

**BEFORE THE OFFICE OF ADMINISTRATIVE HEARINGS
STATE OF OREGON
for the
DEPARTMENT OF CONSUMER AND BUSINESS SERVICES
INSURANCE DIVISION**

In the Matter of the Petition of) **PROPOSED ORDER**
)
A SHARP PAINTER, LLC) **Case No.: INS 04-09-010**
)

HISTORY OF THE CASE

A Sharp Painter, LLC (employer) appeals its final premium audit billing for the period April 1, 2003 through March 31, 2004 (audit period). On December 2, 2004, the Insurance Division, Department of Consumer Business Services (department) referred the matter to the Office of Administrative Hearings (OAH). On March 30, 2005, Administrative Law Judge Catherine P. Coburn conducted a contested case hearing in Salem, Oregon. Randal D. Thomas, LLC Senior Member, represented petitioning employer pursuant to OAR 137-003-0555. Assistant Attorney General David B. Hatton represented respondent SAIF Corporation (insurer). Auditor John Hegner and Dee Anne Hoyt testified on SAIF's behalf and the record closed on the date of hearing.

ISSUE

Whether SAIF incorrectly assessed premium for the audit period April 1, 2003 through March 31, 2004 by including payments made under employer's incentive plan in the premium basis.

OFFICIAL NOTICE

As noted at hearing, I take official notice of the *Basic Manual of Workers' Compensation and Employers Liability Insurance (Basic Manual)*. The *Basic Manual* is a publication of NCCI. It includes the rules insurers follow to arrive at the correct class code for a business and the official description for all class codes filed with the department. The *Basic Manual* is a required part of every insurer's audit procedure guide. OAR 836-43-115(1)(a). I also take official notice of another NCCI publication, the *Scopes of Basic Manual Classifications (Scopes Manual)*. The *Scopes Manual* consists of a numerical listing of class codes with descriptive terminology and examples of types of business activities that have been included in class codes in the past.

EVIDENTIARY RULINGS

Petitioner's Exhibits 1 through 11, and 13 through 16, as well as SAIF's Exhibits A1 through A31 were admitted into the record without objection.

FINDINGS OF FACT

1. Employer is a commercial and residential painting business, operating in the Pendleton, Oregon area since 1985. (Ex. A1; testimony of Thomas.) In March 2001, employer instituted an “Incentive Plan” (March 2001 plan) which was intended to encourage employees to make good business choices and to reduce employee turnover. At the time employer formulated the plan, Thomas was unaware of the requirements specified by OAR 836-042-0055(2)(c) concerning workers’ compensation insurance. (Testimony of Thomas.) During the audit period, employer made incentive payments to employees in various amounts. (Ex. A20; testimony of Thomas.)

2. Section 3.3 of employer’s March 2001 plan reads, “An amount for overhead is allocated to the profit center. A suitable number as of March 2001 appears to be approximately 15% of revenues.” (Ex. A7-3.)

3. Section 4.3 of employer’s March 2001 plan reads, “Profit Shares are paid on a quarterly basis. Team Leader shares are paid monthly.” (Ex. A7-4.)

4. Section 4.4 of employer’s March 2001 plan reads, “Each participating employee’s payout will be adjusted according to their most recent performance evaluation, based upon the following:

- Rating Score: 59 or below, no payout.
- Rating Score: 60 – 69, 50% payout.
- Rating Score: 70 – 79, 75% payout.
- Rating Score: 80 – 89, 100 payout.
- Rating Score: 90 – 100, 125% payout.”

5. The written plan does not contemplate payments based on an hourly wage rate. (Ex. A7.)

6. On January 1, 2004, employer revised the “Incentive Plan” (January 2004 plan) to reflect employer’s actual business practices. (Ex. A19; testimony of Thomas.) Following adoption of the January 2004 plan, employer made incentive payments in various amounts once during the audit period. (Ex. A20; testimony of Thomas.)

7. Section 3.3 of employer’s January 2004 plan reads, “An amount for direct overhead is allocated to each Profit Center. Overhead will be deducted each six week period based on a percentage of revenue to create a Net Profit for disbursement.” (Ex. A19-2.)

8. Section 4.3 of employer’s January 2004 plan reads: “Profit shares are paid every six weeks, based on the previous six week Profit Share Period.” (Ex. A19-2.)

9. Section 4.4 of employer's January 2004 plan reads, "Each participating employee's payout will be adjusted according to their most recent performance evaluation, based upon the following:

- 4.4.1 Rating Score: 59 or below, no payout.
- 4.4.2 Rating Score: 60 – 69, 50% payout,
- 4.4.3 Rating Score: 70 – 79, 75% payout,
- 4.4.4 Rating Score: 80 – 89, 100% payout,
- 4.4.5 Rating Score: 90 – 100, 125% pay-out.

(Ex. A19-2.)

10. Under the terms of the January 2004 plan, employees were paid various amounts in the last payout during the audit period. (Ex. A11; testimony of Thomas.)

11. Employer's overhead costs were between 19 and 20 percent during the audit period. (Ex. A30.)

12. During the audit period, employer used 16.5 percent of revenues to calculate its overhead for the purpose of making incentive plan payments. (Ex. A30; testimony of Hoyt.)

13. In one instance, employer reported 1.2 percent overhead costs in calculating one employee's incentive payment. (Ex. A27-6 and 7; testimony of Hoyt.)

14. Employer distributed incentive plan payments to team leaders monthly. (Exs. A12, A21 through A29, A31-1 and 2; testimony of Hoyt.)

15. Employer paid 30 percent to team leaders and 20 percent to employees. (Exs. A12, A21 through A29, A31-1 and 2; testimony of Hoyt.)

16. During the audit period, employer made various incentive payments to employees based on an hourly wage of \$12.50. (Exs. A12, A21 through A29, A31; testimony of Hoyt.)

