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OFFICE OF
WORKER'S COMPENSATION JUDGE
HELENA, MONTANA

IN THE WORKERS' COMPENSATION COURT OF THE STATE OF MONTANA

CATHERINE E. SATTERLEE, et al. Petitioners, v. LUMBERMAN'S MUTUAL CASUALTY COMPANY, et al. Respondents/Insurers.	WCC No. 2003-0840 **MONTANA STATE FUND'S STATEMENT OF ADDITIONAL UNCONTROVERTED FACTS**

In support of Petitioners' (hereinafter referred to as "Satterlee") motion for partial summary judgment, Satterlee set forth several facts with respect to each claimant. Taken collectively, the facts presented by Satterlee indicate that three of the claimants reached retirement age after their injury or occupational disease, and a fourth claimant was past the age of retirement on the date of her injury. Satterlee Br. 2-4 (Feb. 18,

DOCKET ITEM NO. 22L

2005). All four claimants had their total disability benefits terminated by operation of Montana Code Annotated § 39-71-710. For purposes of summary judgment, the Montana State Fund ("State Fund") does not dispute any of the facts set forth by Satterlee. However, the State Fund believes additional facts are necessary and relevant to allow this Court to fully consider and analyze the constitutional issue presented through briefing. Therefore, pursuant to Administrative Rules of Montana 24.5.329(3), the State Fund submits the following additional uncontroverted facts in support of its Answer Brief and in support of its Cross-Motion for Partial Summary Judgment.

A. Benefit Costs Associated With *Satterlee*

1. The State Fund has estimated the cost of benefits associated with a retroactive application of *Satterlee*. Excluding claims which are coded or otherwise identified as settled, for claims arising on or after October 1, 1981 through June 30, 1990, the increase in benefit costs against the Old Fund is estimated at $93 million to $116 million. For non-settled claims arising on or after July 1, 1990 through December 22, 2004, the increase in benefit costs against the State Fund is estimated at $135 million to $186 million. In total, the benefit costs associated with retroactively applying *Satterlee* to PTD claims is estimated at $228 million to $302 million. The State Fund's estimate is not a "best case/worst case" scenario but instead represents the "highly likely range" from an actuarial standpoint. Aff. Daniel Gengler ¶¶ 1-3 (Aug. 8, 2005).

2. If *Satterlee* invalidates Montana Code Annotated § 39-71-710 as applied to PTD claims, the prospective application of *Satterlee* will result in an increase in benefit costs which would require rate increases ranging from 11% to 21% for the State Fund's policyholders. Based on annual premiums of approximately $200 million, this rate increase corresponds to an annual increase of approximately $21.6 million to $41.4 million for the State Fund's policyholders. This rate increase might be offset somewhat by future investment income that is earned pending payment of benefits at retirement age. This offset is known in the industry as "discounting" rates, in consideration of future investment income. The amount of offsetting discount is a business decision contingent upon an assessment of risk and market conditions each time rates are established. Aff. Gengler ¶ 4.

3. An insurance company's equity is known as "surplus" in the industry, that is, money available in excess of liabilities. Surplus is not excess, unnecessary funds. Because insurance liabilities are uncertain, surplus is a prudent measure of contingency against the financial failure of an insurance company. Reasonable surplus provides assurance that the insurance company's financial obligations to its policyholders will be met. The State Fund is required by statute to maintain at least a minimal surplus to

ensure financial solvency. Aff. Gengler ¶ 5.

4. The amount of surplus that an insurance company needs is based on industry standards developed to provide reasonable but not certain assurance against financial failure. Ultimately, surplus is intended to assure that the State Fund will be able to fulfill its obligations to policyholders and injured employees. A strong surplus, along with adequate loss reserves, protects injured employees, policyholders, and allows the State Fund to continue to operate as a strong and viable insurance carrier. The State Fund is statutorily required by Montana Code Annotated § 39-71-2330(2) to maintain a minimum surplus of 25% of its annual earned premium. The State Fund is also statutorily required by Montana Code Annotated § 39-71-2311 to be self-supporting. The State Fund's analysis concludes that while the statutory minimums provide some protection against financial failure, it is at a level at which the State Fund would be unacceptably vulnerable to financial failure. Aff. Gengler ¶¶ 6, 9-10.

