

MINUTES

MONTANA SENATE 55th LEGISLATURE - REGULAR SESSION

COMMITTEE ON LABOR & EMPLOYMENT RELATIONS

Call to Order: By **CHAIRMAN THOMAS F. KEATING**, on February 15, 1997, at 11:48 a.m., in 413/415

ROLL CALL

Members Present:

Sen. Thomas F. Keating, Chairman (R)
Sen. James H. "Jim" Burnett, Vice Chairman (R)
Sen. Sue Bartlett (D)
Sen. Steve Benedict (R)
Sen. C.A. Casey Emerson (R)
Sen. Dale Mahlum (R)
Sen. Debbie Bowman Shea (D)
Sen. Fred Thomas (R)
Sen. Bill Wilson (D)

Members Excused: None.

Members Absent: None.

Staff Present: Eddye McClure, Legislative Services Division
Gilda Clancy, Committee Secretary

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:

Hearing(s) & Date(s) Posted: SB 304, SB 307; 2-11-97
Executive Action: SB 67, DO PASS AS AMENDED
SB 302, TABLED
SB 304, DO PASS

HEARING ON SB 304

Sponsor: SENATOR MACK COLE, SD 4, Hysham

Proponents: Jim Almond, J.B. Grierson Company
John Bloomquist, Montana Stockgrowers' Association
Candace Torgerson, Women In Farm Economics
Nancy Butler, State Fund
Jacqueline Lenmark, American Insurance Association

Opponents: None.

Opening Statement by Sponsor:

SEN. MACK COLE, SD 4, Hysham, introduced SB 304. This is a bill which will help the small business corporations and is probably something which should have been addressed a long time ago.

There is one small amendment he would like to make to the bill. On page 3, line 17 where the language "shares owned by a person" exist, he feels this should read "shares owned by a person or persons". He believes this will take care of the language in the bill which reads "20% or more of person or persons". What has happened to small businesses over the years where gradually more and more people which were shareholders within this business in respect to whether or not they fit under the Workers' Compensation Act. In referring again to page 3 where it states less than 20% of the number of shares in the corporation are limited liability, some of these are agricultural business, some are private business, as they have gradually been diluted out they have not had the choice as to if they want to be under Workers' Compensation or not.

SB 304 simply attempts to allow the Workers' Compensation Act to be flexible as ownership of family businesses moves outward to other family members.

Proponents' Testimony:

Jim Almond, Vice President and General Manager, J.B. Grierson Co., supported SB 304. (EXHIBIT 1)

John Bloomquist, Montana Stockgrowers' Association, said when this issue was raised to their attention, they had met with members from State Fund as well as others to make sure this issue could be addressed. He has also spoken with attorneys who have dealt in this area of the state planning and, of course, raising family corporations and gifting of dispersal shares is a very common practice in terms of state planning strategy. Many folks who practice in this area are not very aware of this situation. State Fund assisted in some of the drafting of the language in the bill. He met with them yesterday and did not hear any concerns with this proposal. On behalf of Montana Stockgrowers' Association, he urged the Committee's support.

Candace Torgerson, Woman In Farm Economics, said they rise in support of SB 304. Many of today's family farms are held as close corporations or limited liability companies and they believe this bill will add stability and security to those persons trying to pass ownership of their family corporations on to the next generation while still providing Workers' Compensation Coverage. The hope the Committee will support this bill.

Nancy Butler, State Fund, stated they support this bill and would like to explain how it works. Currently, if you are a corporate

Nancy Butler, State Fund, stated they support this bill and would like to explain how it works. Currently, if you are a corporate officer and own 20% of the corporation or are a manager of a limited liability company, you are not covered under the Workers' Compensation Act, you are automatically out but can endorse yourself onto the policy if you like.

This bill would allow an officer in a cooperation or a manager in a limited liability company who has less than 20% but can look to the family members listed in the bill if a person can aggregate up to 20% with these family members, then they could also be out of the Workers' Compensation Act. However, they could endorse themselves onto a policy if they desired, it still leaves that option in there.

Jacqueline Lenmark, American Insurance Association, stated they support this bill.

Opponents' Testimony:

None.

Questions From Committee Members and Responses:

SEN. THOMAS asked **Nancy Butler** if she would go through her explanation one more time. **Ms. Butler** explained if you are a corporate officer or a manager of a liability company and you own 20% of the company, you are automatically out of coverage in the Workers' Compensation Act, but if you so desire, you can endorse yourself onto a policy and be covered. If you own less than 20% but can look to one of these family members in your corporation, you can aggregate up to 20%. That officer or manager who could look to those other family members who own stock would also be out of the act automatically but could still endorse themselves on it if they so desired. This does not impact employees of the corporation, they are still always covered.

CHAIRMAN KEATING asked **Nancy Butler** in the case of a professional employment organization, an owner or owners of a small company may opt to contract with a PEO for administrative purposes and sometimes they will put themselves on the payroll in order to take advantage of the insurance pool or the retirement 401K, are they able to opt out of Workers' Compensation if they own more than 20% of this business. **Ms. Butler** said in that circumstance you have two conflicting provisions, one would be an officer who owns more than 20% at the same time they are on the payroll as an employee, so she would have to think through which provision would govern in that situation.

CHAIRMAN KEATING stated an officer of a company who is on the payroll anyhow can opt out from Workers' Compensation. **Ms. Butler** said the law provides if you own 20% you are out and you have to do something to get back in. It is a little unusual you would come back in as a paid employee. At that time the law

provides protection as an employee. She stated she would have to research that since there are two conflicting provisions.

Closing by Sponsor:

SENATOR COLE said the people who spoke on this did a very good job of explaining what the bill is. It is a bill which will help small businesses all across the state, whether it is agriculture or whatever, where there is a family, private corporation where their stock has been diluted down to other family members. He hoped the Committee would look at this with a favorable do pass.

HEARING ON SB 307

Sponsor: SENATOR WILLIAM "BILL" CRISMORE, SD 41, Lincoln

Proponents: David Owen, Montana State Chamber of Commerce
Riley Johnson, National Federation Independent
Business (NFIB)
Chuck Hunter, Department of Labor & Industry
Moe Wosepka, Kalispell & Bozeman Chamber of
Commerces
Don Chance, Montana Building Industry Association
David Cogley, Independent Contractor
Jacqueline Lenmark, American Insurance Association
Don Allen, Coalition Workers' Compensation System
Improvement
Carl Schweitzer, Montana Contractors' Association
Ben Havdahl, Motor Carriers' Association
Bob Worthington, Montana Municipal Insurance
Authority

Opponents: George Wood, Self-Insurers' Association
Nancy Butler, State Fund
Russ Penkal, Independent Contractors' of Montana

Opening Statement by Sponsor:

SEN. BILL CRISMORE, SD 41, Lincoln, said SB 307 substitutes the term "independent business owner" in place of "independent contractor" through the present statutes. This also deals with their Unemployment Insurance, Income Tax and other withholdings definitions. With that he will let those who worked on the bill give explanations.

Proponents' Testimony:

David Owen, Montana Chamber of Commerce, said this bill is a product of a group of people who worked over the interim trying to find a better definition for independent contractors. As the contractor registration was slowly blowing up all over the state, along with it was this part 'C' with the independent contractor. A group of them, along with the Department's help started working on the idea of how to better define the term independent contractor. SB 307 is the product.

Along with a group of two or three other people, **Mr. Owen** thought that this idea of changing to independent business owner would spare this process of being confused with contractor registrations. That change resulted in a 45-page bill. This was a bill which changed the definition so that businesses working together so that they don't get deemed as employees of one another. That is the attempt in SB 307.

On the first page of the bill is 'A' which is free of direction and control and 'B' which is separate and an independent business. It leaves us with the question of how this is established. We have some Workers' Compensation and Unemployment auditors out there trying to deal with what 'A' and 'B' means and they have come up with a list of criteria because people are failing. We have farmers in Eastern Montana who have been told that in custom combine operations they are employees because they went out into the field to talk about how much stubble to leave, and that meant that combine was under their influence and control. He has stores who have carpet installers who are independent business people who were told they are employees because either the customer or the store told them which way the carpet pattern was suppose to run in the room.

Mr. Owen had at least five members on his last tour tell him they had lost at least \$1,000 because yard service people didn't have a personalized receipt, didn't have an add in the yellow pages, didn't have a number of things on this mystical list these auditors came up with so, therefore, they have been deemed employees and there are some penalties to pay for Workers' Compensation and Unemployment Insurance.

