



Montana Legislative Services Division
Legal Services Office

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Memo Re: State Fund Assets
January 23, 2018

Issue Presented

The Economic Affairs Interim Committee requested a legal memo relating to ownership of Montana State Fund assets in the event of a sale, dissolution, or privatization of the Montana State Fund.

Brief Answer

It is unclear how a Montana court would rule as there is no controlling case. Ultimately, a Montana court would look to relevant Montana statutes and nonbinding state and federal court cases that have addressed similar issues.¹ However, because workers' compensation is unique in each state, most cases can be factually distinguished from Montana. This makes it difficult to predict how a Montana court would rule.

¹ *Eckles v. State of Oregon*, 306 Ore. 380, 760 P.2d 846 (1988). Funds held by the state workers' compensation insurer in Oregon could not be transferred to the state because it implicated the contracts clause. The state legislature created statutes providing for autonomy of the workers' compensation insurer and provided that it had no proprietary interest in its funds and assets.

Workers' Comp. Fund v. State of Utah, 2005 UT 52, 125 P.3d 852 (2005). Although originally created by the legislature, Utah's quasi-governmental insurer, the WCF, was not owned by the state. Utah had no managerial, financial, or operational control of the WCF, the WCF's assets, or a separate injury fund. Additionally, the legislature had previously deleted statutory language for which the State attempted to argue presented validity of its ownership over the insurer's funds. The WCF was private in ownership according to the definition of quasi-public corporation in Utah code. Thus, any attempt by the State to appropriate the assets of the WCF would constitute a taking of property.

Gronning v. Smart, 561 P.2d 690 (Utah 1977). Appropriation of trust funds by the legislature was a violation of the Due Process Clause of the Fourteenth Amendment and Article I, § 7, of the Utah Constitution. The money in the state insurance fund was not public money subject to appropriation to meet expenses of government. It was a trust fund to be used to meet liabilities of employers when an employee was entitled to compensation. If the appropriation were to be made, it would amount to a seizure of trust funds for state purposes without due process of law.

Tulsa Stockyards v. Clark, 2014 OK 14, 321 P.3d 185 (2014). Funds of the Oklahoma State Insurance Fund were not state funds and did not belong to the state, were trust funds for the benefit of employers and employees, and were not available for the general or other purposes of the state, nor were they subject to appropriation by the legislature for purposes other than those contemplated by the State Insurance Fund Act.

Moran v. Oklahoma, 534 P.2d 1282 (1975). Oklahoma insurance fund assets did not belong to the state, because if the fund were to become insolvent or fail to pay a workmen's compensation award, appellees and other employers insured by the fund, not the state, would be required to pay the award. Because fund assets did not belong to the state, the state had no right to appropriate them for purposes other than workmen's compensation and appellees were entitled to an injunction.

Fun 'N Sun RV v. State (In re Certified Question), 447 Mich. 765, 777-778, 527 N.W.2d 468, 474 (1985). Statute providing that the profits from the sale of the Michigan Accident Fund was the property of the state and not the policyholders was upheld because the Michigan Legislature did not clearly and unconditionally mandate that monies held by the Accident Fund could not be appropriated by the legislature.

Kansas Building Industry Workers Compensation Fund v. State of Kansas, 302 Kan. 656, 359 P.3d 33 (2015). Dismissal of a lawsuit challenging "cash sweeps" of \$2.35 million from the Kansas Workers Compensation Fund into the Special Revenue Fund to make up for a revenue gap was remanded. The court analyzed that the insurance funds were held in trust, therefore, not subject to appropriation for general expenditures of the state.

Methodist Hosp. of Brooklyn v. State Ins. Fund, 64 N.Y. 2d 365, 476 N.E. 2d 304 (1985). Policyholder employers challenged the constitutionality of fund transfers from the State Insurance Fund to the general fund. The Court of Appeals of New York upheld the transfer because applicable statutes did not establish the Insurance Fund as a mutual insurer, there were more dissimilarities than likeness between the insurer and a mutual insurance company, the state created the insurer as a state agency, and the state was liable for the state insurer's liabilities. The court also concluded that the policyholders had no proprietary interest in the insurer's surplus and the transfer was proper.

Indus. Comm'n v. Brewer, 231 Ariz 46, 290 P.3d 439 (2012). The Arizona Court of Appeals court found that the legislature had authority to transfer funds from the Industrial Commission of Arizona to the state's general fund. The court found that the workers' compensation fund was a public fund and not a trust.

