Mr. Rooter-South Puget Sound

ASSESSMENTS

Successor liability

When a change in business occurs without a change in business type, RCW 51.16.090 does not make the transfer of the old owner's cost experience mandatory but permits the new ownership to prove that the change in ownership, interests, or personal operating property was a "bona fide" change within the meaning of the statute and thus avoid imposition of the previous owner's cost experience rating. ***….In re Mr. Rooter-South Puget Sound*, BIIA Dec., 10 17889 (2011)** [*Editor's Note*: The Board's decision was appealed to superior court under Thurston County Cause No. 11-2-01983-4.]

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BEFORE THE BOARD OF INDUSTRIAL INSURANCE APPEALS
STATE OF WASHINGTON

IN RE:	**MR. ROOTER-SOUTH PUGET SOUND**	)	**DOCKET NO. 10 17889**
		)	
		)	
FIRM NO. 135,635-00		)	**DECISION AND ORDER**

APPEARANCES:

Mr. Rooter-South Puget Sound, by
Andrews Law Office, PLLC, per
Karol Whealdon-Andrews

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

The firm, Mr. Rooter-South Puget Sound, filed an appeal with the Board of Industrial Insurance Appeals on August 18, 2010, from an order of the Department of Labor and Industries dated June 23, 2010. In this order, the Department affirmed the experience rate levels assigned for the firm for 2010. The Department order is **REVERSED AND REMANDED**.

DECISION

As provided by RCW 51.52.104 and RCW 51.52.106, this matter is before the Board for review and decision. The employer filed a timely Petition for Review of a Proposed Decision and Order issued on May 12, 2011, in which the industrial appeals judge affirmed the Department order dated June 23, 2010.

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

We have granted review because we conclude that when a change in ownership of an existing business occurs without a change in business type, RCW 51.16.090 permits the Department to carry over a high experience factor of a company to the new owner of the company unless the new owner can prove that the change was a "bona fide" change within the meaning of that statute. We find that the change in ownership of the Mr. Rooter-South Puget Sound franchise and company was such a bona fide change. We conclude that the that new ownership of the company is entitled to have its 2010 experience factor calculated based on the neutral (1.00) experience factor for 2007, the year the change in ownership occurred, subject to subsequent adjustments to that factor that would be applicable in the years since then.

Evidence Presented

Mr. Rooter-South Puget Sound is a franchise of the national Mr. Rooter Company, which does plumbing and sewage-line work. Until April 2007 the South Puget Sound franchise was held by Paul Livesey Enterprises. On April 24, 2007, the owner and Michael Min, doing business as A II KK Inc., signed an "Asset Purchase Agreement" (Exhibit No. 1) in which all assets, inventory and property of the company were sold to Mr. Min's company. (A II KK is also referred to as A2K2 in the record.) Mr. Min had owned other businesses, but never a plumbing company. The franchise itself could not be conveyed in that manner, so Livesey canceled the area franchise agreement, and A II KK applied for and was awarded the now-vacant South Puget Sound franchise by Mr. Rooter. The lease of the business premises was transferred to Mr. Min. The employees were told that they must reapply to work for A II KK. They did and were hired, although none of them remained much longer with the company. The purchase agreement took effect on April 30, 2007. Mr. Livesey retained no further interest or connection with the business after that date.

There is no information in the record regarding Mr. Rooter's safety practices prior to the sale. We infer from the claims history found in Exhibit No. 2, that they were not effective. In the four years before the sale, seven claims for industrial injuries at Mr. Rooter were allowed, at least two of which were long-term claims and expensive. The last of these claims did not close until early 2011.

Mr. Min testified that he took safety seriously when he took over the business. He attended a "Mr. Rooter" training course at the company's national office, which included safety topics. When he returned, he instituted weekly safety meetings and required at least two workers to be available to lift heavy objects. In the three years since the sale, there have been three claims for injuries, all of which have closed quickly.