We need a better definition than the one we have. The change on the first page of the bill keeps the language of 'A' and 'B' free of direction and control and then introduces what he thinks is the most important part of this. That is an accumulation of these factors, the critical accumulation. We are trying in this definition to get away from this idea that says, if you touch the tools which happen to be at a site, that means you are an employee. So what you have in all of the lettered incidences is some language which comes from court cases. What is clearly says is as long as you follow the preponderance of this list, you are in independent business. The same is true on the back of the page which is a similar list, again, an accumulation of these things is all that is necessary to prove you are in independent business and not an employee.

That concept of critical accumulation will make this system work better than what we now have. We have one of three choices, stay with 'A' and 'B' on the auditor's list which is going to work worse than it does now over a period of time, we have the 'Molnar' definition of an independent business which is if they said they were one, they are, and every part of **Mr. Owen** would like to think it will be that easy, but the only legal person who says they will work with the Supreme Court on this is **REP. MOLNAR**

himself. Everyone else tells **Mr. Owen** that isn't going to work. And if it doesn't, we need a better definition and **Mr. Owen** thinks this bill is a good start.

Riley Johnson, National Federation Independent Business, (NFIB), said he, too, would like to begin with a new definition. He believes **SEN. BARTLETT** solved the problem two years ago when she went in and changed the personal property tax to business equipment tax. This is a very similar type situation. They have many businesses calling them and saying they do not have any personal property, it all belongs to the business and why should they have to pay tax on it. That solved a lot of problems for small businesses that don't have the time or the inclination to read the law.

The name change is something we can certainly live with. When this blew up after the 1995 session, every conversation **Mr. Johnson** had, began with "Now you understand we have two things in the old SB 354, one is the construction contractor and the other is the independent contractor". It is very difficult to identify.

NFIB was present for the interim committee by the Labor Department and they tried to work out a better definition for 'A' and 'B'. Their positions are all set by ballot and **Mr. Johnson** took that survey in January of this year among their 9,000 members of Montana and asked them if they would like to have the name changed and 'A' and 'B' re-written to update the language. Their survey came back from their members which right now stands at about 44% return which is pretty normal. The survey came back with 82% in favor of changing the name and updating 'A' and 'B'. 9% were opposed and 9% were undecided. They feel that their legal help on this task force actually drafted a lot of this language to conform to Supreme Court decisions. They feel confident that this will meet Supreme Court rulings in the future.

SEN. CRISMORE'S bill also eliminates certification all together. The **NFIB** members do not feel this is a problem because if they have an employee, the law states they have to have Workers' Compensation. It does eliminate the opportunity to voluntarily go in and get a certification which people have been able to do the past two dozen years and be able to show that you have opted out of Workers' Compensation. They still feel the elimination of this will get rid of a lot of work through the Department of Labor, and will save a lot of money in state government with paperwork, etc.

He does have one problem with the bill. Referring to page 10, line 16, **Mr. Johnson** stated they have a number of members as do other people who are representing other groups where it is common practice and common industry practice where a person is considered an independent contractor and is hired independently. When that person uses the employers equipment for whatever reason

and his suggestion is to go to receiving payment on an accepted contract basis upon the completion of labor or services or based upon the standard business practice for this issue in the industry.

Mr. Johnson said if you amend this bill to allow that a person can prove his business, this is a standard business practice. One instance that he referred to was a computer programmer. You cannot take the computer to Bozeman, program it and then bring it back. He suggested an amendment to number 3, line 16 to make some reference to a standard business or accepted business or industry practice. He suggested a do-pass on SB 307.

Chuck Hunter, Department of Labor & Industry, stated that many of the points he would make have already been made. One area he would like to focus on is the change in title from independent contractor to independent business owner. He believes the change to independent business owner provides one more benefit which is significant. **Mr. Hunter** said he thinks this more closely describes the type of individual who ought to be considered under this definition.

Traditionally, the independent contractor definition is one which should be applied to individuals who own their own businesses. They have the ability in running that business to take the business risk and make the choice about that risk in order to have Workers' Compensation coverage or not. That is much better described by using independent business owner and subsequent exemption. They are very much in favor of that.

Secondly, **Mr. Hunter**, discussed the exemption process. They favor the elimination of exemption. Right now, the Department takes the applications for people who want the independent contractor exemption. That frees them from needing to cover themselves with Workers' Compensation, but there are a couple of problems associated with that. One is that there are many employees who are forced to come in and get that exemption by their employers. It is very common on a weekly basis where people come to them and say that they cannot get their paycheck that week until they get their independent contractor exemption. Their employer sends them to the Department to get it before they can get paid. They also have people who come in who are seeking to enter into a business, seeking to learn a trade and are told by their perspective employer that they cannot have the job and be taught to do the work until they get the independent contractor exemption. Those are the people who should not have the exemption. They are not independent business owners, they are truly employees. Yet we do have a system today that allows them to get that exemption and with that exemption there is the presumption that they are not employees any longer. **Mr. Hunter** stated they do not feel that is a good process.

In addition, the independent contractor exemption process has changed quite a bit over the past couple of years. They used to

do an almost pre-audit process. They would look at the application that came to them and would try to determine in an up-front way whether someone really did have their own independent business from the way they were operating. That was quite controversial, they asked for a lot of information and some of that information was valuable in terms of really proving that people were business people and tax records were used, but tax records were not really something people wanted to share with the Department.

With the advancement and implementation of the contractor registration bill, which contained the part 'C' which required so many more people to go out and get the exemption, they also had a big boom in that business. They went from issuing a couple of thousand independent contractor exemptions per year to seven and eight thousand per year. As part of that influx of business, merely dealing with the volume there, they have gone to an affidavit style exemption. People apply for them on an exemption form, an application form which lists the law. The law does state if they acquire this exemption they will not have access under the Unemployment Insurance benefit system.

It also provides some warnings to the employer. These warnings say unless this person is meeting the definition, part 'A' and part 'B' when working for you, this paper in front of you is pretty meaningless, because it is still the facts of the case which is going to determine whether a person is an employee under the contract.

Mr. Hunter stated the Department feels the current exemption process has some risk which is out there and provides a false sense of security to those who are relying on that exemption. For that purpose, they feel there may be some value in simply doing away with that exemption process. They would propose to those who feel there is some sense of security having that paper, that the form used could simply be printed and used between independent business people and those who are contracting with them to have an individual contractual statement agreeing to enter into this as an independent relationship and having the independent business person saying, "I'm signing this, I'm entering into this arrangement with you as an independent business owner". So they feel the benefits could be there without having the Department of Labor in the process. For those reasons they support this bill.

Moe Wosepka, Kalispell & Bozeman Chamber of Commerce, said because of corporate down-sizing or other factors, perhaps the entrepreneurial attitudes of the people in Montana, more companies are being formed in the state. Because of this, many of them derive a good portion of their income from contracts they have with other businesses.

Mr. Wosepka said they have a concern about the present definition of independent contractor and feel the present contractor

definition included in this bill takes care of many of those problems. On that basis, the Chambers of Kalispell and Bozeman support SB 307. One of the problems they see in the definition of small businesses is that they may not do any local work. With that alone, the provision of having the yellow pages ad is an expense they do not need to incur.

Don Chance, Montana Building Industry Association, said they were also part of the task force who worked on revising the 'A', 'B' test during the interim. They support those provisions in this bill.

They have one concern that **Mr. Hunter** addressed on page 66. That is the repeal of the independent contractor's certificate. It has been their understanding as employers for a long time, in the case of an accident, or in the case of an audit, the Department of Labor and/or the insurer is going to look at the 'A', 'B' test in terms of whether a person meets the terms of the test of being an independent employee or an independent contractor. They perceive that as continuing into the future. Every time there's an accident the Department comes in and regardless of whether or not an individual has an independent contractor certificate, they still look at the 'A', 'B' test to see if that person was truly an employee or an independent contractor.

On the other hand, however, the issuance of independent contractor certificates are quite helpful in the industry. They have the problem in that an individual comes to them and tell them they are an independent business person and wants to act as a subcontractor on a job. They hire that individual as an independent contractor and when an accident occurs, a person comes back and states that actually he was that person's employee. That certificate is the only thing they have at that time to hang their hat on to say they declared themselves as an independent contractor.

The one component of this bill which is of concern to the **Montana Building Industry Association** is the repeal of the issuance of the Independent Contractor Certificate. Other than that, they support the components of this bill.

David Cogley, Independent Contractor, Representing Self, said he also speaks as an attorney and was involved in this legislation in 1983 when HB 277 was passed which adopted this subsection 3, the certification process.