As the selected cases from other states indicate, the sale, dissolution, or privatization of the State Fund could potentially raise issues associated with the Montana and federal constitutions' contracts clauses, may implicate a due process and takings analysis, and could also require amendment or repeal of the Montana Constitution's provision relating to investment of State Fund assets.

Analysis

1. State Fund Assets Held in Trust -- Funds Sole Property of the State Fund

The State Fund is a nonprofit, independent public corporation established for the purpose of allowing an option for employers to insure their liability for workers' compensation and occupational disease coverage.² The State Fund provides insurance for the guaranteed market, meaning that it is generally required to insure any employer who requests insurance coverage.³

The current Montana State Fund was created in 1990, in reaction to nearly \$500 million in unfunded liabilities that existed in the previous workers' compensation program.⁴ The 1989 Legislature designed the State Fund to be independent, no more nor less than self-supporting, and not reliant on continuous legislative funding.⁵ To achieve this, the 1989 Legislature specified that assets held by State Fund were solely those of the State Fund.⁶ Subsequently, the 2003 Legislature required the State Fund to include a policy provision in every insurance policy restating the restrictions on the use and transfer of money collected by the state fund.⁷

In the event of a sale, dissolution, or privatization of the State Fund, a Montana court would likely analyze the following statutes:

39-71-2316. Powers of state fund.

[...]

(2) The state fund shall include a provision in every policy of insurance issued pursuant to this part that incorporates the restriction on the use and transfer of money collected by the state fund as provided for in 39-71-2320.

39-71-2320. Property of state fund — investment required — exception. All premiums and other money paid to the state fund, all property and securities acquired through the use of money belonging to the state fund, and all interest and dividends earned upon money belonging to the state fund are the sole property of the state fund and must be used exclusively for the operations and obligations of the state fund. The money collected by the state fund for claims for injuries occurring on or after July 1, 1990, may

² 39-71-2313, MCA.

³ Id.

⁴ Chapter 613, L. 1989.

⁵ **39-71-2311. Intent and purpose of plan — expense constant defined.** (1) It is the intent and purpose of the State Fund to allow employers an option to insure their liability for workers' compensation and occupational disease coverage with the State Fund. The State Fund must be neither more nor less than self-supporting. [...]

⁶ Section 9, Chapter 613, L. 1989.

⁷ Chapter 603, L. 2003 (inserting subsection (2) into 39-71-2316).

not be used for any other purpose and may not be transferred by the legislature to other funds or used for other programs. However, state fund money must be invested by the board of investments provided for in 2-15-1808, and subject to the investment agreement with the board of investments, the earnings on investments are the sole property of the state fund as provided in this section.

39-71-2322. Money in state fund held in trust — disposition of funds upon repeal of chapter. The money coming into the state fund must be held in trust for the purpose for which the money was collected. If this chapter is repealed, the money is subject to the disposition provided by the legislature repealing this chapter. In the absence of a legislative provision, distribution must be in accordance with the justice of the matter, due regard being given to obligations of compensation incurred and existing.⁸

These statutes provide that State Fund assets are to be held in trust for the purpose of providing workers' compensation insurance and must be used for that purpose. As the cases below indicate, these statutes would be analyzed by a court in determining ownership of State Fund assets.

2. *Selected State Cases Involving Transitions of State Insurers*

In November, the Economic Affairs Interim Committee received information relating to the privatization of certain state-chartered workers' compensation funds. While a review of the enabling legislation for Arizona, Maryland, Nevada, Texas, and West Virginia did not reveal a court case upholding or overturning the legislation, cases from Michigan, Oklahoma, and Utah provide insight in the event of a sale, dissolution, or privatization of the Montana State Fund. The following summaries are provided in general form.

Michigan

In *Fun 'N Sun RV v. State*, Michigan enacted legislation providing for the sale of its State Accident Fund (SAF).⁹ The legislation at issue provided for the sale of all or substantially all of the assets of the SAF to a transferee and the assumption of SAF liabilities by the transferee. The legislation further provided that money acquired from the sale was the property of the state. Ultimately, Michigan sold the SAF to Blue Cross and Blue Shield of Michigan for \$291 million.