Khanh Tran, the Department account manager testified that had A II KK started an entirely new business, its experience factor would have been 1.00 in both 2007 and 2008 because it would not have been in business long enough for cost experience to be calculated. However, because A II KK purchased the business from Livesey, Ms. Tran transferred the Livesey experience factor based on worker hours and claims to A II KK. This resulted in the franchise receiving an experience factor of 1.09 in both 2007 and 2008. Due to the presence of six claims with injury dates prior to April 30, 2007, two of which Ms. Tran characterized as "major," Mr. Rooter's experience factor ballooned to 1.71 for 2010. It was this increase that led to A II KK's appeal.

Experience Rating and the Sale of a Business

The multiple policies behind the Department's assessments of premiums are found in RCW 51.16.035, which states in part:

> (1) The department shall classify all occupations or industries in accordance with their degree of hazard and fix therefor basic rates of premium which shall be:
>
> (a) The lowest necessary to maintain actuarial solvency of the accident and medical aid funds in accordance with recognized insurance principles; and
>
> (b) Designed to attempt to limit fluctuations in premium rates.
>
> (2) The department shall formulate and adopt rules governing the method of premium calculation and collection and providing for a rating system consistent with recognized principles of workers' compensation insurance which shall be designed to stimulate and encourage accident prevention and to facilitate collection. The department may annually, or at such other times as it deems necessary to achieve the objectives under this section, readjust rates in accordance with the rating system to become effective on such dates as the department may designate.

As part of the formula for assessing premiums to all state fund employers individually, the Department calculates an experience factor that is recalculated each year in accordance with RCW 51.16.035(2). A base rate for each job classification is calculated and then is multiplied by the experience factor of the employer to determine the total premiums owed. WAC 296-17-850 and WAC 296-17-855. For new employers, who have no cost experience, the experience factor is 1.00, which is arithmetically neutral (Base rate X 1.00 = Base rate). If an employer has an unusually large number of claims or its claims are expensive, the experience factor will increase (although the percentage of that increase can be limited; see WAC 296-17-865). If an employer has no claims, or only a few minor claims, the experience factor can decrease. Thus the 2010 experience factor of 1.71 assigned to A II KK means that its premiums are 71 percent higher than those of an identical employer with the same job classifications whose experience factor is 1.00. Similarly, an employer with an experience rating of 0.90 will pay only 90 percent of the premium amounts of an identical employer with a 1.00 experience factor. Thus, the inclusion of an experience factor into industrial insurance premium rate calculations is an efficient tool to promote both actuarial solvency of the Medical Aid and Accident Funds, and the stimulation and encouragement of accident prevention, which are policy goals found in RCW 51.16.035.

At the same time, it is advantageous to an employer's bottom line to possess as low an experience factor as possible. It is clear that the Legislature intends this process to be an incentive to employers to strive for workplace safety as a means to obtain the financial advantage of a low experience factor. Unfortunately, there are always individuals and companies that attempt to evade a high experience factor in ways other than promoting workplace safety. One of the more common means of doing this is to change ownership, legal structure, operating property, or interests in the company in an attempt to "reset" a high experience factor to the neutral 1.00 factor provided to new employers.

RCW 51.16.090 empowers the Director of the Department to prevent this type of evasion from happening. That statute permits the Director to determine if changes in an employer's ownership, assets, business, and so forth, represent bona fide changes, that is, changes that were not made wholly or in part for the purpose of lowering the cost experience (experience factor) of the business entity in question. That statute reads:

> To the end that no employer shall evade the burdens imposed by an unfavorable or high cost experience, the director may determine whether or not an increase, decrease, or change (1) of operating property; (2) of interest in operating property; (3) of employer; (4) of personnel or interest in employer is sufficient to show a bona fide change which would make inoperative any high cost experience: PROVIDED, That where an employer is now or has prior to January 1, 1958, been covered under the provisions of this title for a period of at least two years and subsequent thereto the legal structure of the employer changes by way of incorporation, disincorporation, merger, consolidation, transfer of stock ownership, or by any other means, such person or entity as legally reconstituted shall be entitled to a continuation of the experience rating which existed prior to such change in the employer's legal structure unless there has been such a substantial change as provided in subdivisions (1), (2), (3) or (4) of this section as would warrant making inoperative any high cost experience.

