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RESEARCH MEMO

TO: Interim Committee on Operation of Pinnacol Assurance

FROM: Bart Miller, Office of Legislative Legal Services

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SUBJECT: Alternate models for organization of state-sponsored workers' compensation insurance entities

INTRODUCTION

Beginning in the early years of the 20th century, states created workers' compensation systems to provide a means of paying medical expenses and providing compensation to employees injured at work. Because this type of insurance was a new product at the time that was not offered widely by private insurance companies, and workers' compensation systems necessarily required that all employers have insurance coverage, many states created government-sponsored entities to offer workers' compensation insurance. You have asked for a synopsis of the organizational models used for these entities.

With the caveat that each state is somewhat different in terms of how these entities were created and organized because of differences among state constitutions and other legal requirements, three basic models of organization emerged: The state agency; the quasi-governmental option; and the private option. This memo briefly introduces the three organizational models so that the Interim Committee on the Operation of Pinnacol Assurance can understand them and utilize this information in carrying out its duties under Senate Bill 09-281.

THE STATE AGENCY

Under this option, a state creates a state agency that operates as an insurance company to offer workers' compensation insurance to employers in the state.

Colorado utilized this model from 1915 until the late 1980s.¹ With this particular model, state government employees operate an insurance company under the umbrella of state government to make workers' compensation insurance available. With this model of operation, typically the state entity is the insurer of last resort and must write policies of insurance for all businesses within the state. In some situations this is not the case.

Because these entities are actually state government agencies, they are exempt from federal and state income taxes and in many cases from having to collect premium taxes generally collected by private insurance companies based on the total amount of premium dollars collected.

THE QUASI-GOVERNMENTAL OPTION

Under this model, a state creates a governmental entity separate and apart from state government to function as an insurance company to sell workers' compensation insurance. This is the option currently used here in Colorado. Pinnacol is a political subdivision of the state, created by state statute. It is organized for the purpose of selling workers' compensation insurance to employers in Colorado.

Because each state constitution is somewhat different, some states have created entities that are public in nature, but more like private businesses than the organizational structure of Pinnacol here in Colorado. An example of this would be Utah's non-profit, self-supporting, quasi-public corporation, known as the Workers' Compensation Fund.

As a quasi-governmental entity, this type of organization is usually tax-exempt at the federal and state level.

This type of entity may have more flexibility with the types of employees the entity may hire. While a state agency must usually have employees that are part of the state's civil service system, quasi-governmental entities are able to hire employees outside of the civil service system. Here in Colorado, Pinnacol employees are not part of the state personnel system. However, because they are still public employees, they are eligible for inclusion in the public employees retirement system.

¹ See 1915 Colo. Sess. Laws 529. Pinnacol Assurance was originally known as the State Compensation Insurance Fund administered by the Industrial Commission of Colorado. See also 1986 Colo. Sess. Laws 520 and 2002 Colo. Sess. Laws 1865.

It seems to be typical that quasi-governmental workers' compensation insurers operate as insurers of last resort. In Colorado, Pinnacol always had a policy of functioning in this manner, but an actual provision mandating this was not placed in Colorado law until the mid-1990s.

THE PRIVATE OPTION

Under this model, a private insurer of some kind offers workers' compensation insurance to employers.

Nevada and Texas are examples of States that have gone in this direction. In Nevada, Employers Insurance Group, formerly the Nevada State Industrial Insurance System, was privatized in 1999 through legislation enacted by the Nevada Legislature. In a similar fashion, the Texas Legislature also privatized its state worker's compensation insurance fund.

A legal/policy issue that arises in these scenarios is what happens if the state requires employers to carry workers' compensation insurance, as is the case here in Colorado. In these situations, does a state require that the private entity be the insurer of last resort? Michigan did so when it privatized its state-run workers' compensation entity in the mid-1990's. Texas, on the other hand, decided to make workers' compensation insurance optional.

Another major issue that can arise in the private option relates to how the privatization occurs. In some situations, states have chosen to simply allow an existing governmental organization to make itself into a private company. Nevada and Texas followed this course. However, another option could be to sell the government-sponsored entity to a private entity. This raises several questions. For example, what if the private entity consists of persons drawn from the top management of the former government-sponsored entity? And if the governmental entity is sold, where does the consideration for the sale go: To the State, to the resulting private entity, or back to policyholders?

Michigan is an example of a State that chose to sell its government-sponsored workers' compensation insurer to the private sector. In the mid-1990s, the State of Michigan received more than \$250 million for the sale of its workers' compensation entity. This transaction was challenged in court and ultimately upheld in *In re Certified Question Fun'n Sun RV, Inc. v. Michigan*, 527 N.W. 2d 468 (Mich.1994).

In 2001, a bill was considered, but not passed, by the Colorado General Assembly to set up a process similar to Michigan's for selling Pinnacol.

CONCLUSION

States primarily use three basic organizational models to make workers' compensation insurance widely available to businesses within their states. Some states use a state agency operating like an insurance company to serve this purpose. Other states, in order to achieve more flexibility, have opted for a quasi-governmental option, using an entity that is governmental in nature, but separate from state government itself, for this purpose. In other cases states have chosen to privatize the function of offering workers' compensation insurance to employers. In contemplating a change from one model to another, Colorado must consider not only the benefits and disadvantages of one over another, but also specific issues arising during the transaction.

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