He knows there have been problems administering that and he realizes the Department has done the best the could. The satisfaction and assurance that certificate gives him when he brings a subcontractor onto his job is that at that subcontractor has made a statement which verifies he would like to present himself as an independent person and this is a public record of his statement of being an independent contractor. It is real difficult for those in the field who aren't attorneys to make a

judgement as to whether or not that person meets all the criteria.

Mr. Cogley believes it is important to have a certification process, possibly as **Chuck Hunter** mentioned with a contractual agreement.

Jacqueline Lenmark, American Insurance Association, AIA, stated this has been a difficult issue and with some reservation **AIA** does support SB 307.

The concern they have is the change of the term for independent contractor to independent business owner. They feel this is a good move in an appropriate direction because of the trouble in Montana with the confusion over contractor registration and the independent contractor exemption. However, **Ms. Lenmark** is concerned that we have litigated over a number of years the meaning of the term independent contractor. When we go to a new term we will begin litigation process all over again. None will know that until this legislation is passed and a case goes to the Supreme Court. To address that concern, she suggested we add to this bill some 'whereas' or 'purpose' clauses which clarifies why the change in terminology is being made and the importance of that terminology change and its relationship to past court decisions may be helpful to those who are concerned about defending this in the future.

Ms. Lenmark said her second concern with SB 307 as drafted, has been articulated by **Mr. Chance** and **Mr. Cogley**. **AIA** is also concerned about the removal of the exemption from the statute. It is a protection to the employer and to the insurer to have affirmative declaration by the independent business owner. The Department in the past two years has withstood a firestorm of controversy. **AIA** commends the Department for working through that problem and making every effort to make that work.

She suggested to the Committee that Montana has engaged in two years of education, that firestorm is going to subside, it is better for business owners to have that affirmative declaration by an independent business owner seeking that exemption status. They urge retention of this certification process in some form. But they would prefer that exemption remain in the law. Right now her association is using Montana as an example of how to address this problem in other states.

Don Allen, Coalition Workers' Compensation System Improvement, said he could stand as an opponent on this bill because there are parts of it which have been touch on that certainly need real close attention. He also attended the task force meetings and felt like there was good effort to come up with a definition and since that is the key here he is going to support this bill. His concerns are the same as **Jacqueline Lenmark** and **Don Chance**.

In regard to the exemption certificate, he believes it is real important to keep something in the law to deal with that. As an independent contractor himself, he went to the hearing and said he didn't like the first rules that **Chuck Hunter** came up with because they were really intrusive in some things. But they did come up with this approach which he thinks we all hate more bureaucracy on, but he does believe it is important for there to be some sort of a declaration that this is the status and is also important for those people who employ an independent contractor.

Some of the members of the Coalition also have a concern about the tools. When you have an expensive set of specialty tools used to repair certain kinds of equipment and are involved in lock-out situations in terms of safety, yet unless something is done to change this, it would still be difficult for that to happen and still qualify the people who are independent contractors. **Mr. Allen** hopes the Committee will take a close look to fix the part about the certificate to make sure that stays in some way. As far as the shopping list on what qualifies the independent contractor, again, there is a lot of thought given to that and there are a lot of things considered which were thrown out and this is what came out. Overall, this is pretty good, but there are some things which can be fine tuned.

Another question is regarding a franchisee person who has a franchise under the definition of individual. He does not know what the answer to that is at this point.

Carl Schweitzer, Montana Contractors' Association, supported the bill with the same concerns that the Home Builders have. They are asking for a name change from independent contractor to independent businessman. For the past two years this has been a source of grief to sort out construction contractors from the term independent contractors. This bill is a big step forward.

Ben Havdahl, Montana Motor Carriers' Association, said he did not know if he should stand up as a proponent or opponent after hearing the testimony and the concern about the application process which is their major concern with this bill.

They are supporting this bill, although they have a couple of problems with the definition in a couple of areas since the bill suggested a preponderance of these things having to be met. For interstate motor carriers based in Montana that operate owner/operators who are independent contractors under a contract with the interstate motor carrier, these people operate all over the country in 48 states. The problem with an independent place of business, the cab of a truck is the owner/operator's place of business. He is not sure this would qualify under here.

Mr. Havdahl said the other part is dealing with the licensing and the insurance requirements. Those are laid on the back of the carrier by federal regulation and he has to provide those. The

biggest concern they have with the bill is the elimination of the application process.

Montana Motor Carriers supports the continuation of that process. He also has a letter from one of his major members who was going to be present to testify but was not able to attend. (EXHIBIT 2) Mr. Havdahl believes this letter really underscores the importance of maintaining the application process in the law.

Bob Worthington, Program Administrator, Montana Municipal Insurance Authority, (MMIA), said they do a substantial amount of contracting with small independent business organizations and this has been a problem for them. Clarification of this issue is certainly of benefit. He expressed the same concerns which have been brought before the Committee and would encourage the continuation of addressing the certification process.

Opponents' Testimony:

George Wood, Montana Self-Insurers' Association, said he has to stand against SB 307. Three definitions which we want to look at in the Workers' Compensation Law are employer, employee, and independent contractor.

Independent contractor is one which is an individual who sometimes will be an employer, sometimes an employee, and sometimes an independent contractor. The situation surrounding whether or not this individual is an independent contractor is always going to be based on the specific facts of that individual case at the time it becomes an issue. SB 45 which was discussed and passed this Committee discussed the definition of independent contractor. 'C' was removed, and 'A' and 'B' were left. 'A' and 'B' have been in the law for years and it is what we have litigated which makes the case law and as an adjustor for 40 years in Workers' Compensation, it is what we use when we try to determine where the independent contractor situation lies. This bill leads to litigation and confusion. First, we do not need the name change because the name was changed in the contractor registration bill from independent contractor to contractor, so there is no conflict between those two terms any longer. They call them construction contractors in the registration bill. Independent contractor is a generic name. It is used in all states. All the states are working on a definition of independent contractor with very little success. The federal government tried it in the last session and failed. The term is not one which is easily understood or easily changed.

Mr. Wood would like to call attention to something in the bill which we have heard gives some definitiveness to the definition of independent contractor. This is what the proponents have said. Referring to lines 19 and 20 on page 1, the terms accumulation of factors including but not limited to, what is a convincing accumulation of factors? Does it mean all of them, part of them, is there weight to numbers we comply with, is there

weight to the importance of those numbers? Using including but not limited to, what other 47 different standards can be added to the ones that are presently in this bill. Look at all those changes which are intrusive and they conflict with the right to contract.

Mr. Wood called attention to one which states federal and state taxes must be filed. The only way to verify that is to get the release from the feds. The tool problem is another. Everyone who supported the bill has addressed the exemption.

If this bill is passed it is going to need some substantial amendments. Beginning with line 18 which states the independent business owner is an individual, the independent contractor can be a partnership which can be a limited liability company and there are others who can be owners unless the authors of the bill intend that it only recover the sole proprietorship and not any of the other ones we generally consider an independent contractor. The bill would make people who belong to **Mr. Wood's** association, who are the ones who hire a lot of independent contractors, difficult to verify whether or not those accumulation of factors are limiting since it states not limited to.

This bill also does not make a person an independent contractor if he buys a Workers' Compensation policy to cover himself. **Mr. Wood** has no doubt the auditors for state government won't find a reason to make that person an employee the way this bill is written. For those reasons he asked for a do-not-pass vote.

{Tape: 1; Side: B; Approx. Time Count: 12:46 p.m.}

Nancy Butler, State Fund, said she does not feel comfortable being either an opponent or proponent of this bill. She would like to state what she thinks this bill will do.

She believes it can be administered and knows what it means and how to apply it. It does not significantly impact the State Fund to its detriment and it does not impact their employers. She is concerned that this bill may not change things for the better.

Ms. Butler believes this bill codifies a lot of the provisions which are currently in court decisions and that is good but it is not going to make it easier to be an independent contractor. She thinks the Supreme Court will ultimately apply this statute pretty much the same way it is being applied today. So we would be where we are now in the long run.

Russ Penkal, Independent Contractors of Montana, said this bill is related to SB 45 and the old SB 354.

He stated that through this bill we are trying to get out of the independent contractor construction controversy and everybody wants out of that and is running for cover. He believes this

bill is late in coming and muddies the water for that issue in that it deals with the certification process and also takes out some language that deals with that.

His group has never been opposed to voluntary certification as it existed with SB 354. To get the certification you have to show three previous contracts. This bill muddies the whole process and he feels we should let the previous bills deal with these issues. He is also concerned about the terms not limited to in the definition of determining factors. The 'A', 'B' test has worked well in the past and doesn't need to be changed. One more problem is the phrase that says independent performing services who does not meet the requirements is an employee under this chapter. This is assuming employee status rather than allowing a person to be an independent until he is proven to be an employee.

