

**BEFORE THE STATE OF ALASKA OFFICE OF ADMINISTRATIVE HEARINGS
ON REFERRAL BY THE DIVISION OF INSURANCE**

In the Matter of:)	
)	
NORTHERN FLUID POWER, INC.,)	
)	
Appellant.)	OAH No. 05-0188-INS
<hr/>)	Division No. H-05-01

DECISION AND ORDER

I. Introduction

This case is an appeal from a decision by the Alaska Workers' Compensation Rating and Classification Grievance Committee in which appellant, Northern Fluid Power, Inc., challenges the premium calculation for its 2003 workers' compensation insurance under Policy No. 03F WW 82045. Northern Fluid requested a hearing under AS 21.39.090, and the Director of Insurance referred the case to the Office of Administrative Hearings.¹ Based on the evidence, the premium for Northern Fluid was correctly calculated, and it owes Alaska National Insurance Company \$2,531 for unpaid premium.

II. Facts

David Conover, Patricia Henderson and Carolyn Pearl testified under oath and subject to cross-examination at the hearing. Exhibits 1 through 7 and "A" through "I" were admitted as evidence. The audiocassette tape record of the hearing is not transcribed at this time. The following findings are based on the record in this case:

1. Northern Fluid Power, Inc., is an Alaska business corporation whose primary activity involves providing commercial equipment services, typically involving repairs to hydraulic parts for heavy equipment. As part of its business activities, Northern Fluid employed three of its officers, the President, Vice President, and Secretary. Northern Fluid first obtained workers' compensation insurance under an assigned risk policy through an application dated March 20,

¹ This case arises from application of AS 21.39 in the insurance code. It is not within the mandatory jurisdiction of the Office of Administrative Hearings under AS 44.64.030(a)(18), but was referred voluntarily pursuant to AS 44.64.030(b) and § 94, ch. 163, SLA 2004. The referral letter to OAH references the insured's right to appeal under AS 21.39.090.

2001, to the National Council on Compensation Insurance, Inc. (NCCI)², the plan administrator for the Alaska Workers' Compensation Insurance Plan. NCCI assigned a binder of coverage for Northern Fluid to Alaska National Insurance Company for servicing. The 2001 policy was renewed in 2002. In 2003, Alaska National issued Policy No. 03F WW 82045 to Northern Fluid as a renewal workers' compensation policy. The majority of the premium was calculated based on a 3632 classification code for "Machine Shops NOC." The 2003 policy was in effect from June 12, 2003, through June 12, 2004. The policy was issued in accordance with the rules of the Alaska Workers' Compensation Insurance Plan, and it was in full force and effect for the entire policy period.

2. The plan uses NCCI's Basic Manual to determine an insured's premium. The Basic Manual has the following pertinent parts in Rule 2-E-1:

b. Premium Determination

Premium for executive officers is based on their total payroll, subject to the following limitations and the requirements of Rule 2-D:

- (1) The minimum individual payroll for an executive officer is shown on the individual state pages in the **Basic Manual**.
- (2) The maximum individual payroll for an executive officer is shown on the individual state pages in the **Basic Manual**.
- (3) The payroll limitations in (b)(1) and (b)(2) apply to the average weekly payroll of each executive officer for the number of weeks the officer was employed during the policy period.

3. The Basic Manual contains an Alaska page Applicable to Assigned Risk Policies Only that provides "**Minimum Payroll** applicable [weekly] in accordance with Basic manual Rule 2-E-1 – 'Executive Officers' \$350.00."

4. At the conclusion of the policy period, Alaska National conducted an audit to determine the premium on Policy No. 03F WW 82045. Based on information given to Alaska National, Northern Fluid's combined payroll under Section II of the Final Audit Report used to determine insurance premium on the policy was \$10,653.88. Applying a minimum payroll amount under the Alaska Workers' Compensation Insurance Plan, Alaska National determined that the minimum imputed annual payroll for Northern Fluid's officers was \$18,200.00, resulting in an additional premium of \$2,531.00. It billed Northern Fluid for that amount.³ Northern Fluid responded by filing an appeal with the Alaska Workers' Compensation Rating and Classification

² Under the plan, NCCI is authorized to "make and file rates, rating values, classifications, and rating plans for workers' compensation insurance including rates for the residual market." See Exhibit A, p. 1.

³ The amount remained unpaid at the time of the hearing in this case.

Grievance Committee in accordance with dispute resolution procedures under the Alaska Workers' Compensation Insurance Plan.

