



1 of the acquired entity to the acquiring entity when a change of  
2 ownership occurs.

3 2. Signature operates nursing homes in Arizona and  
4 additional homes outside of Arizona. Signature acquired each of  
5 the homes it operates in Arizona from other entities.

6 3. The NCCI holds a license in Arizona as a workers  
7 compensation rating organization.

8 4. The NCCI has filed a rating and classification  
9 system (the "System") with the Director. The Director has  
10 approved the System, which consists in part of an experience  
11 rating plan.

12 5. Under Arizona's laws relating to the  
13 establishment of workers compensation rates, insurers that sell  
14 workers compensation insurance in Arizona must belong to a  
15 rating organization.

16 6. Great States Insurance Co. ("Great States")  
17 subscribes to the System filed with the Department by the NCCI.

18 7. Signature purchases workers compensation  
19 insurance for its Arizona operation from Great States.

20 8. The NCCI publishes the terms of the System at  
21 issue in this proceeding in the NCCI's Experience Rating Plan  
22 Manual for Worker's Compensation and Employers Liability  
23 Insurance (the "Experience Rating Plan").

24 9. The Department approved the portion of the  
25 Experience Rating Plan, at issue in this proceeding, the "change  
26 of ownership filing," on June 18, 1990.

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1           II.    Summary of the Change of Ownership Filing.

2                   10.   The Experience Rating Plan provides a general  
3 rule to determine the applicable E-mod when the ownership of an  
4 existing business risk changes: "the experience for any entity  
5 undergoing a change in ownership shall be transferred to the  
6 experience ratings of the acquiring surviving or new entity."  
7 Experience Rating Plan, Part Three, § B(1) (the "change of  
8 ownership filing").

9                   11.   Insureds such as Signature pay workers  
10 compensation insurance premiums based upon a series of  
11 calculations involving several variables, including:

- 12                           a.   The amount of the insured's payroll.  
13                           b.   The rate, determined by the classification  
14 codes applied to the insured's business.  
15                           c.   The insured's loss experience history.

16                   12.   To calculate premium, loss experience history  
17 must be converted to a numerical expression, referred to as the  
18 E-mod, "a factor applied to premium to reflect a risk's  
19 variation from the average risk. Using the risk's own past  
20 experience, the experience modification is determined by  
21 comparing actual losses to expected losses." Experience Rating  
22 Plan, Part One, § II(F).

23                   13.   The change of ownership filing contains a three  
24 part test that excludes a prior owner's experience when  
25 determining the applicable E-mod. Experience Rating Plan,  
26 Part Three, § B(2). This aspect of the change of ownership  
27 filing dictates that all three elements of the test must be met  
28 for the exclusion to apply. This three part test consists of:

1 a. An evaluation of the degree of ownership  
2 change. Id. at § B(2)(a).

3 b. A determination of whether the ownership  
4 change "is accompanied by a change in operations sufficient to  
5 result in reclassification of the governing classification."  
6 Id. at § B(2)(b).

7 c. A determination of whether the ownership  
8 change "is accompanied by a change in process and hazard of the  
9 operations." Id. at § B(2)(c).

10 14. The application of the change of ownership filing  
11 to Signature's nursing home operation results in the  
12 consideration of the experience of Signature's predecessors in  
13 interest to calculate Signature's workers compensation insurance  
14 premium. Although a complete change of ownership occurred  
15 between Signature and the previous operators of the facilities  
16 now owned by Signature, no changes have been made to the  
17 governing classification or to the process and hazard of the  
18 operation.

19 **III. Summary of the Issues Raised in the Proceeding.**

20 15. Pursuant to A.R.S. §20-358(B), Signature  
21 submitted a request for hearing (the "hearing request") together  
22 with supporting data to challenge the change of ownership  
23 filing. In relevant part, this statute provides:

24 If the Director finds that the application  
25 is made in good faith, that the applicant would  
26 be so aggrieved if his grounds are established,  
27 and that the grounds otherwise justify holding  
28 such a hearing, he shall . . . hold a hearing

A.R.S. §20-358(B).

1           16. After receiving and reviewing Signature's hearing  
2 request, the Director issued a Notice of Hearing (the  
3 "Notice"). Through the issuance of the Notice, the Director  
4 found Signature's hearing request to have been made in good  
5 faith, that Signature would be aggrieved if it could establish  
6 the grounds stated in its hearing request, and that a hearing  
7 should be held.

8           17. Signature raised several issues in its hearing  
9 request related to the determination of an employer's E-Mod, a  
10 variable used by Great States to calculate the Signature's  
11 workers compensation premium.

12           18. Signature contends that only its experience  
13 history should be used to calculate the workers compensation  
14 premium for the nursing homes it acquired in Arizona. Instead,  
15 the premium for Signature's coverage has been calculated based  
16 upon the loss experience of the previous operators of the  
17 facilities. Thus, Signature contends that the change of  
18 ownership filing inappropriately compels the acquirer of a  
19 business to pay for coverage based upon the experience  
20 established by old management, experience over which the  
21 acquirer (Signature) had no control.