Questions From Committee Members and Responses:

SEN. EMERSON stated first of all contracts are the strongest thing we have in society. The minute we begin goofing around with contracts we really have problems. Someone had a man working for him who said he was an independent contractor then they got hurt, then someone along the line upheld the breaking of the contract and that is where the problem began. He does not know if this was in the judicial system or the Supreme Court but this did happen. The problem occurred when they broke that contract. Now we are going to solve that by just changing the names. Before this the Supreme Court or judicial system broke this contract. Now we get a word change to independent businessman. **SEN. EMERSON** asked **George Wood** if he thought this would be enough to stop them from breaking contracts.

Mr. Wood responded he does not think there is anything to change human nature to change the contract. If we can identify things in the light most favorable to us, we are going to do it. His objection was not on this grounds but on the grounds that this bill puts into statute requirements that he must put in his contract.

SEN. EMERSON stated he thought **Mr. Wood** said something about the name change not getting the job done, it would end up with a lot of litigation again. If somebody comes along and says he is an independent businessman, even if he has a slip of paper that has been broken before.

Mr. Wood responded the name change does not change the definition or the operation of the independent contractor. It is a cosmetic change and his understanding was that the problems which came up over the contractor registration became overwhelming. When you talked to anybody the confusion was they weren't talking about independent contractor but about the registration and they confused the two. So there was a good-faith attempt in this bill

to change the name from independent contractor to independent businessman. The name change is cosmetic.

SEN. EMERSON asked **Mr. Wood** what would happen if we just went back and said since both sides signed the piece of paper and now we have a written contract, and we try to pass a law which says that holds up no matter what happens? He also asked if **Mr. Wood** would be in favor of something like that.

Mr. Wood said he would probably oppose it for the reason the Supreme Court would never uphold it and we would mislead many people into thinking we had something we didn't have.

SEN. BENEDICT stated to **Chuck Hunter** as he reads the bill it still does nothing to stop the migration of liability.

Mr. Hunter responded that is correct.

SEN. BENEDICT asked if we put the voluntary exemption back in and you apply for an exemption, that's a voluntary application for an exemption. Put a \$25 fee on it, let the exemption run for 5 to 8 years so you can go back in and check to make sure they are still an independent contractor, then would that solve some of the migration of liability problem?

Mr. Hunter responded he believes that voluntary exemption process does provide one important link in that protection of floating liability. **Mr. Hunter** said he would like to comment on the historic significance of the testimony here today regarding this point. He will never again experience being a government employee and the only person in a room of business people to suggest less government and have them suggest more.

SEN. BENEDICT asked **Riley Johnson** if we put words in on page 1, line 27 after services which say something to the affect that other than those customarily provided as standard basic industry practices to other qualified independent business owners, if that would solve some of their problems.

Mr. Johnson responded he thought it would provide that it was carried all the way through for all the definitions on page 10. He also thinks this particular problem has sprung up more in the past five years than ever, and he foresees it going even further as the cost of equipment and everything goes up.

SEN. BENEDICT asked **Russ Penkal** if they put the voluntary exemption back in and set the fee at \$25 so the Department can get some help with the paperwork that they have got to do, would it satisfy some of their concerns about the bill and the migration of liability.

Mr. Penkal said he would like to see this. The other thing is treating all businesses the same. We can get rid of SB 45 and have all business fall under this.

SEN. BARTLETT asked **Nancy Butler** regarding her legal experience, in the work she has done in legal matters, if we were to make this name change, does she think that would mean we would start over on case law in relation to the independent contractor. Would the courts make the name change with them or are they looking at building a whole new set of case law?

Ms. Butler responded she did not think the name change itself would cause any litigation but it would be painful for everybody to switch gears. If you look at the definition it is essentially the same. We will probably have some enhanced litigation just on the definition itself, but it is very similar to what the courts have interpreted the independent contractor statute to mean but the end result would be very similar.

SEN. BARTLETT asked if the identification of different factors in the new definitions pretty accurately reflect **Ms. Butler's** understanding of what kind of a scale court cases use to determine if someone is an employee or the traditional independent contractor.

Ms. Butler responded the new section two that states the definition of the 'A' test is that it does allow other factors to help prove that other than just the four we are use to. 'B' is very much the same. It has always been very flexible. The only thing she saw was a slight tightening of the definition and that was the independent contractor has to bring supplies. She said they have always applied the definition to be a little bit flexible. You were basically bringing your own equipment but the prime contractor had it all and wanted you to use it versus you buying and bringing it. This could tighten the definition to bring your own supplies. Also, one other technicality is line 30 in the long run would come out as interpreted as employees.

SEN. BARTLETT asked **Ms. Butler** in the scenario of the issue of independent contractors there is a list which is similar to what we have here is the agency enforcing that particular decision someone who had to meet each and every element in order not to be considered an independent contractor, in subsection (a) is it pretty much the case you have to meet all four but there is more flexibility in relation to subsection (b)?

Ms. Butler responded the flexibility is still there by the way it is written, it is just a convincing accumulation there for (b) so it doesn't mandate all of those.

SEN. BENEDICT asked **Chuck Hunter** regarding page 2, line 9 and 10, why do we need that language, is it not redundant?

Mr. Hunter answered that presumption has been there since the dawn of the Workers' Compensation Act and it says that a person is presumed to be an employee unless they meet the test, so it is not in his view redundant.

CHAIRMAN KEATING asked **Chuck Hunter** if anyone is an employee unless they meet the test? **Mr. Hunter** responded they need one or more business exemptions which are creating the law.

SEN. THOMAS asked **Chuck Hunter** regarding **SEN. BENEDICT'S** question to him, **SEN. THOMAS** had noted earlier in the sentence regarding "who does not meet", he is wondering if there should be an adjective in there such as substantially.

Mr. Hunter responded in his view, the way section 1, part 'A' and part 'B' have been set up now to be a convincing accumulation, not necessarily all the ingredients there but a preponderance of those will allow some flexibility.

SEN. BARTLETT asked **Chuck Hunter** regarding the request of **Riley Johnson** to add a bit of a modification on the furnishing of tools, equipment, materials and supplies type of factor, if he had some thoughts about that.

Mr. Hunter said he does, the language as he heard it would be an improvement to the language that is there. When they look at equipment and supplies, that is almost an industry-specific kind of thing. If you look at the trucking industry, the furnishing of the truck by the employer certainly would be a major consideration to them to believe that is not someone who is an independent business owner. In another industry we talk construction, if there is already a couple of pieces of drywall on the site that the general contractor has purchased, that should not be enough to indicate that there is an employment relationship. They have historically looked at those on a one-by-one industry.

{Tape: 2; Side: A; Approx. Time Count: 1:07 p.m.}

SEN. BARTLETT spoke to **Mr. Hunter** in regard to the conversation she had with **David Owen** and **Riley Johnson**. It is clear to her that there are changing circumstances in the labor force and employment relationships that we are just beginning to see emerge. She has an increasing interest in seeing the Department of Labor take a look at what those emerging and more common types of employment relationships are, and see how our statutes and traditional relationship legislation does or does not apply. Is there any undertaking within the Department to sort of look at that in a comprehensive overview fashion?

Mr. Hunter responded there is not at the present time, although there are some avenues they may have to do that. They certainly agree to do that and are seeing transitions in the work place and many of the old ways looking at the independent contractor are great ways. They view this differently than they did ten years ago because there are those new relationships. One avenue that they might point to is that they are going to be studying the dispute resolution process. If **Chase Hibbard's** joint resolution pulls through and as they look at that we will need to look at

the venues for how they decide questions of employment and if **SEN. BARTLETT** would be interested in that, they would certainly add that to their list of items to consider.

SEN. BENEDICT asked **Chuck Hunter** regarding SB 45 in its current form, would some of the provisions of SB 45 and this bill if it were to pass, conflict?

Mr. Hunter responded he believes they would conflict.

SEN. THOMAS asked **David Owen** in relation to the intent and the court ruling that **Ms. Lenmark** mentioned, if he would be willing to begin to put that together.

Mr. Owen responded that he would be willing to do that.

CHAIRMAN KEATING asked **David Owen** regarding SB 354, everyone lined up and said we have to have this bill so the Committee thought they would send it through and when he got home, individuals who had a small accounting office who would leave their office and go into their clients office and check the books and then go back to their office and do things and were clearly independent business people. Yet they were threatened under SB 354 and HB 200 that now all of a sudden they could be considered an employee unless they go get an exemption or certificate.