5. Workers' compensation insurance differs from most other insurance lines in that benefits are open-ended and are not subject to a policy limit. For a workers' compensation carrier like the State Fund, there are several characteristics that have the potential for a greater volatility of results than the norm in the property casualty industry and therefore require a stronger than average surplus to address these issues, including the following:

a. Extremely long-term obligations associated with claims in which actual costs are not known with certainty for decades.

b. The State Fund writes only one type of insurance in one state;

c. Courts are constantly changing the workers' compensation laws and benefits, making it difficult for the State Fund to accurately set premiums;

d. The State Fund provides the guaranteed market; and

e. Unlike a stockholder-owned insurance company, the State Fund cannot access additional capital to cover adverse financial results.

Aff. Gengler ¶¶ 7-8.

6. The State Fund's long-range target is to have a reserve-to-surplus ratio of 1.5-2.0 to 1. The higher the ratio, the less adequate the reserve. For 2004, the reserve-to-surplus ratio was 3.55 to 1. For 2003, the reserve-to-surplus ratio was 3.4 to

1. For 2002, the reserve-to-surplus ratio was 2.19 to 1. The State Fund lowest reserve-to-surplus ratio has been 2.18 to 1. Aff. Gengler ¶ 11.

7. The financial impact of retroactive application of *Satterlee* to the State Fund was not included in the rates for prior years and therefore such costs are not included in current reserves. The financial impact of retroactive application of *Satterlee* would reduce or eliminate current surplus. If the financial impact exceeds current surplus, liabilities would exceed assets and the State Fund would be deemed financially insolvent. Aff. Gengler ¶ 12.

8. The State Fund's surplus at the end of fiscal year 2004 was $127.5 million. As of March 31, 2005 and as presented to the State Fund's board of directors, the State Fund's projected surplus for the end of fiscal year 2005 is $141.8 million. Aff. Gengler ¶ 13.

9. Assuming the midpoint of cost estimates, the State Fund's surplus would be eliminated as a result of the benefit costs associated with retroactively applying *Satterlee* to PTD claims. The elimination of the State Fund's surplus would result in a significant rate increase over many years in an attempt to restore surplus to target levels. The significant rate increase to restore surplus would, of course, be added to the other rate increases required as a result of prospectively applying *Satterlee* to PTD claims. Aff. Gengler ¶ 14.

10. The State Fund would be severely crippled or insolvent if *Satterlee* applied retroactively. After analyzing the impact associated with retroactively applying *Satterlee* to PTD claims, the State Fund's actuarial analysis arrived at the following conclusions:

a. A change in Montana's statutory benefits to pay lifetime benefits to injured employees with permanent total disability is estimated to cost Montana employers insured by the State Fund 15% more for their workers' compensation coverage, possibly offset by up to 7 percentage points in consideration of future investment income. The State Fund anticipates that other carriers and self-insured pools would see similar rate increases. Statewide, Montana employers would pay approximately $60 million more for their workers' compensation insurance each year;

b. The 15% estimate is a mid-range estimate. It is highly likely that actual results will vary. Slight variations in assumptions can swing the estimate by material amounts. One source of uncertainty is anticipating the incidence of PT claims. Lifetime PT benefits will likely change the dynamics by which injured workers seek PT status. Another source of uncertainty is life expectancy. Life expectancy among this population is not well understood in the industry. In any event, given the relatively small numbers of PT claims, actual average life spans are subject to considerable variability. COLAs are another source of uncertainty. The number and amount of COLAs are unlimited under current law and therefore have a highly leveraged effect on cost estimates. By slightly varying its assumptions regarding the numbers of PT claims, life expectancies, and average annual COLAs, the State Fund derives indications of rate increases ranging from 11% to 21%;

c. The National Council on Compensation Insurance ("NCCI") has provided a preliminary estimate of the rate impact of lifetime PT benefits, tentatively concluding an increase in rates of between 5% to 11% as a result of prospectively applying *Satterlee*. A copy of NCCI's estimate is attached hereto as Ex. "A." NCCI's estimate assumes that carriers will offset the increase in benefit costs in consideration of future investment income (discounting). But for the assumption of discounting, the State Fund and NCCI estimates are consistent with one another.