5. In its appeal, Northern Fluid disputed the application of NCCI's Basic Manual⁴ minimum and maximum rules to determine corporate officers' payroll for purposes of calculating workers' compensation insurance premiums. Northern Fluid asserted in the appeal that its officers are paid the minimum wage of \$7.25 under Alaska law. It provided Alaska National with documentation of the actual wages paid to its corporate officers and requested that the grievance committee order Alaska National to charge a premium based on actual wages paid to officers, rather than an amount based on the minimum payroll requirements set forth in the Basic Manual. Northern Fluid also argued that because it is a Subchapter S corporation under the Internal Revenue Code, the provision of the Alaska Workers' Compensation Act treating officers of corporations as employees (AS 23.30.240) does not apply to it.

6. The grievance committee met in executive session and determined that the Subchapter S distinction had no bearing on determining applicable payroll for workers' compensation premium development in Alaska. The grievance committee further determined that Basic Manual Rule 2-E-1-b-3 should be applied for the purpose of calculating the workers' compensation insurance premium attributable to Northern Fluid's officers.⁵ The committee denied Northern Fluid's appeal.⁶ Northern Fluid appealed the decision to the Director of Insurance under AS 21.39.090, which allows an insured to appeal a decision of the grievance committee to the director.

III. Discussion

The legal issues in this case are whether the Alaska Workers' Compensation Plan applies to Subchapter S corporations and whether the Alaska Workers' Compensation Plan requires Alaska National to apply a minimum payroll for services provided by Northern Fluid executive officers if their actual payroll does not exceed the minimum amount. The discussion will first

⁴ This publication, along with NCCI's Assigned Risk Supplement, contain rules that govern the issuance and administration of insurance policies under the Alaska Workers' Compensation Insurance Plan. The Basic Manual's provisions were approved by Alaska's Director of Insurance. (April 26, 2005, letter to David Conover from Sarah McNair-Grove) Manual provisions apply to all servicing carriers under the plan. (Direct exam of Henderson; Direct exam of Pearl)

⁵ Filings in this case sometimes misreference Rule 2-E-b-3, instead of Rule 2-E-1-b-3.

⁶ A motion passed by the committee that rejected the appeal states: "Resolved, that the distinction between corporation and "S" corporation has no bearing on the employer's status as a corporation for the purpose of determining applicable payroll for workers' compensation premium development in Alaska, and the Basic Manual rule 2-E-b-3 would apply. The appeal is denied." See Exhibit G, p. 2.

briefly review the mandatory workers' compensation scheme in Alaska. Next, the discussion turns to Subchapter S and the minimum payroll requirement.

A. Alaska Workers' Compensation Act (AS 23.30)

Alaska, like all states, has a workers' compensation statutory scheme providing an exclusive remedy to victims of work-related injury. The Alaska Workers' Compensation Act (AS 23.30) is intended to compensate injured employees "for a part of their economic loss, measured by the wage loss to the worker or the surviving family."⁷ By law, provisions of the Act are part of every contract of hire.⁸ An employer-employee relationship must be present. An entity that is engaged in a "business or industry" is an "employer" within the meaning of the Act.⁹

All employers must meet the statutory liability requirements of AS 23.30. Many obtain insurance through the voluntary market with insurance carriers. Alternate coverage for employers who are unable to obtain insurance through an insurer in the voluntary market is provided through the assigned risk pool. Under AS 21.39.155, the insurance code authorizes the Director of Insurance to require insurers, as a condition of writing workers' compensation insurance in the state, to participate in the assigned risk pool.¹⁰ In this case, Northern Fluid is an employer that obtained insurance under Policy No. 03F WW 82045 through the assigned risk pool.

AS 23.30.240 addresses workers' compensation coverage for corporate officers. The statute provides that an executive officer of a corporation is an employee of the corporation for the purpose of the Alaska Workers' Compensation Act, unless the officer waives worker's compensation coverage with approval of the commissioner of labor and workforce development. Northern Fluid did not seek approval from the commissioner under AS 23.30.240 to waive coverage.¹¹ The company provided insurance coverage for its officers through Policy No. 03F WW 82045.

B. Status as a Subchapter S Corporation Does Not Exempt Northern Fluid From AS 23.30

Northern Fluid argues that its status as a Subchapter S corporation under 26 U.S.C. §§ 1361 et. seq. of the Internal Revenue Code exempts it from provisions of the Alaska Workers'

⁷ See Wien Air Alaska v. Arant, 592 P.2d 352 (Alaska 1979).

⁸ See AS 23.30.010.

⁹ See Gaede v. Saunders, 53 P.3d 1126, 1126-27 (Alaska 2002).

¹⁰ See AS 21.39.155; 3 AAC 30.010 et seq. (regulations creating and implementing assigned risk pool).

¹¹ Exhibit G.