This statute was in existence in 1971 when the Legislature, through the enactment of RCW 51.16.035, delegated authority to the Department to create and administer the rating system that currently exists today. To this end the Department promulgated rules, currently found in WAC 296-17-873, and so forth. WAC 296-17-873 states:

> WAC 296-17-87301 through 296-17-87306 shall be used to determine the assignment of past loss experience associated with a change in business ownership for experience rating purposes. It is the intent of these rules that every firm (business) shall be responsible for its past experience irrespective of ownership as long as the firm (business) continues to conduct operations which are subject to Washington Workers'

> Compensation Act. When a business or portion of a business is sold, the new owner or owners of such business or portion thereof shall also take over the past loss experience associated with the business unless another treatment is specified in these rules.

The regulations cited within WAC 296-17-873 make it clear that in almost all instances not involving a change in the nature of the business, the Department will pass on the cost experience, and therefore the experience factor, to the new owner of that business. Ms. Tran stated that it was "rare" that such a transfer of experience to a new owner would not occur. We note, however, that the legislation that created RCW 51.16.035 (Laws of 1971, Ex. Sess. ch. 289, § 16) did not amend RCW 51.16.090; nor has the latter statute been amended subsequently. The regulations promulgated by the Department cannot conflict with RCW 51.16.090 or any other statute. We disagree with the firm's contention that such a conflict exists.

The regulations created by the Department can be read consistently with RCW 51.16.090. That statute does not make the transfer of the old owner's cost experience mandatory, it permits the new ownership to prove that the change in ownership, interest, operating property, and so forth, was a "bona fide" change within the meaning of the statute. In enacting the regulations in question the Department merely created a presumption that a change in the operating property, interest in operating property, employer, or personnel or interest in an employer is **not** "bona fide" within the meaning of RCW 51.16.090. The regulations cannot and do not prevent the new owner from proving that the changes in question were bona fide within the meaning of RCW 51.31.095. That statute does not define the term "bona fide," but from the context of the statute we conclude that it means: a change that is not in any way for the purpose of evading unfavorable or high cost experience. The burden is on the successor–in-interest or new owner (in this case A II KK) to prove that its acquisition of the assets of the business as well as the local "Mr. Rooter" franchise is "bona fide," such that the business would have been entitled to the 1.00 experience factor of a new business in its first year of operation as well as calculation of its yearly experience factor thereafter based on its own experience and not that of the predecessor ownership.

We have interpreted the language of RCW 51.16.090 on two occasions: *In re I-Do-It Lawn Sprinklers, Inc.*, Dckt. Nos. 92 4750, 93 1113 & 93 1809 (November 10, 1993); and *In re Chehalis Well Drilling, LLC*, Dckt. No. 09 14702 (July 1, 2010), neither of which we have denominated as Significant Decisions. We stated in *I-Do-It Lawn Sprinklers, Inc.*, at p. 3:

> This provision clearly restricts itself to instances where the employer is attempting to evade a high cost experience by changing ownership or changing the structure of the employer. The initial phrase

> clearly sets forth the purpose of the statute--"to the end that no employer shall evade the burdens imposed by an unfavorable or high cost experience . . .". The proviso goes on to indicate that unless such a substantial change has occurred that reflects a bona fide change, the employer shall continue the experience rating which existed prior to the change. The proviso cannot be taken out of the context of the whole statute. **The proviso itself ends with a reference to changes in the employer's legal structure as would warrant making inoperative any high cost experience. We conclude that the plain reading of the statute is that an employer with a high cost experience who undergoes a corporate change such as a merger or transfer of stock ownership shall maintain that high cost experience unless they can establish a substantial bona fide change of operating property, or change of interest in operating property, or change of employer, or of personnel or interest in employer.** (Emphasis ours.)