d. Retroactive application of lifetime PT benefits from October 1, 1981 to June 30, 1990 is estimated to cost the Old Fund approximately $105 million. By varying assumptions slightly, the State Fund derives indications ranging from $93 million to $116 million. The Old Fund is an obligation of the State's General Fund. Therefore, any cost impact to the Old Fund would not affect the State Fund's rates;

e. Retroactive application of lifetime PT benefits from July 1, 1990 to June 30, 2005 is estimated to cost the State Fund approximately $161 million. By varying its assumptions slightly, the State Fund derives indications ranging from $135 million to $186 million. The State Fund would very likely be insolvent, or at a minimum, its financial position severely crippled. Unlike private carriers who can access capital markets to raise additional funds, the State Fund is solely reliant on premiums charged to employers for its capital needs. The State Fund would need to rebuild its equity by more aggressive pricing than would otherwise be the case. It is difficult to say precisely how much higher rates would be because of the many complex variables involved in pricing decisions. Such variables include competitive pressures in the market, adverse or favorable development on prior year claims, investment income, etc. However, absent another source of capital, it is certain that the State Fund's rates would be higher than they otherwise would be for a very long time, perhaps decades;

f. While the State Fund might apply best available methods to best available data, any cost estimate of a benefit change of this magnitude is highly uncertain. Given the level of uncertainty in the cost estimates, it would only be prudent for the State Fund to consider adding a contingency provision in its rate structure, to protect against the risk that the 15% estimate is too low until sufficient loss experience is incurred to gain greater certainty of losses. A rough characterization is that, market conditions allowing, the State Fund might look to maintain an additional five percentage points of rate increase over and above the 15% estimate in consideration of the uncertainty of the true costs of this benefit change; and

g. The State Fund would need to add additional margin to its rates to restore prudent levels of financial equity. At a minimum, the State Fund would need to rebuild its surplus to the statutory minimum as quickly as possible. A one year recovery of the statutory minimum surplus would require an additional rate increase of about 60%. Such a rate increase is probably not sustainable as the State Fund would likely lose a significant portion of its current market share. A three year recovery of surplus to the statutory minimum would require an additional rate increase of about 16%. The recovery period would be longer to the extent that the State Fund loses market share due to the additional rate increase. In any event, because the statutory minimum represents a weak financial position, the State Fund would need to maintain some additional margin in its rates for much longer, in order to rebuild to surplus levels that represent financial strength.

Aff. Gengler ¶ 15.

11. The Old Fund currently has an unfunded liability. At the end of fiscal year 2004, the Old Fund's liabilities exceeded its assets by $7,442,792. If the Old Fund is not adequately funded, any amount necessary to pay and administer claims must be transferred from the State of Montana General Fund to the Old Fund. As a result, the financial impact of retroactive application to the Old Fund will be paid out of the General Fund. The General Fund would be impaired as a result of the estimated $93,000,000 to $116,000,000 impact of retroactively applying *Satterlee* to PTD claims. Previously, the Old Fund received funding through a payroll tax, but the tax was terminated in 1998. Aff. Gengler ¶¶ 16-17.

12. The insolvency of the Old Fund in the 1980s was the result of inadequate pricing and reserves and rate suppression. During that time, many private sector insurers left Montana. Aff. Gengler ¶ 18.

13. In addition to the benefit costs and administrative efforts discussed above, the *Satterlee* decision will have a cost impact on policyholders and the State Fund. Ratemaking in the prior years did not take into consideration the potential increase in PTD benefits which may be due to affected claimants if *Satterlee* applies retroactively to PTD claims. Aff. Gengler ¶¶ 19, 23.