Compensation Act (AS 23.30), because AS 23.30.240 generally references corporations, not “S” corporations in particular and, as a consequence, the statute is not “relevant” to determining employee premiums for an “S” corporation. Alaska National argues that Subchapter S status has no bearing on provisions of AS 23.30.240, or any other provision of AS 23.30, and that, Northern Fluid’s officers were employees of the corporation.

AS 23.30.240 addresses employee status for officers of corporations in general. The statute contains an exception from automatic coverage for executives of certain classes of corporations.¹² No type of for-profit corporation is included in that exception. This strongly suggests that the Alaska Legislature intended to include executives of all for-profit corporations in the coverage of this provision. No published cases in Alaska apply AS 23.30.240, and hence there is no case law suggesting otherwise.¹³

The “Subchapter S” designation refers to a portion of the Internal Revenue Code that allows a preferred tax status for some corporations. This federal law was enacted to eliminate tax disadvantages that might dissuade small businesses from adopting the corporate form and to lessen the tax burden on such businesses. The law accomplishes these goals by means of a pass-through system under which corporate income, losses, deductions, and credits are attributed to individual shareholders in a manner akin to the tax treatment of partnerships.¹⁴ Subchapter S corporate status is not referenced anywhere in the Alaska Workers’ Compensation Act. No published Alaska cases suggest that Subchapter S alters the coverage of the Act.

In summary, neither Subchapter S, nor the status it affords qualifying corporations for federal tax purposes, alter Alaska’s workers’ compensation scheme with regard to premium determination for an assigned risk policy. Subchapter S status is inapplicable to interpret AS 23.30.240. The grievance committee, therefore, was correct in rejecting Northern Fluid’s argument that Subchapter S corporation status exempted it from requirements of AS 23.30.

C. Under Basic Manual Rule 2-E-1-b-3, the Insurer May Apply a Minimum Payroll for Services Provided by Northern Fluid Executive Officers.

It is not disputed in this case that Alaska National provided assigned risk coverage to Northern Fluid’s corporate officers under Policy No. 03F WW 82045. Northern Fluid is obligated to pay for coverage under the policy. The remainder of the discussion addresses the premium calculation for this obligation.

¹² The exception is for executives of municipal corporations and nonprofit corporations.

¹³ Cf. Witmer v. Kellen, 884 P.2d 662, 664 (Alaska 1994)(AS 23.30.240 referenced but not at issue on appeal); Gordon v. Burgess Construction Co., 425 P.2d 602, 604 (Alaska 1967)(AS 23.30.240 referenced but not applied).

Northern Fluid challenges the applicability of Basic Manual Rule 2-E-1-b-3 to the premium calculation for Policy No. 03F WW 82045, arguing that NCCI, the division of insurance and Alaska National have no authority to use the rule. Alaska National argues that the rule was properly adopted, governs the premium calculation in this case, and was properly applied. The discussion will first address NCCI's authority to use the Basic Manual and then apply Rule 2-E-1-b-3 to the facts in this case.

AS 21.39 provides the authority to use the Basic Manual in Alaska. Under AS 23.30.035, workers' compensation insurance rates "must be made in strict compliance with the rate regulation provisions of state law [AS 21.39 of the insurance code]." AS 21.39.040 addresses rate filings. Subsection (a) of the statute requires rates and rating rules to be filed with the division of insurance, and subsection (h) requires insurers to use the rates and rules that are filed. AS 21.39.043 requires a rating organization, on at least an annual calendar year basis, to make a workers' compensation assigned risk pool rate filing. The Alaska Workers' Compensation Plan mirrors AS 21.39.040 by stating "All policies issued to employers to which this Plan applies shall be written utilizing the classifications, forms, rates and rating plans approved by the Director and authorized for use in the residual market by this Plan."¹⁵

NCCI is a rating organization under provisions of AS 21.39 (Rates and Rating Organizations) and it serves as the plan administrator for the workers' compensation assigned risk pool. The regulation at 3 AAC 30.030 requires the assigned risk pool to establish a written plan of operation. The plan "may provide for . . . its own applications, policies and endorsements, rates and rules, manuals, and similar materials if they are submitted to the director for approval before their implementation."¹⁶ The plan authorizes NCCI to use the Basic Manual to calculate the premium for an assigned risk policy by stating that NCCI shall establish written performance requirements for servicing carriers including "maintenance of premiums on policies consistent with manual rules, rates, rating plans, and classifications," "completion and billing of final audits," and "collection of premium."¹⁷ The pool's plan of operation also gives NCCI authority to administer the "dispute resolution mechanism."¹⁸ NCCI uses the Alaska Workers'

¹⁴ See Bufford v. Commissioner of Internal Revenue, 506 U.S. 523, 524 (1993).