Then the Department sent out all the requirements or all the things that you might do as a pre-audit as being qualified as an independent contractor, and the flurry hit and the phone rang off the hook and letters came. Now we are told if we call everybody an independent business owner that this is going to solve our problems, whereas, in the other section of the law we can find this independent contractor pertains to just construction. Are we now opening this up to everyone in saying that everyone who does this thing is an independent business owner?

Mr. Owen does not think so. The combination of things that happened between SB 354 and HB 200 last session he does not think could have been woven together with any kind of intent. He was astonished at the number of phone calls he was receiving. He thinks we are on a better track with this bill.

The Department's conclusion when they finally came up with the certificate for part 'C' was in HB 200. He clearly saw at the bottom that this exemption is not worth anything if you do not match 'A' and 'B'. The Department does not have the capacity to rule on 'A' and 'B'. Then they turn themselves into a paper factory and confess the futility of that whole course. That is what has set us on the need for a better definition. If we have a better definition we do not need some of those other things, because it will be clear for people to know and protect themselves and explain it to us.

CHAIRMAN KEATING stated to **Mr. Owen** that in section 27 where we still have the certificate of registration, now instead of saying independent contractor we are referring to independent business owner. Now we are saying to anybody out there who is an independent business owner may not have to worry about Workers' Compensation at the present time, all of a sudden under this law, is going to have to get a certificate. **Mr. Owen** said if that is the way it is written, it is not what the group had talked about this summer. If that is the language he would encourage it to be changed.

Mr. Owen said he has been so focused on the definition, when it comes to exemptions and registrations and some of the other things in the bill, he cannot speak to those specifics.

CHAIRMAN KEATING said he is wondering about the proponents who said they really should be an opponent. There were some good ideas but now all of a sudden this is being dumped on the Committee and telling us you like some of it and don't like some of it and asking that the Committee work it out and there are five days until transmittal and we want you to work it out for us. He asked if this feeling is substantiated.

Mr. Owen responded there are two things which are moving in this bill and one is the definition and how do we, in the law, talk about businesses and have them say that they are two businesses working together.

The other is the whole issue of the exemption in the process related to Workers' Compensation. That process probably needs to be refined as they talked about it this summer. It isn't their intent to take something that is only half baked and dump it on the table. He was not sure, most of the people who stood up as proponents signed up as opponents.

Mr. Owen said he knows the time is short. He wanted to encourage the sponsor to bring some information that might fit some other places. So to a limited extent **CHAIRMAN KEATING** may be correct. He stated if they can do anything to clear it up and move forward with it, they will do anything they can with the group to make that happen within a short time frame.

SEN. EMERSON asked **Jacqueline Lenmark** if it was true there are other bills dealing with this situation and that they are coming to the Committee in a few days.

Ms. Lenmark said she is aware of a number of bills that are coming to this Committee which will touch on this issue and do not directly relate to the entire issue but there is also **REP. MOLNAR'S** bill in the House which she did not think action had been taken on, but there are a number of bills yet coming which will touch on this issue.

SEN. THOMAS asked **Nancy Butler** in tying these two together, SB 45 which is the independent contractor bill and this bill which changes the name to independent business owner, she had mentioned changing the name does not change the law, so can we change this to not take out independent contractor but include business owner as an independent contractor or business owner? If we were to do that, we are identifying that this person could either be an independent contractor or they could be an independent business owner. The purposes of having the other laws apply specifically to it, if an independent contractor is one by definition isn't here, then the law applies to an independent contractor whereas this definition applies to an independent business owner.

Ms. Butler responded as long as you make it clear that they both mean the same thing, using independent contractor/independent business owner, and they were defined the same, this would clarify what is being talked about.

CHAIRMAN KEATING spoke to **Don Chance** regarding the question of upward mobility, there is nothing in this bill that references upward mobility, and in addressing that in SB 45 there is a cap or barrier to the upward mobility, but there is a caveat that the contractor has to verify that the subcontractor is certified as a subcontractor. His question is why don't we just repeal the upward mobility section, why don't we just get rid of it altogether and not weave it in to everything else.

Mr. Chance said they are talking about liability in two separate areas, there is an administrative liability which they created in statute. It is the old wages and claims Section 701 through 706 which states if a general contractor hires a subcontractor and he doesn't pay his employees, the general contractor got stuck. If the general contractor hires a subcontractor and he doesn't carry Workers' Compensation insurance on his employees and there is an accident, the general contractor got stuck. We created that in statute. SB 45 does eliminate that upward migration of liability, specifically related to those sections. It is, what they are terming administrative liability. In other words, the Department of Labor comes back to them, because of those provisions in the law.

The second set of liability is tort liability. There is nothing we can do in the statute to protect ourselves from being sued by an individual who was working without Workers' Compensation insurance got injured, then is desperate and said he was working in an unsafe work place and files a lawsuit against him as the general construction contractor. Ideally, in their industry, because they are such a dangerous industry, the ideal circumstance is that everyone on the work side would have Workers' Compensation insurance. That is the ideal solution. If you have an accident and are not insured, you get desperate and sue.

SB 45 takes care of the upward migration of liability related to this administrative situation created in the statutes. **REP. MOLNAR'S** bill eliminates exactly the same sections that we eliminate in SB 45. The difference in **REP. MOLNAR'S** bill versus SB 45. He has a provision in there which states if a person claims he is an independent contractor, that is what he is regardless of what happens. There is no documentation of that. You could have a situation where there is a handshake or verbal agreement. That does not protect us, it puts us right back to where we have always been and there is an accident and the independent contractor claims he was never an independent contractor.

They are dealing with two sets of liability. Administrative liability is currently in the statute and a number of bills are taking care of that, then we are dealing with this tort liability question. The only thing that we can do to protect ourselves in that regard is either to require that everybody has insurance or get some kind of formal public documentation which says that person was an independent contractor.

Closing by Sponsor:

SEN. CRISMORE said he appreciates all the help with this bill. He knows it is late for this committee and that it is a big challenge. Whatever comes out of this committee is going to be very important to everybody in the State of Montana. He used to tell his crew that the reason you are here is because you are the best.

{Tape: 2; Side: A; Approx. Time Count: 1:37 p.m.; Comments: The Committee took a 10 minute break.}

EXECUTIVE ACTION ON SB 67

CHAIRMAN KEATING asked the Committee to refer to the Grey Bill (EXHIBIT 3) in review of SB 67. SB 67 and the amendments to it are presented in the Grey Bill.

Amendments: SB006701.AEM (EXHIBIT 4), Revised (EXHIBIT 5).

Motion: **SEN. BENEDICT** moved SB 67 do-pass with amendments.

Discussion: **SEN. BENEDICT** explained the amendments in that since the bill was first introduced, there have been some ongoing discussions with different people who represent different interests and also some members of the House who had some concerns with the bill. They came up with some solutions that satisfy a lot of those concerns.

He doesn't think anybody is going to be completely satisfied. They are not planning to merge the Old and New Fund yet. **SEN.**

BENEDICT stated the Old and New Fund will be merged when the Old Fund is fully funded plus 10%. He said we are going to transfer \$63.8 Million to the Old Fund by 6/30/98. We are going to transfer \$20 Million to the General Fund, \$10 Million in 1998, and \$10 Million in 1999.

The Old Fund Liability Tax (OFLT) will be eliminated when the State Fund's independent actuary projects Old Fund unpaid liabilities are adequately funded with the combination of the OFLT and State Fund contribution of the \$63.8 Million. In other words, we are not going to put a stake certain in the statute that the Old Fund tax is going to come off. We are going to say it is going to come off when it is fully funded plus 10% to give us a little assurance. Those are probably the biggest changes. There are some changes to the cap, the administrative expense limit will be 15% of the prior year's premium revenue and up to one-half of the prior year's investment income as approved by the State Fund Board. Each year the State Fund management will present the board-approved budget to the Legislative Finance Committee for review.

SEN. EMERSON asked **SEN. BENEDICT** if the 10% was of the liability which was covered by the Old Fund.

SEN. BENEDICT responded that is the Old Fund liability. The actuarial estimate of the Old Fund Liability which could run for 25 years, because those are fixed claims, those are indemnity claims that are fixed claims. Once we have the money in the bank to take care of the Old Fund Liability to where the actuary says it is the very end, plus 10%, then we can go ahead and merge the funds and take off the payroll tax. This is a compromise, **SEN. BENEDICT** believes they have come up with a solution that everyone can live with.

CHAIRMAN KEATING referred to first section regarding the transfer of \$63.8 Million to the Old Fund account. He asked what that transfer does to the Old Fund.