In *Chehalis Well Drilling*, a failing drilling company was essentially absorbed by another more successful drilling company with no change in the type of business or the general classification of the business. Similarly in Mr. Rooter's case, the change in ownership did not result in a change in the nature or classification of the business. We found that the agreement between the former and current owners had created a bona fide change in that company's operating structure with the result that the former owner's high cost experience was rendered inoperative and not applicable to the new ownership. We held that the Department's application of WAC 296-17-873, and more specifically, WAC 296-17-87304, was inconsistent with the controlling statute, RCW 51.16.090.

In the Proposed Decision and Order the industrial appeals judge erroneously cites the holding in *I-Do-It Lawn Sprinklers* as authority for determining that the new owner, A II KK, Inc. must maintain the seller's cost experience. The industrial appeals judge noted that the regulations had changed during the period between the decisions in *I-Do-It Lawn Sprinklers* and *Chehalis Well Drilling*, and used this as a basis for distinguishing between the two Board decisions. That analysis is incorrect. Our holding in *Chehalis Well Drilling* was based on our interpretation of the language of RCW 51.16.090 and **not** on the regulatory language that was the basis of our holding in *I-Do-It Lawn Sprinklers*. Our two decisions are consistent in their reading of that statute.

The important factual distinction between the situations in *I-Do-It Lawn Sprinklers* and *Chehalis Well Drilling*, and the facts that give the appearance of a difference in the holdings of those cases, is that in the former case the new employer was seeking to have the Department transfer its predecessor's **low** experience factor to it instead of establishing a new (neutral) factor, while in the latter situation (similar to Mr. Rooter's situation in this appeal) the employer was seeking to begin business with the neutral experience factor rather than the very **high** experience

factor its predecessor had earned. In *I-Do-It Lawn Sprinklers*, we discussed both of the scenarios described above. The holding in the case currently before us is that stated in the emphasized portion of the quotation on page 6 of this decision. We recognize that in *I-Do-It Lawn Sprinklers* that language was *dictum* because the fact pattern it discussed was not before us in that appeal. Nonetheless, the reasoning was sound and we adopt it in this case.

The next step in our analysis is to determine whether the change in ownership of Mr. Rooter to A II KK, Inc. represented a "bona fide" change within the meaning of RCW 51.16.090. In *Chehalis Well Drilling*, we found the change was bona fide because the former business's assets were liquidated by the new ownership; the former owner relinquished all authority over the business; and the business practices of the new ownership were substantially different and designed to improve the cost experience of the firm. In this case, the former owner did not retain any financial interest or authority over the business. The old owner had to cancel the franchise agreement and could not designate its successor, so there was no guarantee in advance that the franchise would pass to the new owner. The new owner had to apply for the Mr. Rooter franchise on its own. Additionally, the business practices of the new owner were materially different and designed to improve worker safety and thereby the cost experience of the firm. The success of these practices is illustrated in the improvement in the claim history of the firm as shown in Exhibit No. 2.

We find that A II KK, Inc. has met its burden of proving that its purchase of the assets of the company and its pursuit and acceptance of the vacated Mr. Rooter franchise were "bona fide" within the meaning of RCW 51.16.090. The new owner is entitled to have its experience factor for 2010 calculated based on a neutral (1.00) experience factor beginning in 2007, plus whatever subsequent adjustments to that factor are applicable in the years since then. We reverse the Department's June 23, 2010 order, and remand the matter to the Department to recalculate the 2010 rates assigned to the firm consistent with this Decision and Order.