¹⁵ Exhibit A, p. 3, § 2, prov. 2 (Forms and Rates). The 10-member Alaska Review and Advisory Committee, which is appointed by the Director of Insurance, assists and advises the director regarding workers' compensation matters.

¹⁶ See 3 AAC 30.030(g)(6).

¹⁷ Exhibit A, p. 8.

¹⁸ See id.

Compensation Rating and Classification Grievance Committee to resolve premium disputes, as in this case.

In accordance with AS 21.39.040, AS 21.39.043 and 3 AAC 30.030(g)(6) and the Alaska Workers' Compensation Plan, NCCI drafted the Basic Manual and filed it with the division of insurance. The manual was approved by the Director of Insurance.¹⁹ Upon approval, the manual became binding.

The following provisions of the Basic Manual are pertinent to premium calculation for the contract of insurance in this case. Rule 2-E-b-1 provides "The minimum individual payroll for an executive officer is shown on the individual state pages in the **Basic Manual**." Rule 2-E-b-3, which is an adjunct with Rule 2-E-b-1, states "the payroll limitation in b(1) [minimum] and b(2) [maximum] apply to the average weekly payroll of each executive officer for the number of weeks the officer was employed during the policy period."²⁰ The Alaska "state page" in the Basic Manual provides that the minimum payroll for corporate officers is \$350 per week.

Under the Alaska Workers' Compensation Plan, the initial premium is determined based on an estimate of payroll provided by a prospective insured or as indicated by historical information. An initial annual premium is billed to the insured by the servicing carrier. The initial premium is subject to a final audit to determine the actual premium due. NCCI audits Alaska National to ensure that rules contained in the Basic Manual are followed. In this case, because Northern Fluid calculated payroll for its corporate officers that was less than the minimum payroll provided for by the Basic Manual, the minimum payroll of \$350 per week applies for the purpose of determining premium. Neither NCCI nor Alaska National has discretion to vary the minimum payroll amount established by the Basic Manual.

Northern Fluid argued that Alaska's minimum wage law (AS 23.10.050 *et seq.*) precludes NCCI and Alaska National from using the minimum payroll limitation from the Basic Manual. The argument confuses the employment contract (between Northern Fluid and its officers) with the contract of insurance (between Alaska National and Northern Fluid). An insurance policy is

¹⁹ Direct exam of Henderson; Direct exam of Pearl; April 26, 2005, letter to David Conover from Sarah McNair-Grove; Exhibit C.

²⁰ Exhibit B. According to Patricia Henderson, Vice President of Audit at Alaska National, the rule has existed since at least 1967.

a contract.²¹ The policy provisions are terms of the contract. Provisions of the employment contract do not alter the premium calculation for Policy No. 03F WW 82045.

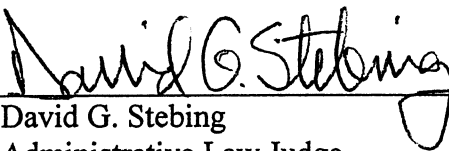
Alaska National's application of the minimum payroll amount resulted in an annual payroll for Northern Fluid officers in the amount of \$18,200. Since the reported payroll for the corporation's officers was less than the minimum payroll amount allowed under the Alaska Workers' Compensation Plan, Alaska National was required to recalculate the premium based on the minimum payroll amount.

The insurance premium due for Policy No. 03F WW 82045 is \$4,759. Northern Fluid previously paid \$2,228 based on its payroll estimate.²² Unpaid premium remains in the amount of \$2,531.00, based on the minimum payroll amount obtained from Rule 2-E-1-b-3 of the Basic Manual.

IV. Conclusion

The fact that Northern Fluid is a Subchapter S corporation under the Internal Revenue Code does not exempt it from any requirements of AS 23.30. Alaska National correctly applied NCCI's Basic Manual Rule 2-E-1-b-3 to the premium calculation for Policy No. 03F WW 82045.

DATED this 20th day of January, 2006.

By: 
David G. Stebing
Administrative Law Judge

²¹ See Fejes v. Alaska Insurance Co., 984 P.2d 519, 522 (Alaska 1999); AS 21.42.150 (insurance policy contains "the entire contract between the parties").

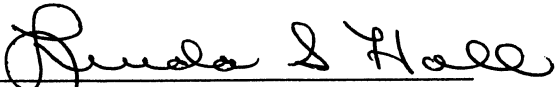
²² Exhibit G.

Adoption

The undersigned Director of Insurance adopts this Decision and Order in OAH Case No. 05-0188 INS as the final administrative determination in this matter.

Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska R. App. P. 602(a)(2) within 30 days after the date of this decision.

DATED this 3rd day of February 2006.

By: 
Signature
Linda S. Hall
Name
Director
Title