14. Other common fund litigation is currently pending which may further impact the State Fund's financial condition and affect rates. If *Stavenjord* applies retroactively, the State Fund has estimated that the overall retroactivity benefit costs will amount to $14,000,000 to $19,000,000, with an additional benefit cost to the Old Fund of $5,000,000 to $7,000,000. If *Schmill* applies retroactively, the State Fund has estimated that the overall retroactivity benefit costs will amount to $1,400,000 to $1,900,000, with an additional benefit cost to the Old Fund of $800,000. If *Reesor* applies retroactively to PPD claims, the State Fund has estimated that the overall retroactivity benefit costs will amount to approximately $2,000,000, with an additional benefit cost to the Old Fund of approximately $1,000,000. The cumulative benefit cost impact on the State Fund of retroactively applying *Reesor*, *Satterlee*, *Stavenjord* and *Schmill* ranges from $152,000,000 to $209,000,000, with an additional benefit cost to the Old Fund of $100,000,000 to $125,000,000. Further, retroactively implementing each decision involves significant claims-related and administrative expenses. Aff. Gengler ¶ 25.

B. <u>Administrative Costs and Burdens</u>

15. If *Satterlee* applies retroactively, the State Fund will have to identify claimants who may be affected by the decision. Although a single computer run will not locate all the potential *Satterlee* claims, they can be substantially identified by using complex computer queries to search the CMS and DB02 systems. Aff. Cristine E. McCoy ¶ 9 (Aug. 8, 2005).

16. Because of the over-inclusive parameters of the computer search query, manually locating and reviewing each file may be the only reliable means of identifying affected claims. A manual review process would be time-consuming. Aff. McCoy ¶ 9.

17. Locating files on various media types at the State Fund is a labor-intensive, manual process, and several different procedures are employed to retrieve the stored media. Aff. McCoy ¶ 3.

18. Retrieval time depends on what media type the file is stored, the date of the claim, when the claim was active, and how long the claim was active. Aff. McCoy ¶ 4.

19. A claim may be closed and re-opened. If a claim has been closed and re-opened, it may be stored on multiple or all media types. A *Satterlee* review may include a review of a claim file with information stored on all media types. Aff. McCoy ¶ 5.

20. To determine the media type of a claim, the adjuster must make a file request from the State Fund's only records person, who will search the computer system to ascertain when the claim was active and on which media it is likely to be stored. The records person will then check the records for each claim. A simple search may take ten minutes. A complex search may take three hours or longer. Aff. McCoy ¶ 6.

21. Depending on the date of a claim, records are retained in one of four media types: (1) paper; (2) microfilm, which are rolls of film containing photos of documents; (3) microfiche, which are sheets of film with photos of documents that are much smaller than film; and (4) optical imaging platters, which utilize technology similar to compact disks to store documents as digital images on glass platters that assign a document number and claim number to each image. Aff. Marvin Kraft ¶ 4 (Aug. 8, 2005).

22. From inception until 1976, all open files were maintained on paper and closed files were copied to microfilm. Beginning in 1976, open files were still maintained on paper but closed files were copied to microfiche instead of microfilm. Aff. Kraft ¶ 5.

23. In July of 1995, the State Fund began using optical imaging platters in addition to paper files. Except for active files with the Old Fund unit, the use of paper files on active claims was gradually phased out and all paper files were destroyed by the summer of 2001. As noted, the only paper files remaining are active files with the Old Fund unit, which handles claims arising on or before June 30, 1990. Aff. Kraft ¶ 6.

24. Documents presently received at the State Fund are imaged to disk and made available via the computer system. Each original document is electronically date-stamped upon receipt and stored in "batches," which are groups of documents imaged at the same time. The batches are placed in boxes which are marked by date and batch number. Approximately once per month, the State Fund notes which boxes are more than six months old and requests permission to destroy those boxes from the State Records Retention Committee. When permission is received, which usually takes four to six weeks, the boxes are destroyed by the State Fund. Aff. Kraft ¶ 7.