22  
23           **A. Does the Change of Ownership Filing Produce Excessive  
24 and Discriminatory Rates and Premiums?**

25           19. The Department approved the change of ownership  
26 filing on June 18, 1990. The previously filing regarding the  
27 transfer of experience following a change of ownership had  
28 provided that an acquiring party did not inherit its  
predecessor's experience.

1                   20. Signature urges that the change of ownership  
2 filing that became effective in June 1990 produces excessive and  
3 discriminatory rates and premiums in violation of A.R.S.

4 §20-356. In relevant part, this statute provides that:

5                   All rates subject to to this article shall be  
6 made in accordance with the following provisions:

7                   1. Rates shall not be excessive, inadequate or  
8 unfairly discriminatory. No rate shall be held to be  
9 inadequate unless the director finds that the loss  
10 experience of the insurer in the classification  
11 covered by the rate has been adverse for a continuous  
12 period of not less than two years immediately  
13 preceding the date of such finding.

14                   2. Due consideration shall be given to past and  
15 prospective loss experience within and outside this  
16 state, to catastrophe hazards, if any, to a reasonable  
17 margin for underwriting profit and contingencies, to  
18 dividends, savings or unabsorbed premium deposits  
19 allowed or returned by insurers to their  
20 policyholders, members or subscribers, to past and  
21 prospective expenses within and outside this state and  
22 to all other relevant factors within and outside this  
23 state.

24   \*   \*   \*

25                   4. Risks may be grouped by classifications for  
26 the establishment of rates and minimum premiums.  
27 Classification rates may be modified to produce rates  
28 for individual risks in accordance with rating plans  
which establish standards for measuring variations in  
hazards or expense provisions, or both. Such  
standards may measure any differences among risks that  
can be demonstrated to have a probable effect upon  
losses or expenses.

A.R.S. §§20-356(1), 20-356(2) and 20-356(4).

21                   21. Signature presented insufficient evidence to  
22 support its contention that the change of ownership filing  
23 violates A.R.S. §20-356. Its evidence established only that  
24 after the change of ownership filing went into effect in 1990,  
25 Signature assumed the experience history of each entity from  
26 which it acquired a nursing home. The evidence further

1 established that because Signature acquired nursing homes with  
2 less favorable experience histories, Signature's E-mod has  
3 increased.

4           22. The increase of Signature's E-mod due to the  
5 acquisition of entities with unfavorable experience histories  
6 does not demonstrate a violation of A.R.S. §20-356. Similarly,  
7 a violation of A.R.S. §20-356 would not be established if  
8 Signature had acquired a business with a more favorable  
9 experience history and realized a better E-mod.

10           23. Witnesses for both the NCCI and Signature  
11 indicated that a change of ownership will not have an immediate  
12 impact on the acquired entity's loss experience. A lag will  
13 occur between a change of ownership and the realization of the  
14 consequences of the policy changes implemented by new  
15 management. Because workers' habits that led to the development  
16 of a loss experience history under old management will not be  
17 immediately erased when a change of ownership occurs, the change  
18 of ownership filing preserves this history until new management  
19 has had the opportunity to make its mark on the operation of the  
20 business. Thus, the change of ownership filing represents the  
21 application of "[d]ue consideration . . . to past and  
22 prospective loss experience . . . ." A.R.S. §20-356(2).

23           24. Signature produced no evidence to establish that  
24 the change of ownership filing results in the collection of  
25 excessive rates. Under the filing, if an entity acquires a  
26 business with a negative loss experience history, its premiums  
27 may increase. Conversely, an entity that acquires a business  
28

1 with favorable loss experience history may enjoy a premium  
2 decrease.

3           25. That Signature's E-mod increased after the  
4 acquisition of nursing homes in Arizona does not amount to proof  
5 that the change of ownership filing results in the imposition  
6 and collection of excessive or discriminatory rates. Instead,  
7 the increase in Signature's E-mod demonstrates that consistent  
8 with the filing's design, when Signature acquired an ongoing  
9 business with a worse than average experience history, the risk's  
10 history became a part of the formula to be used to determine  
11 Signature's workers compensation premium.

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13           **B. Should the Director Have Held a Hearing Before  
14 Approving the Change of Ownership Filing?**

15           26. Signature contends that the Director should have  
16 convened a hearing before approving the change of ownership  
17 filing in 1990. In support of this contention, Signature cites  
18 A.R.S. §20-358(A). In relevant part, this statute provides:

19                   If at any time the director finds that a filing  
20 does not meet the standards set forth in §20-356, he  
21 shall, after a hearing . . . issue an order specifying  
22 in what respects he finds that the filing fails to  
23 meet the requirements of the rate regulatory  
24 provisions of this article, and stating when . . . the  
25 filing or rating system shall be deemed no longer  
26 effective.

27           27. Neither A.R.S. §20-358(A) nor any other statute  
28 requires the Director to hold a hearing before approving a  
proposed filing. Rather, the statutes contemplate that proposed  
filings may be approved by the Director without a hearing; the  
obligation to schedule a hearing concerning a filing exists only



1 when the Director questions whether a filing meets the standards  
2 prescribed by A.R.S. §20-356. See A.R.S. §20-357.