The underlying lawsuit involved two SAF policyholders who alleged that they and other similarly situated policyholders were the owners of any surplus accumulated by the fund in excess of the amount needed to cover liabilities. The policyholders argued that since SAF assets were held in trust for the policyholders they were entitled to distribution of any surplus or profit of a potential sale. The policyholders argued that the legislation violated the Michigan and federal constitutions in that it impaired contractual obligations and deprived them of property without compensation.

⁸ Importantly, 39-71-2322 appears to provide a roadmap should the Legislature repeal the State Fund. However, the language of the statute applies to the repeal of the entire chapter. Title 39, chapter 71, includes all of workers' compensation and not just the State Fund.

⁹ *Fun 'N Sun RV v. State (In re Certified Question)*, 447 Mich. 765, 527 N.W.2d 468 (1985)(Supra. N. 1).

The Supreme Court of Michigan disagreed with the policyholders and upheld the transfer of the proceeds to the state. The court noted that there was no statutory provision for the possible sale of the SAF nor a mention of who would own the proceeds.¹⁰ Thus, the court held that there was no implied contractual right created by the Michigan legislature on behalf of the policyholders. The court similarly stated that although Michigan allowed for dividend payments from SAF to policyholders in the event of excess surplus, this did not constitute a vested right of a policyholder to any surplus in the event of a sale. As such, the court noted that there was no statutory language that vested the policyholder with ownership over SAF surplus. Finally, the court noted that under the authorizing legislation, the assets and liabilities of the SAF was transferred to the buyer and the surplus was not being retained by the state.

Montana contains statutes similar to that at issue in *Fun 'N Sun* with distinctions. Montana has a similar statute providing for the repeal of the State Fund and there is no statute addressing a potential sale of the State Fund. This could be potentially construed by a court as to not grant a right to State Fund surplus by a policyholder. On the other hand, *Fun 'N Sun* can be distinguished in that Michigan's statutory scheme did not provide explicitly that SAF funds were to be held in trust for the purpose of workers compensation. Montana's statutory scheme specifically includes language that State Fund assets are to be held in trust. Some jurisdictions have analyzed whether similar trust language indicates that a policyholder has a right to surplus of the insurer.¹¹ Ultimately, a court determining the legality of a sale, dissolution, or privatization of the State Fund would consider the arguments made in *Fun 'N Sun* and apply it to the particular facts of Montana's State Fund.

Oklahoma

In *Tulsa Stockyards, Inc. v. Clark*, Oklahoma passed a law requiring CompSource Oklahoma to do business as a financially independent, nonprofit domestic mutual insurer without capital stock or shares under the name of Compsource Mutual Insurance Company (CompSource).¹² The predecessor entity to CompSource was created by a state statute and administered by a state department to provide workers' compensation insurance as the insurer of last resort. Tulsa Stockyards, Inc., challenged the constitutionality of the act, primarily arguing that the act interfered with its constitutional contractual rights. The company contended that CompSource was a state agency and its money and other assets were the assets of the people of Oklahoma and not the succeeding mutual insurance company.

¹⁰ The court cited a New York Court of Appeals case addressing the transfer of \$190 million from New York's State Insurance fund to the state's general fund. *Methodist Hosp. of Brooklyn v. State Ins. Fund*, 64 N.Y. 2d 365, 476 N.E. 2d 304 (1985). Here, the New York Court of Appeals noted that the statutory provisions "simply do not deal with what is to be done with surplus" and concluded that the language used by its legislature evidenced a legislative policy, not legislative intent to be bound to a contract.

¹¹ *Moran v. State*, 534 P.2d 1282 (Okla. 1975)(Supra N. 1); *Chez v. Industrial Comm'n of Utah*, 90 Utah 447, 62 P.2d 549 (1936).

¹² *Tulsa Stockyards, Inc. v. Clark*, 2014 OK 14, 321 P.3d 185 (2014)(Supra N. 1).

Ultimately, the Supreme Court of Oklahoma disagreed with *Tulsa Stockyards*, holding that the Oklahoma Constitution did not prohibit the legislature from placing CompSource's money and other assets in trust with a domestic mutual insurer. The court focused on a prior case where it overturned a legislative appropriation from the insurer, holding that the appropriation interfered with the contracts clause. In that case, the Oklahoma Supreme Court recognized that a vested right existed on behalf of policyholders that the money collected by the insurer was to be used exclusively for insurance. Following that logic, the Oklahoma Supreme Court determined that the conversion of the predecessor entity into a mutual insurance company did not change anything. The court found that the legislation was valid because CompSource assets were still held in trust for the benefit of employers and employees.