FINDINGS OF FACT

1. On June 23, 2010, the Department of Labor and Industries issued an order in which it affirmed the rate levels assigned for 2010 for Mr. Rooter-South Puget Sound. On August 18, 2010, the firm filed a Notice of Appeal of the June 23, 2010 Department order. On October 11, 2010, the Board of Industrial Insurance Appeals granted the appeal under Docket No. 10 17889, and agreed to hear the appeal.

2. On April 20, 2007, Livesey Enterprises, Inc., sold Mr. Rooter-South Puget Sound, a franchise operation providing plumbing and drain cleaning services, to A II KK, Inc., owned by Michael Min. The terms of

the parties' "Asset Purchase Agreement" became effective on April 30, 2007. As of that date, ownership of all assets, inventory, and property were transferred to A II KK, Inc. Livesey Enterprises, Inc., retained no ownership interest or control over any aspect of the business.

3. The April 30, 2007 transfer of the business did not include the Mr. Rooter franchise itself. Livesey Enterprises did not have the power to transfer the franchise to A II KK, Inc., or anyone. A KK II Inc., had to apply for the franchise. It was successful in its bid for the newly vacated franchise.

4. After the sale on April 30, 2007, AII KK, Inc., continued to operate Mr. Rooter-South Puget Sound and perform the same services as provided by the firm when owned by Livesey Enterprises, Inc. The job classifications of Mr. Rooter-South Puget Sound did not change in any way due to the change in ownership of the assets of the business and the holder of the franchise license.

5. Between January 2003 and April 30 2007, workers employed by Mr. Rooter-South Puget Sound filed seven industrial insurance claims of which two were high cost claims. These claims increased the firm's experience factor year after year to the point that for calendar year 2010, the Department calculated the firm's experience factor at 1.71. The Department did not adjust or modify its calculation of the Mr. Rooter-South Puget Sound experience factor after April 30, 2007, to reflect the change in ownership or the franchise operation.

6. After April 30, 2007, A II KK, Inc., instituted new practices for its employees including new safety practices. Since April 30, 2007, only three minor claims have been filed for industrial insurance benefits by Mr. Rooter–South Puget Sound workers.

7. For 2010, the experience factor for A II KK, Inc, as the owner of Mr. Rooter–South Puget Sound would have been lower than what the Department calculated when it included the cost experience for the period under the ownership of Livesey Enterprises, Inc.

8. The 2007 transfer of ownership of the assets, inventory, and property of Mr. Rooter-South Puget Sound, as well as the change in the franchise license from Livesey Enterprises, Inc., to A II KK, Inc., was not done in whole or in part for the purpose of enabling the business to evade unfavorably high cost experience resulting from poor past business practices and claims history.

CONCLUSIONS OF LAW

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

2. The transfers of ownership, assets, and the franchise license of Mr. Rooter-South Puget Sound from Livesey Enterprises, Inc. to A II KK, Inc., represent "bona fide" changes within the meaning of RCW 51.16.090.

3. The transfers of ownership, assets, and the franchise license of Mr. Rooter-South Puget Sound from Livesey Enterprises, Inc., to A II KK, Inc., make inoperative any high cost experience attributable to the old owner of the firm. Mr. Rooter-Puget Sound South is entitled to have its experience factor for 2010 calculated based on a neutral (1.00) experience factor beginning in 2007, plus whatever subsequent adjustments to that factor are applicable in the years since then.

4. The order of the Department of Labor and Industries dated June 23, 2010, is incorrect and is reversed. This matter is remanded to the Department to recalculate the firm's 2010 experience factor and industrial insurance premiums (taxes) consistent with this decision, and thereafter for further action as indicated.

DATED: August 18, 2011.

BOARD OF INDUSTRIAL INSURANCE APPEALS

/s/_____
DAVID E. THREEDY Chairperson

/s/_____
FRANK E. FENNERTY, JR. Member

/s/_____
LARRY DITTMAN Member