3 28. Signature presented no evidence to establish that  
4 the Director made a finding that the change of ownership filing  
5 violates the standards prescribed by A.R.S. §20-356. Signature  
6 also presented no evidence that the information submitted by the  
7 NCCI in support of the filing, together with other information  
8 available to and within the expertise of the Director and the  
9 Department, constitutes an insufficient basis from which the  
10 Director could have exercised the judgment and discretion to  
11 approve the filing without first convening a hearing.

12 29. The record does not support a finding that the  
13 Director had to convene a hearing before approving the change of  
14 ownership filing.

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16 **C. Does the Change of Ownership Filing Violate Arizona  
Law?**

17 30. As previously discussed, the change of ownership  
18 filing must be judged within the context of A.R.S. §20-356(2).  
19 For the reasons stated above, the change of ownership filing  
20 gives "[d]ue consideration . . . to past and prospective loss  
21 experience . . . ." A.R.S. §20-356(2).

22 31. The record does not support a finding that the  
23 change of ownership filing violates A.R.S. §§20-341 or 20-356.

24  
25 **D. Is the Change of Ownership Filing Inconsistent with  
Experience Rating and its Own Terms?**

26 32. The change of ownership filing acknowledges that  
27 the accumulated experience of an existing business will not  
28 disappear upon the acquisition of this existing business risk.

1 The risk remains unchanged until new management has had the  
2 opportunity to implement its plan of operation.

3 33. The change of ownership filing requires the use  
4 of "the risk's own past experience, [with] the experience  
5 modification . . . determined by comparing actual losses to  
6 expected losses." Experience Rating Plan, Part One, § II(F).

7 34. Consistent with A.R.S. §20-356, the filing  
8 requires insurers to consider the loss experience history of  
9 previous management as the best predictor of future losses for  
10 the risk.

11 35. The record does not support a finding that the  
12 change of ownership filing is inconsistent with experience  
13 rating or its own terms.

14 **E. Is the Change of Ownership Filing Overbroad?**

15 36. Signature contends that goal of the change of  
16 ownership filing could have been accomplished by other means and  
17 that therefore, the filing should be determined to be invalid  
18 due to overbreadth.

19 37. In urging that the change of ownership filing is  
20 overbroad, Signature focuses entirely upon concerns raised  
21 within the NCCI regarding steps taken by some insureds to avoid  
22 negative experience histories the insureds had developed.  
23 However, the change of ownership filing also satisfies the  
24 statutory requirement that an experience rating plan give "[d]ue  
25 consideration . . . to past and prospective loss experience  
26 . . . ."

27 38. Not only does the change of ownership filing  
28 ensure that an entity that acquires a risk with a favorable

1 meets the rate regulatory requirements of this article." A.R.S.  
2 §20-357(A).

3 43. Insurers and rating plans may make  
4 recommendations and suggestions concerning the provisions of a  
5 proposed System. However, only the Director can approve the use  
6 of a System. Further, insurers may not enter into insurance  
7 contracts, "except in accordance with the filings which are in  
8 effect for such insurers as provided in the rate regulatory  
9 requirements of this article." A.R.S. §20-357(E).

10 44. Before approving a proposed System, or a proposed  
11 change to a System, the Director must undertake substantial  
12 analytical steps to ensure that the proposal satisfies the  
13 requirements of Rates and Rating Organization article of Title  
14 20. See A.R.S. §§20-341 through 20-374.

15 45. Signature suggests that the Director approved the  
16 change of ownership filing without complying with the statutory  
17 requirements and responsibilities delegated by the Legislature.  
18 Signature suggests that the Director "simply" approved the  
19 change of ownership filing proposed by the NCCI.

20 46. Nothing in the record supports the position that  
21 the Director did other than to discharge the obligations of  
22 Title 20 when considering, reviewing, and ultimately approving  
23 the change of ownership filing.

24 47. The record does not support a finding that the  
25 change of ownership filing constitutes an unlawful delegation of  
26 legislative authority.

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CONCLUSIONS OF LAW

1. Signature and the NCCI received notice of this proceeding as prescribed by A.R.S. §§20-163, 20-358 and 41-1061.
2. The Director has jurisdiction over this matter pursuant to A.R.S. §§20-142 and 20-358.
3. Signature had the burden to prove that the experience rating filing at issue in this proceeding violated the Insurance Code. Signature has not met this burden.
4. The evidence supports the conclusion that the experience rating filing regarding the change of ownership filing complies with the provisions of Title 20.

ORDER

IT IS ORDERED denying the relief sought by Signature.  
EFFECTIVE this 12th day of July, 1995.

  
\_\_\_\_\_  
CHRIS HERSTAM  
Director of Insurance

  
\_\_\_\_\_  
GREGORY Y. HARRIS  
Chief Administrative Law Judge

NOTIFICATION OF RIGHTS

The aggrieved party may request a rehearing with respect to this Order by filing a written petition with the Administrative Law Division within 30 days of the date of this Order, setting forth the basis for such relief pursuant to A.A.C. R4-14-114(B).

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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.

COPY of the foregoing mailed/delivered this 12th day of July, 1995, to:

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