In the event the Montana legislature converts the State Fund into a mutual insurer, a court would potentially analyze *Tulsa Stockyards* for guidance. While some facts are similar between Oklahoma and Montana's workers' compensation systems, Montana does not have any court precedent establishing that State Fund policyholders have a vested right in the assets or surplus of the company. This was a major consideration for the Oklahoma Supreme Court in *Tulsa Stockyards*. Since it would be a case of first impression, it is unclear how a Montana court would rule.

Utah

In *Workers' Comp. Fund v. State*, the Utah Workers' Compensation Fund (WCF) filed a court action seeking a declaration that the state had no ownership interest in the WCF.¹³ The WCF was a nonprofit, self-supporting, quasi-public corporation to provide workers' compensation insurance. The WCF was charged with maintaining the fund that consisted of premiums reserves, investment income, and any other funds administered by the entity. Furthermore, state of Utah was statutorily not liable for the expenses, liabilities, or debts of the WCF and not allowed to use any assets for the fund for any purpose. In response to the lawsuit, the state of Utah disagreed with the WCF and argued that it exercised all the incidents of ownership over the WCF.

Ultimately, the Utah Supreme Court found that the state had no ownership interest in the assets of the WCF. The court analyzed the legislative history of the WCF, noting that since the state created the entity in 1917, Utah had gradually relinquished control of the entity. Based on the evolving statutory language, the court ruled that Utah had transferred its ownership rights to the WCF. The result was that Utah was not the owner of WCF assets.

Workers' Comp. Fund v. State would likely be viewed by a Montana court as having several similarities in the event of a sale, dissolution, or privatization of the State Fund. Similar to Utah, Montana has established the State Fund as a nonprofit, public corporation. Including legislation from 2015, Montana has gradually made the State Fund more independent.¹⁴ Thus, a court may use similar rationale when determining the ownership of State Fund assets in the event of a sale, privatization, or dissolution of the State Fund.

¹³ *Workers' Comp. Fund v. State of Utah*, 2005 UT 52, 125 P.3d 852 (2005)(Supra N. 1).

¹⁴ See SB 123, Ch. 320 L. 2015.

3. *State Fund in the Montana Constitution*

Article VIII, section 13, of the Montana Constitution provides for the investment of State Fund assets. This was a constitutional referendum in 1999 that inserted the State Fund into the provision relating to investment of state public and retirement funds:

Section 13. Investment of public funds and public retirement system and state compensation insurance fund assets.[...] (4) Investment of state compensation insurance fund assets shall be managed in a fiduciary capacity in the same manner that a prudent expert acting in a fiduciary capacity and familiar with the circumstances would use in the conduct of a private insurance organization. State compensation insurance fund assets may be invested in private corporate capital stock. However, the stock investments shall not exceed 25 percent of the book value of the state compensation insurance fund's total invested assets.

This provision was enacted by Constitutional Amendment No. 34, proposed by Chapter 516, Laws of 1999, and was approved at the general election held November 7, 2000. Although the primary focus of the discussion on this provision concerned investment in private corporate capital stock, the provision explicitly imposes a fiduciary duty and directs the Montana Board of Investments to invest Montana State Fund assets in the same manner that a prudent expert would use in investing the assets of a private insurance organization. The provision is silent on the sale, privatization, or dissolution of the State Fund.

In the event of a sale, privatization, or dissolution of the State Fund, any proposed legislation should consider that the State Fund is specifically mentioned in the Montana Constitution. While the provision presupposes that there is a valid State Fund, it is unclear whether a Montana court would view the provision serves as a protection against the dissolution of the State Fund. Again, there are no applicable Montana cases at issue.

Conclusion

There is no controlling Montana or federal case that would apply should the Legislature sell, privatize, or dissolve the State Fund. However, as the cases indicate, a court would likely look at statutes declaring rights and duties of various parties. Michigan upheld its sale of its workers' compensation insurer because there was no clear statutory expression prohibiting it. Oklahoma upheld the mutualization of its insurer because policyholders funds remained in trust with the successor insurer. Utah confirmed that the state had no interest in the assets of its insurer because it had gradually made the entity more independent. While various constitutional challenges may present themselves with any course of action, it is unclear how a Montana court would rule.