SEN. BENEDICT responded the balance in the Old Fund is around \$216 Million at this point. That would reduce it by \$63.8 Million, but he did not have exact numbers available.

SEN. BENEDICT asked **Carl Swanson** if he gave \$63.8 Million to the Old Fund one year from this summer, what would the balance of the Old Fund liability be?

Mr. Swanson responded July 1, 1998 the Old Fund was actually a deficit and comes down to \$83.3 Million.

CHAIRMAN KEATING asked if that is where the deficit will be on 6-30-98?

Mr. Swanson responded that is correct.

CHAIRMAN KEATING asked if the \$63.8 Million is transferred in if the total would be \$83.3 Million.

Mr. Swanson answered that with the payroll tax we are planning to fund it plus 10% by July 1, 1999. We would have the Old Fund fully funded so the deficit would be eliminated plus another 10%.

CHAIRMAN KEATING asked **Mr. Swanson** why the State Fund in putting in \$63.8 Million on that particular date and what is magic about \$63.8 Million?

Mr. Swanson said in the discussion one of the things we are looking at in the bill is to keep the Old Fund and the New Fund separate. That addresses some of the concerns being expressed. Also, to create some cushion which is the 10%. The Old Fund Liability Tax needs to come down to six-month increments. Originally they were planning to end the tax on December 1998, but to build a 10% cushion in the Old Fund requires that tax to be extended through June, 1998. So with the revenue from the Old Fund Liability Tax, it will pay \$63.8 Million of projections to fund the Old Fund plus 10% by July, 1999.

SEN. BENEDICT asked if **Mark Barry** would explain to the committee where the Old Fund is right now and where is it going to be on June 30, 1998 and where will it be after the \$63.8 Million is transferred.

Mr. Barry responded they are projecting at the end of this fiscal year the **State Fund** will be at a deficit of \$198.6 Million.

SEN. BENEDICT asked what the figure is right now.

Mr. Barry responded the unpaid liability will be at \$216 Million. They anticipate having about \$20 Million in assets. So that is where they come up with a negative fund balance in the Old Fund of \$198.6 Million. Operating results in the Old Fund are expected to \$51.5 Million in 1998. That includes \$49.9 Million in Old Fund Liability Tax plus about \$4.6 Million in investment income off the \$63.8 Million that the New Fund will contribute, plus the assets in the Old Fund. He estimated they will have a surplus in the Old Fund on July 1, 1998 of \$83.3 Million. That amount is on an undiscounted basis. Their proposal is to fully fund it at a present value basis to take into account investment earnings on the amounts they will put up as assets. In 1999, the operating results in the Old Fund will be an estimated \$97.3 Million.

SEN. THOMAS asked if \$83 Million is present value.

Mark Barry responded that is not present value. In fiscal year 1999, their operating results will be \$97.3 Million. The Old Fund Liability Tax will be \$51.3 Million, investment income in the Old Fund will be \$9.9 Million. There will be an adjustment to the same liability to bring it to present value of

approximately \$38 Million. That is where the \$97 Million comes from, that is the adjustment. That will bring to a surplus estimated at July 1, 1999 of \$14 Million. The present value unclaimed liability in the Old Fund at June 30, 1999 is estimated to be \$130 Million. 10% of that is \$13 Million, so they are estimating a bit of a cushion there. Again, these are estimates based on their actuary's current estimates of ultimate projections in the Old Fund and the New Fund. They are subject to change based upon what the actuary provides. (EXHIBIT 6)

SEN. KEATING asked **SEN. BENEDICT** why transfer \$20 Million into the General Fund?

SEN. BENEDICT responded the General Fund advanced the Workers' Compensation system money in 1990 to cover the claims and expenses in 1990. They are making a good faith effort to pay that back, although it was not written as a contracted loan.

CHAIRMAN KEATING asked if we use the \$20 Million against the Old Fund Liability, then we can get rid of the payroll tax six months faster, can we not?

SEN. MAHLUM said in their October or November meeting, the Board of Directors for the Fund voted unanimously to do the right thing for our state by giving the money back which was given them to get started with the New Fund.

SEN. SHEA asked about paying some of that excess money back to the workers who contributed it? On page 3, lines 6 and 7, the State Fund transferring \$63.8 Million to the Old Fund account to pay Old Fund claims and then allowing direct payment of dividends to policyholders. Some of the excess dollars from that, which workers have contributed towards this, doesn't seem like they are accounting for this and taking it into consideration at all.

SEN. BENEDICT said that is a philosophical question and you would get a lot of different people with a lot of different ideas on it, but to him there were a lot more dollars taken out of the employers of this state over a much longer period of time. The employers and employees all got together to say, "let's get this thing paid off".

SEN. THOMAS said he thought most of the \$63 Million is our premiums as he understood it. The reason they are in the situation in paying that money back and having it available is that everyone was doing an extraordinarily poor job under the noses of some of the people here of running the State Fund and of handling claims, or more in the fashion of not handling claims.

SEN. SHEA asked how that addresses the worker.

SEN. THOMAS answered that tons of claims were paid that probably didn't need to be paid, or shouldn't have been paid. There is probably some principles at stake here which probably won't be

taken care of. Millions more were paid out by premium payers, so he thinks we need to move forward and get rid of this problem as soon as possible.

CHAIRMAN KEATING said as a matter of fact, the State Fund did suggest a premium dividend to the policy holders but there was quite a bit of objection to the fact of giving the policy holders a dividend and still charging the payroll tax on the Old Fund Liability. So the State Fund backed away from the dividend idea until the Old Fund is finally paid off. Then if they have surpluses and want to pay dividends, that is fine. There is a give and take in this situation and **CHAIRMAN KEATING** said he shares **SEN. SHEA'S** sympathy and would like to see that payroll tax gone as soon as we can get rid of it.

SEN. MAHLUM said to look at this like the State of Montana went into Chapter 11 bankruptcy in 1990 and we are just coming out of Chapter 11, just starting to pay off the bills and once we get clear again, this will not be an imposition on the workers. We want to get out of bankruptcy and have some pride and start all over again.

SEN. BENEDICT said he thinks **SEN. THOMAS** touched on a good point and that is that the \$63.8 Million is not payroll tax dollars. It did not come from the workers, it did not come from the employers, it came from premium dollars charged to employers throughout the State of Montana. So the \$63.8 Million needs to go to pay out those old unfunded liabilities regardless of the payroll tax.

SEN. BARTLETT said the \$63.8 Million is premiumed money and earned interest on that. One of the reasons we got into the situation that we got into with the Old Fund is that the premiums were artificially depressed. To that extent, the money coming from premiums paid by the employers who are suppose to paying these premiums and did not for a number of years, that seems appropriate. It is suppose to be the employers who pay the premiums, when they didn't pay those premiums all of a sudden, we ended up in a situation where we have a supposed state debt that people never covered by the State Fund and employees who were never suppose to be paying premiums, in effect, have to pay that off.

{Tape: 2; Side: B; Approx. Time Count: 2:01 p.m.}

SEN. EMERSON said going back to the reduction in the premiums, the State Fund is loosing some of their business because other companies are coming in and selling this insurance cheaper than they are, so if they want to keep that business, they also have to compete in order to help pay off the Old Fund and keep the New Fund in the black.

SEN. BARTLETT said that amendments that relate to each other, even if they are not numerical order, should be discussed. A

part of the whole set up in terms of retiring the Old Fund, unfunded liability and the transfers of money going off a summary sheet that the State Fund provided has to do with beginning in July of 1999, or when the fiscal year when the Old Fund taxes eliminated the amount in the Old Fund fiscal year ended is in excess of the adequate funding requirement for the Old Fund would be returned to the State Fund up to the amount contributed to the Old Fund after July 1, 1997. She is not sure she is understanding that. She is looking at the summary sheet from State Fund. (EXHIBIT 6) She would like to discuss what would happen once the tax is off and what is happening with the balance in the Old Fund and also a reversion of some monies to the State Fund.

SEN. BARTLETT asked once the Old Fund Liability Tax is eliminated there are some provisions in here that deal with what happens if there is any excess money in the Old Fund at a fiscal year end, what are those provisions?

Mark Barry, State Fund, answered that first of all, the State Fund has contributed approximately \$103 Million already to retire Old Fund debt. The \$63.8 Million is an addition to that. What the proposed amendment will do is after the Old Fund Taxes come off and the Old Fund is fully funded and there is that 10% contingency, the independent actuary will evaluate each year and determine if there is still a full funding plus the 10% in the Old Fund. Any amount over that amount reverts to the State Fund up to the \$63.8 Million if it is available, but according to their projections, it won't be available. In contrast to that, if the funding is less than the 10% contingency, the State Fund will pay back to the Old Fund to bring back up to that 10% contingency, up to the amount that the State Fund has received in previous years.