25. The State Fund stores the different types of media in various locations. Optical imaging platters are stored on site at the State Fund and copies are stored in a secure vault offsite. Microfilm and microfiche files are stored with the State Auditor's Office in their records retention center. The Old Fund unit stores paper files on site for active claims arising on or before June 30, 1990. Open files in the Old Fund unit with claims arising on or before June 30, 1990, may be lengthy files consisting of several volumes and thousands of pages. When these files are closed, the original documents are microfiched and the paper files are destroyed. Aff. McCoy ¶ 7; Aff. Kraft ¶ 8.

26. A file's media type is determined by what storage system was in place at the time the file was closed. For files that closed before 1976, the files are stored on microfilm. For files that closed from 1976 through 1994, the files are stored on microfiche. For files with claims that occurred before July 1, 1995 but remained open after that date, the file before July 1, 1995, is microfiched and the remainder after July 1, 1995, is stored on optical imaging platters. For files with claims that occurred on or after July 1, 1995, the files are stored on optical imaging platters. Aff. Kraft ¶ 9.

27. Microfiche may be either copied to other microfiche or may be copied to paper by the State Auditor's Office. With its present staff, the maximum document production by the State Auditor's Office is about 600 pages per day and the average claim file is about 90 to 100 pages. The State Fund also has two machines that allow it to print paper copies from microfiche. With experienced operators and minimal equipment malfunction, it is reasonable to estimate each machine could produce an average of 100 pages per hour from microfiche to paper. Aff. Kraft ¶ 10.

28. Since July 1, 1995, all incoming fiscal year 1996 claim documents have been imaged. All incoming claim documents have been imaged since February of 1997. Aff. Kraft ¶ 11.

29. In 1999, the State Records Retention Committee approved the State Fund's optical imaging system as its primary means of records retention. Six months after that approval, the State Fund destroyed all of its paper files. Aff. Kraft ¶ 12.

30. Optically imaged documents can be retrieved via the State Fund's computer system. Entire files are printed via a FileNet printer, which can print several claim files per night. Individual pages can be printed at any workstation at about eight pages per minute. Aff. McCoy ¶ 8.

31. Entitlement determinations are made more difficult because of transfer and coding problems that exist with respect to the different computer systems the State Fund has used over the years. Prior to July 1, 1987, and until February of 1997, claim summary information was kept on DBO2, the mainframe. The DBO2 system was used to transfer claim information to the Department of Labor & Industry. Aff. David Ogan ¶¶ 2-3 (Aug. 8, 2005).

32. In February of 1997, the information on the DBO2 system was transferred to CMS, a system which integrates a database and imaging software and stores claim summary information. DBO2 and CMS do not interface. Some of the information that was compacted for transfer from DBO2 could not be disassembled in the CMS system. Aff. Ogan ¶ 4.

33. In the CMS system, financial information is produced for the user in a template-based format. Unlike the DBO2 system, the CMS system serves as claims handling software and the State Fund uses it to assist in adjusting claims. The State Fund is in the process of developing a new claim management system, Claim Center ("CC"), and currently anticipates bringing this system online in October 2005. CMS and CC will not interface, and information compacted for transfer from CMS to CC will not universally be disassembled in CC. Ultimate impacts to information retrieval and functionality cannot be assessed at this point. Aff. Ogan ¶ 5.

34. A review of potential *Satterlee* claims would also require adjusters to recognize and appropriately address the prior attorney liens filed in the pending common fund litigation, including but not limited to *Murer, Schmill*, *Stavenjord, Rausch, Flynn* and *Reesor*. Aff. McCoy ¶ 14.

35. The State Fund's organization structure has changed over the years. At

the time of the seminal *Murer* common fund decision and during almost all of the *Murer* implementation process, the State Fund's organizational structure was more conducive to accomplishing special projects like implementing common fund decisions. Even with a more flexible structure, completing the implementation process was a strain on the State Fund's business operations. This was so even though the *Murer* review was limited to a four year period, July 1, 1987, through June 30, 1991, and only involved the recalculation of the disability rate for those claimants at the maximum rate. Compared to *Murer*, a *Satterlee* review process would involve a more complex review of each claim and cover a substantially longer period of time. The internal and external resources needed to accomplish a *Satterlee* review, along with attended costs, would be considerably more than *Murer*. Aff. McCoy ¶ 15.