17. On August 3, 2004, insurer issued a Final Premium Audit which included payments made under employer's plan in the premium basis. (Ex. A10.)

CONCLUSION OF LAW

SAIF correctly assessed premium for the audit period April 1, 2003 through March 31, 2004 by including payments made under employer's incentive plan in the premium basis.

OPINION

Inasmuch as petitioner is the party seeking redress before the department concerning SAIF's final premium audit billing for the audit period, petitioner has the burden of proving its position on those issues by a preponderance of the evidence. *Salem Decorating v. Nat'l Council on Comp. Ins.*, 116 Or App 166 (1992), *rev den* 315 Or 643 (1993) (in premium audit cases, burden of proof is on the employer). Proof by a preponderance of evidence means that the facts asserted are more likely true than false. *Riley Hill General Contractors v. Tandy Corp.*, 303 Or 309 (1989).

OAR 836-042-0055(2)(c) provides:

(2) An insurer shall include a payment in or exclude a payment from the workers' compensation premium basis of an employer as follows:

* * * * *

(c) A profit sharing payment shall be excluded from the premium basis if all of the following conditions apply with respect to the payment:

(A) The payment is anticipated;

(B) The payment is distributed in accordance from net realized profits;

and

(C) The payment is distributed in accordance with a written plan that creates a legal obligation for the employer to disburse funds in accordance with the plan.

The department has previously considered whether certain payments to employees constitute a profit sharing plan which is exempt from remuneration for purposes of calculating workers' compensation premium assessment or an employee bonus incentive program which is subject to such assessment. In *Seaman Restaurant Corporation v. SAIF Corp.*, Case No.: 88-2-3 at 11, the department stated, "Whatever this plan is called, we will look to the intent of the maker in determining whether this was a bonus, profit sharing or incentive plan." The department held that payments that were contingent upon performance evaluations constituted remuneration and were properly included in the premium basis. Similarly, in the present case, payments to employees were contingent upon performance evaluations. Therefore, payments made under employer's plan are properly included in the premium basis.

In *Bay News, Inc. v. SAIF Corp.*, Case No.: 89-05-27, the department reviewed a plan whereby employees were paid a percentage share of any quarterly profits made by

the company. In one quarter, the company earned no profit and no payments were made to employees. The department concluded that the employer maintained a *bona fide* profit sharing plan and that such payments were exempt from the workers' compensation premium assessment. In contrast, in the present case, employer made payments to employees based on hourly wages and not based on a percentage of net realized profits. Based on the record, I find that employer's incentive plan was distinguishable from the profit share plan presented in *Bay News*. Therefore, payments made under employer's incentive plan are not exempt from the premium assessment.

Here, employer contends that the plan in question is not an incentive plan, but a profit share plan. However, the record does not support employer's position. To begin, the written plan is titled "Incentive Plan". Next, Thomas testified that he formulated the plan with the intent of motivating employees to make good business decisions and reducing employee turnover. Moreover, payments under the plan were contingent upon performance evaluations. Therefore, I find that the payments constitute remuneration and are properly included in the premium basis.

Insurer contends that employer's plan does not qualify as a profit sharing plan because it fails to meet two of three requirements specified by OAR 836-042-0055(2)(c). I find insurer's arguments persuasive.

Net Realized Profits

OAR 836-042-0055(2)(c)(B) requires excludable payments to be distributed from net realized profits. However, employer did not calculate net realized profits in determining its incentive plan payments. Employer's records show that its overhead costs were between 19 and 20 percent during the audit period, but is used 16.5 percent of revenues to calculate its overhead. Moreover, in one instance, employer reported only 1.2 percent overhead in order to ensure that one employee received an incentive payment. Consequently, employer inflated its profit by inaccurately calculating its overhead costs. Based on the record, I conclude that employer's incentive plan fails to satisfy OAR 836-042-0055(2)(c)(B).

According to Written Plan

OAR 836-042-0055(2)(c)(C) requires excludable payments to be distributed according to the terms specified in the written plan. The record establishes that employer failed to do so. For example, Section 3.4 of the plan specifies that payments are to be made quarterly. However, employer distributed payments every six weeks. Next, Section 3.4 of the plan specifies that 25 percent of the profit center income will be allocated to the team leader and 25 percent to the employees. However, employer paid 30 percent to team leaders and 20 percent to employees. Additionally, the written plan does not contemplate payments based on an hourly wage rate. However, employer made incentive payments for hours worked on another team leaders' job at an hourly rate of \$12.50. (Ex. A31.) Based on the record, I conclude that employer's incentive plan fails to satisfy OAR 836-042-0055(2)(c)(C).

In conclusion, I find that employer's plan does not qualify as a valid profit sharing plan under OAR 836-042-0055(2). Therefore, payments made under the plan constitute remuneration and are properly included in the premium basis. Accordingly, I find that petitioner has failed to carry its burden of proving that the premium audit is incorrect.

PROPOSED ORDER

I propose that the department issue the following final order:

SAIF's final premium audit dated August 3, 2004 is correct and payable.

DATED this 28th day of April 2005.

/s/ Catherine P. Coburn
Catherine P. Coburn,
Administrative Law Judge
Office of Administrative Hearings

NOTICE OF OPPORTUNITY FOR ADMINISTRATIVE REVIEW

NOTICE: Pursuant to ORS 183.460, the parties are entitled to file written exceptions to this proposed order and to present written argument concerning those exceptions to the Director. Written exceptions must be received by the Department of Consumer and Business Services within 30 days following the date of service of this proposed order. Mail exceptions to:

Mitchel D. Curzon
Chief Enforcement Officer
Oregon Insurance Division
PO Box 14480
Salem, OR 97309-0405