SEN. BARTLETT asked if she is correct in believing that overtime is accumulative to the \$63.8 Million. **Mr. Barry** answered that is correct.

CHAIRMAN KEATING asked if this is from the surplus of the balance each year of the declining unfunded liability.

Mr. Barry responded that is correct, leaving the 10% contingency in place.

SEN. BARTLETT asked **Mr. Barry** to clarify his explanation.

Mr. Barry said if in any year, the funding in the Old Fund is below the 10% contingency, the State Fund is to contribute that amount back to the Old Fund to bring it up to that 10% contingency level. That is limited to the amount the State Fund has received of that \$63.8 Million. If the State Fund does not receive any rebate, it will not contribute. If it is below 10% contingency, there will have to be another mechanism to bring it up to that contingency.

SEN. BARTLETT asked if he was implying that there is not a different mechanism to bring it up to the 10% contingency.

Mr. Barry responded other than the State Fund repaying up to the amount that they received, no.

CHAIRMAN KEATING asked if the State Fund hasn't received as much out of the surplus, then there is no other way of replacing any part of the 10%.

Mr. Barry said that is correct.

SEN. BARTLETT asked if everyone is absolutely confident that we would never have a situation where we would go beyond the 10% contingency, in fact the cash flow necessary for the Old Fund claims would be insufficient. If we don't have the 10% cushion in there but are below what is needed to help cover the claims at some point because the payroll tax is off, etc. then she would take a different look at this.

Mark Barry said that in the Old Fund projections of the independent actuary that they use, there is enough cushion in addition to the 10% to alleviate any concern that they might have.

SEN. BENEDICT said one thing that should be mentioned is once you get into a certain point with the tail, the tail is much more stable than it was in the beginning. They have gotten far enough into that tail now that they can project with uncanny accuracy, where that tail is going to end up.

SEN. BARTLETT asked **SEN. BENEDICT** if he felt confident that we are only talking about a play within that 10% margin of comfort and not something that has more serious implications.

SEN. BENEDICT said he does and if there is any indication of any crumbling in those projections, reinsurance can be bought for that tail too for a very small sum of money.

CHAIRMAN KEATING went through each section of the bill with the Committee. **(EXHIBIT 3)** There were no questions or comments on Sections 1 through 5.

Nancy Butler, State Fund explained Section 6. She said in the original bill they were going to merge the funds and therefore, wouldn't be receiving the up to \$3 Million per year to have the Old Fund and now we are not going to merge the funds, so they need that authority back. Section 6 also addresses the Supreme Court system, we want to make it clear if you are an out of state claimant you can use an out of state physician. There were no questions on Sections 7 through 9.

SEN. KEATING asked **George Wood** a question on Section 10. He asked if this increased the ability of claimants for medical benefits.

Mr. Wood responded he did not think so. What the two do together is to allow these people to act as treating physicians when they are outside the state.

Regarding Section 11, **SEN. BENEDICT** said they put some new language in there that **Jerry Driscoll** asked for. He said the language on line 19 through 22 were out of the system and they are now back in. If the insurer misses the deadline of 30 days after a suit signed by the claimant, then they have to hire a lawyer and go to Workers' Compensation Court to get claim paid.

Nancy Butler said there was a Supreme Court case in 1983 involving 'Solheim' which interpreted that section. If you miss the 30 days of either accepting or denying, you didn't automatically accept the claim, you might be subject to a penalty assessed against the insurer which is a statutory 20% penalty for delaying action by an insurer in the Workers' Compensation Act. In 1995 another Supreme Court case came along which stated to forget the interpretation they handed down in 1983, the section means if you didn't accept or deny in 30 days, you automatically accepted the claim. They are trying to put language in the statute that puts it back the way it was in the Solheim case in 1983, which does not mean automatic acceptance but that you might be subject to that 20% penalty.

SEN. BARTLETT said she felt **Mr. Driscoll** had a point in reinducting attorneys into the Workers' Compensation situation. The sentence in section (5), beginning however does make it sound like if the insurer didn't accept the claim within the 30 days, then a claimant would have to get an attorney and let them deal with the situation to get the claim recognized.

Nancy Butler responded that is the way they operated for a number of years. As she is aware, there were not problems. The State Fund tries very diligently to always beat that date.

SEN. BENEDICT asked if the sentence on line 21 after the number 7 were stopped there, and didn't add "if a claim is determined to be compensable by the workers' compensation court", that might help.

Ms. Butler said this would still require court action because that is what 2907 says. This does not change the end result.

Ms. Butler briefly explained Sections 12 through 21.

SEN. THOMAS asked on Section 22 which is stricken from the bill, if there was an amendment in there.

CHAIRMAN KEATING said that section is still in the statutes, they are not repealing it, it taken out of the bill.

Ms. Butler explained Sections 22 through 24.

{Tape: 3; Side: A; Approx. Time Count: 2:37 p.m.}

CHAIRMAN KEATING stated that State Fund's income is coming down but the administration is going up. They are loosing customers but charging more administration fees.

SEN. BENEDICT said they are not loosing customers, they are loosing premium dollars.

Ms. Butler stated their premium dollars are down by about two-thirds and premium reductions by about one-third by loss of customers. They have found they have lost the big customers which took a lot of premium but they still have very similar work loads because of almost the same number of policy holders.

CHAIRMAN KEATING asked if they had the same work load, why can't they get it done for \$11 or \$12 Million instead of \$17 Million? **Carl Swanson, State Fund**, responded in fiscal 1994 they peaked at about \$181 Million. Currently they are at about \$83 Million. \$60 Million of the decrease is due to cutting premiums and rates 35% with no change in work load.

The State Fund operating expense ratio has been historically extremely low, because it was not able to do the things it should have been doing for cost containment. If they look at themselves compared to other State Funds or insurance companies the ratio was extremely low which is one reason benefit costs were so high. They weren't spending dollars where they needed to. For example, if they have a loss control safety department, they cut operating expenses but it does not mean it is healthy for their customers. They want to be able to prevent injuries and accidents.

Managed care has increased some expenses also for the State Fund. Looking at it today, the statutory cap is approximately 10% for the State Fund for fiscal year 1997. So almost 90% of the State Fund's costs are benefits. They need to try to shrink that through cost containment efforts. They weren't spending those dollars in prior years, particularly in 1993, so that is why their operating expense ratios were so low.

To give a comparison, **Mr. Swanson** said typically State Fund was operating around 15% operating expense ratio, but today it is 25% to 35% operating expense ratio. Private carriers are typically around 30%, in fact when they service residual markets operate around 34% to 35%. That is the kind of expense ratio you would anticipate if you are running an insurance company operation. State Fund has had just about the lowest operating expense ratio in the nation because they weren't doing many of the things they needed to be doing to shrink the 90% of their costs. The costs impact rates their customers are paying, if they can shrink the benefit costs 1% as a direct reduction in premium or rates it is a .2% impact on rates.

CHAIRMAN KEATING asked **Carl Swanson** why it costs him more now from \$11 Million to \$17 Million in administration when State Fund has fewer customers.

Mr. Swanson answered the number of customers are basically the same.

CHAIRMAN KEATING asked if they have increased their safety operation some and is that costing them.

Mr. Swanson answered they do have a greater focus on safety.

CHAIRMAN KEATING asked if that was increasing their administrative expense.

Mr. Swanson answered yes.

CHAIRMAN KEATING asked how has managed care increased expense?

Mr. Swanson answered this year there is about \$400,000 of new expense.

CHAIRMAN KEATING asked if that is their administrative expense or benefit expense?

Mr. Swanson answered it is not their administrative expense.

CHAIRMAN KEATING asked if State Fund was still earning a fee from the management of the Old Fund liability claims?

Mr. Swanson answered they are, it is \$3 Million this year, they are anticipating \$3 Million next year, then it will be dropping down to \$1.7 or \$1.8 Million and tapering down.

CHAIRMAN KEATING asked why it is costing them \$5 to \$6 Million more to do the same thing they have been doing, are they spending more on safety or on fraud or paying people more or handling more claims or whatever.

SEN. THOMAS said it seems to him since the budget has gone through in Finance and Claims, the question before the Committee deals with this artificial factor of 15%.