C. <u>Data Regarding Claimants Who are Receiving Retirement Benefits</u>

36. By age 64, the vast majority of people are receiving social security retirement benefits. The percentage of people who receive Social Security retirement benefits gradually rises with age, and by their late 70s, about 91-92% of people report receiving Social Security retirement benefits. Aff. Paul Polzin ¶¶ 10-013 & Ex. 1-2 (Aug. 8, 2005).

37. Approximately 16.3% of males who receive Social Security retirement benefits are also part of the civilian labor force. Persons are classified in the civilian labor force if they are employed, unemployed but seeking employment or in the Armed Forces during the week the survey is conducted. As the age of the retired person increases, there is a corresponding decrease in the amount of retired workers who earn income from working. For example, for people age 67 who receive Social Security retirement benefits, over two-thirds of them do not earn annual income from working. By age 70, over three-fourths of people who receive Social Security retirement benefits do not earn annual income from work. Aff. Polzin ¶¶ 14-15 & Ex. 3.

38. The highest figures for labor force participation were reported for both males and females age 66. This reflects the fact that the earnings limitations for Social Security recipients does not apply after a person reaches their 65th birthday. The maximum labor force participation is approximately 31% for males and about 25% for females who are 66 years old. Aff. Polzin ¶ 16.

39. The rates for males in the civilian work force declines almost every year until reaching about 3% for those age 85 and older. For females, the rates also decline, steadily reaching approximately 1% for those age 85 and older. Aff. Polzin ¶ 17.

40. For males receiving Social Security payments, approximately 40% of those age 62 and older also receive retirement income from another source. Company or union retirement payments were the largest single source, followed by government and military pensions. Among females receiving Social Security, the percent receiving other pensions were generally lower than for males, but company/union pensions and government/military pensions were still the two largest sources. Aff. Polzin ¶ 21 & Ex. 5.

41. The following conclusions apply to claimants who are receiving Social Security retirement benefits:

a. Labor force participation is higher for persons not receiving Social Security retirement payments;
b. Males have higher labor force participation than females;
c. After a peak at age 66, there is a steady decline in labor force participation for males receiving Social Security. For those 85 and older, only about 3% are in the labor force;
d. For females receiving Social Security, after a peak at age 66, there is a also a steady decline in labor force participation For those 85 and older, only about 1% are in the labor force; and
e. The national data accurately represents the workforce situation that exists in Montana.

Aff. Polzin ¶¶ 1-8; 20.

42. The labor force participation rates are generally higher than for those persons not receiving Social Security retirement payments, but the trends are very similar. The participation rates for both males and females not receiving Social Security decline steadily with age. At age 62, about 70% of the males and roughly 63% of the females not receiving Social Security were in the labor force. For those age 85 or older, about 9% of the males and roughly 7% of the females were in the labor force. There are no peaks in labor force participation at age 65 or 66 in the percentages of males or females persons in the labor force. Aff. Polzin ¶ 18.

43. For persons not receiving Social Security, the overall percentages having retirement income are lower, perhaps reflecting the fact that they are still in the labor force. For males not receiving social security, approximately 18% of those age 62 to 65 reported another retirement income source, and this percentage rose to about 25% for those age 71 and older. For females not reporting Social Security payments, approximately 10% of those age 62 to 65 years old reported other retirement sources,

and the corresponding figure for females age 71 and older was approximately 17%. Aff. Polzin ¶ 22 & Ex. 5.

DATED this 8 day of August, 2005.

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CERTIFICATE OF MAILING

I, the undersigned, of GARLINGTON, LOHN & ROBINSON, PLLP, Attorneys for Respondent/Insurer, Montana State Fund, hereby certify that on this 8th day of August, 2005, I mailed a copy of the foregoing **MONTANA STATE FUND'S STATEMENT OF ADDITIONAL UNCONTROVERTED FACTS**, postage prepaid, to the following persons:

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