are subject to a Findings and Award can be used to assess a second penalty under section 5814.6. Prior to a final award, assertions of unreasonable delay of denial of benefits are mere allegations and section 5814.6 requires an actual violation of the statutory standard.

The penalty under section 5814.6 is for the imposition of excessive penalties for the unreasonable delay or denial of benefit payments and is based on very specific conduct, which is significantly different from the conduct addressed by section 5814.

5814 penalties can be monitored through the current audit program by requesting data from the audit subject, or outside the audit program with reports from the local appeals boards. Once the penalty awards are obtained, the auditor must review each award for the quality of the conduct involved. Each penalty must be reviewed to determine whether it was a "knowing violation". Then the qualifying penalties must be reviewed further to see if the violations are sufficiently frequent to constitute a general business practice.

If a general business practice is found, other factors must be evaluated in determining the amount of the penalty under section 5814.6. These factors are not stated in section 5814.6 but the assessment is logically related to the standards set out in Labor Code section 129.5 and should be used by the Audit Unit to determine the final penalty:

> "The administrative director is authorized to impose penalties pursuant to rules and regulations which give due consideration to the appropriateness of the penalty with respect to the following factors:
> (1) The gravity of the violation.
> (2) The good faith of the insurer, self-insured employer, or third-party administrator.
> (3) The history of previous violations, if any.
> (4) The frequency of the violations.
> (5) Whether the audit subject has met or exceeded the profile audit review performance standard.
> (6) Whether a full compliance audit subject has met or exceeded the full compliance audit performance standard.
> (7) The size of the audit subject location."

Knowingly Committed

One of the more significant failures in the proposed regulation is the definition of "knowingly committed ". The proposed regulation fails to address both the letter and the spirit of law. "Knowingly committed" means the intentional commission or omission of wrongful acts. The claim administrator must commit a volitional, as opposed to an inadvertent or negligent, act. For sanctions to be imposed, the claim administrator must be aware that its conduct violates the statute. The proposed regulation makes no distinction between willful and negligent conduct.

> Recommendation: Knowingly Committed – Acting with the knowledge that the conduct is in violation of section 5814, the intentional commission or omission of acts known to be unlawful.

General Business Practice

In the proposed regulation, "General Business Practice" is defined without reference to the statutory standards set out in sections 129.5 and 5814.6 – conduct "performed with a sufficient frequency so as to indicate a general business practice". This phrase is used repeatedly in the Insurance Code and is readily understood by other regulators and claim administrators. But here,

frequently performed misconduct is defined in terms of the handling of a single claim. A series of failures in one claim or the violation of a single statute or regulation can be found to be a general business practice or company policy punishable by the most significant fine.

Sections 129.5 and 5814.6 make it clear that these penalties are only to be imposed for serious, repetitive, intentional misconduct. Any regulation implementing these penalties must be consistent with and not in conflict with the scope of the statute and must reflect the concept of frequency and a pattern of misconduct established by the statute.

The standard set for section 5814.6 penalties -- two 5814 penalties awarded over a 2-year period -- also ignores the fact that the section 5814 penalty was amended to make its application more equitable by linking the penalty to the amount delayed. It will likely be used more frequently to deter delayed payments and other transgressions of the claim administrators. The low standards proposed by the Division will nullify the Legislature's effort to make it a more equitable deterrent. The only way to establish a pattern of excessive penalties is to determine the number of knowing violations and compare them to the number of claims managed by the audit subject.

Labor Code section 4610

The Audit Unit has indicated that they simply attached certain penalty amounts to each deadline contained in the statute. The enforcement philosophy at work here is solely to fine noncompliance. At the meeting we discussed alternatives to this approach, including imposing various remedial plans that would keep the audit subject under close scrutiny until there was adequate compliance with the statute.

We recommended that performance standards be established by the Division to judge the overall compliance with the UR requirements and that penalties be assessed when the performance standards are not met.

It is important to note, as well, that the appeals board has already imposed a serious sanction when claim administrators fail to meet the statutory timelines under section 4610. In the Sandhagen case, the Board ruled that if the claim administrator fails to meet the requirements and timelines contained in section 4610 (g), the utilization review of the proposed treatment would be disregarded by the Board. All of the denial or modification procedures contained in section 4610 (g) (2) and (3) are mandatory, and if the statutory requirements are not met, the utilization review report will not admissible.

Simply restructuring the current audit program to include a review of the audit subject's UR program will be sufficient to identify program deficiencies and encourage compliance.

Benefit Notice System

After nearly 4 years of review and discussion within the workers' compensation community, it became clear that while the system was cumbersome and costly, it reflected the mandates of the statutory scheme and could not be simplified without legislative action.

In a note to the Commission on Health, Safety, and Workers' Compensation in November of 2001, the Institute outlined the impasse – an impasse the still exists.

> For years the administration, the Commission, and the regulated community have been struggling to simplify the benefit notice system in order to reduce the administrative expense and resource allocation that it entails. Numerous experts have worked on the problem over the years without resolving the fundamental questions. The Legislature and the administration have mandated communications between the injured worker and the claim organization that used to be left to the claim administrator, and the audit Unit to secure compliance. We now have a system with too many top priority responses. (Audit penalties for notices in 2000 were $740,560, accounting for almost half of the all penalty assessments.)
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> A proposal was made initially by SCIF, to simplify the benefit notice system by developing a "Super-Notice" that each Injured Worker would receive. The premise of the "Super-Notice" was that very early in the claim, the injured worker would be fully apprised of his/her rights and responsibilities. The trade-off was that many of the mandatory notices would be eliminated.
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> We recently empanelled a group to consider what notices could be eliminated if the injured worker received a "Super-Notice." Because the statute now mandates notices for multiple occasions, the group did not find any notice that could be deleted. The group felt that while notices could be shortened or combined, a formal notice would still have to be sent for each and every statutory occasion. The added expense of revising their systems with new notices, as well as providing a Super-Notice, which would be duplicative, would simply add to the administrative expenses and resource allocation problem and solve nothing.
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> The Institute has again reviewed the statutory requirements for notices with an effort to see if any could be eliminated. There continues to be multiple instances that require specific notices. The decision to regulate the provision of benefit notices is irrevocable. Admittedly, it would be poor social policy at this juncture to simply eliminate some of the occasions that call for notice on the basis that the "Super-Notice" provided sufficient advice to injured workers.

The Institute concluded that the benefit notice system could not be simplified to the extent that any administration costs could be eliminated. Simply reducing language or combining required notices would only add cost. The same holds true today.

The most recent proposal from the Audit Unit is to require the use of the Fact Sheets along with certain notices to the injured worker. One of the long time problems in the benefit notice program, one that was raised again by an auditor at the meeting, has been the inclusion of irrelevant or unnecessary information. The use and appropriateness of the Fact Sheets has been debated for years. The claim organizations found that the most useful aspect of the benefit notice program was their ability to provide the information necessary and appropriate to the circumstances and to customize their communications with the injured workers they were serving. The Fact Sheets use a "one size fits all" approach that has not worked in the past and is not likely to improve communications now.