SEN. THOMAS said he does not believe we need an artificial factor. That is something that prior legislature installed in law and as revenues are coming down, the premiums are coming down which is good. In taking care of people, the percentage gets bigger. So, they are running into this problem of artificial percentage of 15% and he thinks the Fund is sensitive to trying to delete it entirely and they have proposed this version of it. He thinks we should eliminate the 15% cap.

SEN. BENEDICT said **Carl Swanson** came to him about six months ago to start working on this bill and one of the items was the cap.

He told him at that time that eliminating the cap would be something that would be very difficult to do because the legislature likes to feel like everybody has a cap, and to say no cap is probably a lot more difficult than saying let's go ahead and leave the cap in place but go outside the cap if they have to for some other expense. If this Committee would like to go ahead and eliminate the cap, **SEN. BENEDICT** is not sure that is a good idea as far as when it gets on the floor and starts to wander its way through the process.

To go back a little bit farther, **SEN. BENEDICT** said he has cautioned **Mr. Swanson** a number of times that the Committee does not have a Harvard MBA and sometimes he seems to talk in terms like he is talking with someone who has dealt with these things all their lives. Everyone on the Committee knows what kind of mess the State Fund was in.

CHAIRMAN KEATING said he is not trying to find fault with the Fund.

SEN. BENEDICT said when this cap was in place and put in place, these people were handling 600 to 700 claims and doing an absolutely terrible job of it. Now they have gotten themselves down to handling maybe 175 or 180 claims per claims examiner, and so you have got to have more people, you have got to have more administration, and more administrative expense. When they get into loss control and fraud and safety the administrative expense goes up.

Nancy Butler explained Sections 26 and 27.

SEN. BENEDICT said this is a bill that has been a moving target for the past six or seven months and he has appreciated all the input he has gotten on this bill. They are all moving towards trying to get that payroll tax off as soon as possible.

Nancy Butler referred to **(EXHIBIT 3)** the top of page 38, line 3 in making a final comment about the bill. She said that will have to be eliminated from the repealer section.

CHAIRMAN KEATING asked **SEN. BENEDICT** if there has been some significant change to the matrix of this bill since the hearing.

SEN. BENEDICT answer is inaudible.

CHAIRMAN KEATING asked if there was anybody present who testified on the original bill who had a desire to comment on the amended bill. There was no response. **CHAIRMAN KEATING** said he is not certain he really understands it all but guessed the Committee understood the scenario of it. The funds are not merged yet, there is going to be some shifting of financing here and there, the payroll tax will be coming out eventually.

SEN. EMERSON asked **SEN. BENEDICT** if there were any other bills waiting to be introduced which will do the same thing?

SEN. BENEDICT said he is only aware of one which cuts the payroll tax and extends it out to around year 2006.

Eddy McClure explained that there are two missing sections which should have been numbered page 37 in the grey bill (**EXHIBIT 3**). There are no amendments to the page missing. The missing section is 2905 which deals with time limits for filing claims, Section 28 is missing and is a transfer of funds. When the bond fund is deleted any money left in that bond fund is going to be shifted over June 30, 1997 to the State Fund's cap. Section 29 starts the repealer section which is included in the grey bill on page 38.

SEN. WILSON said there is a section he is not comfortable with on page 15 of the grey bill. On line 6 he would like to strike '30' and insert '45' days, then strike lines 19 through 22. He thinks that would force a decision to be made and that **Mr. Driscoll** had a good point in that leaving the language in lines 19 through 22 would force people to go through legal remedy. In order to get into the Workers' Compensation Court is a long, long process that could take up to a year.

CHAIRMAN KEATING asked if those things in the grey bill are in the amendments someplace? **Eddy McClure** said they are.

Motion: **SEN. WILSON** moved to segregate Section 11 from the amendment list of the grey bill and that 30 days be changed to 45 days and subsection (5) be deleted.

Discussion: **SEN. THOMAS** asked **SEN. WILSON** why he feels this leads to litigation.

SEN. WILSON answered it wasn't forcing the claim to be responded to. If the insurer fails to comply with this section he thinks the guy is out there hanging and this leads him to the legal system.

SEN. EMERSON asked if they are going to increase the claims by automatically accepting them.

SEN. WILSON responded no, they have to either accept or deny.

SEN. EMERSON asked if they automatically accepting them after 45 days.

SEN. WILSON answered that is correct.

SEN. BENEDICT said if we were just dealing with the 45 days then it is simply a longer period of time to accept or reject. But we are also dealing with lines 19 through 22 which say that in that 45 day period if they don't respond for some reason, then it

automatically becomes a claim. For one reason or another if it has not been responded to in that 45 day period then it becomes a claim.

CHAIRMAN KEATING asked **Nancy Butler** if she had mentioned if there was a situation where there was an oversight on the claim by the insurer and somebody took advantage of when it was ignored, it automatically became a claim.

Ms. Butler responded yes, it was the Hegg case that came down from the Supreme Court in 1995. It was a Workers' Compensation Court decision that determined the claim was fraudulent. Then it went on to Supreme Court and they said they reversed the Solheim case stating it was not an automatic acceptance, but stating if the 30 day period was missed it is an automatic acceptance. So that claim became accepted by the insurer but was determined by the Workers' Compensation Court to be a fraudulent claim so that was the problem. The penalty comes in on the insurer that if they miss the date, they get a 20% penalty.

SEN. THOMAS said the way he understands the language to be proposed unamended by **SEN. WILSON'S** motion, there is a period of time which is 30 days that the company has to notify the claimant of acceptance or denial of the claim. Then in subsection (5) it states their failure to do that does not constitute an acceptance of the claim, that is the purpose of that language. So the language on lines 19 and 20 he thinks is extremely important. He does not know if the length of days is important but the language on 19 and 20 should be retained.

Vote: The motion failed by voice vote with 3 in favor and 6 opposed. Those in favor were **SEN. BARTLETT**, **SEN. SHEA**, and **SEN. WILSON**.

Motion: **SEN. BARTLETT** moved to segregate amendments 32 and 34 and any that deal with the title for those. Those two amendments are the ones that relate to the proposed benefit increases which were in the bill when it originally came in. She would like to vote on those particular amendments separately from the overall set of amendments.

Discussion: **SEN. BENEDICT** opposed the motion because when the bill was introduced those things were there, however, in going over this bill with a number of people, it was pointed out to him several times that this is not just a State Fund bill, but is a Plan 1, 2, and 3 insurers bill. We didn't have the agreement of all the insurers that are affected by those amendments so he agreed to take out the wage loss and rehab out.

SEN. BARTLETT clarified that she was only asking to segregate those amendments from the whole package and vote on the rest of the package, then come back and vote on those separately.

CHAIRMAN KEATING said they would vote on segregating amendments 32 and 34, then vote on the balance of the amendments.

Vote: The motion carried unanimously by voice vote.

Discussion: **SEN. BARTLETT** said she believes **SEN. BENEDICT'S** comments would apply in terms of debate on the substance of those amendments. She said he is correct but she does not want to vote to take any benefit increase out when any number of people have been so ready to reduce benefits prematurely before they had any essential information on making the decision to reduce them.

Motion: **SEN. BENEDICT** moved to accept amendments 32 and 34.

Vote: The motion carried with 6 in favor and 3 opposed. Those opposing were **SEN. BARTLETT**, **SEN. SHEA** and **SEN. WILSON**.

Motion: **SEN. BENEDICT** moved SB 67 pass as amended.

Vote: The motion carried unanimously by voice vote.

EXECUTIVE ACTION ON SB 302

Amendments: None.

Note: **EXHIBITS 7 through 11.**

Motion: **SEN. EMERSON** moved to do-pass SB 302.

Motion/Vote: **SEN. BARTLETT** made a substitute motion that SB 302 be tabled. The motion failed with 4 in favor of and 5 opposing by roll call vote.

Vote: Motion failed with 4 in favor of and 5 opposing by roll call vote.

Discussion: **SEN. THOMAS** stated that he felt the Committee either needs to move this bill out in a positive manner or table the bill.

Motion: **SEN. THOMAS** moved to table SB 302.

Vote: The motion carried with 5 in favor of and 4 opposing by roll call vote.

EXECUTIVE ACTION ON SB 304

Amendments: SB030401.AEM, (**EXHIBIT 12**)

Motion: **SEN. SHEA** moved SB 304 do-pass.

Motion: **SEN. BENEDICT** moved the amendment.

Vote: The amendment motion carried unanimously by voice vote.


Vote: The motion to do-pass SB 304 carried unanimously by voice vote.

ADJOURNMENT

Adjournment: 3:20 p.m.



SEN. THOMAS F. KEATING, Chairman



GILDA CLANCY, Secretary

TFK/GC