

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE MINNESOTA DEPARTMENT OF COMMERCE

In the Matter of the
Certificate of Authority
to Self-Insure Worker's
Compensation Liabilities
of HealthEast.

FINDINGS OF FACT.
CONCLUSIONS AND
RECOMMENDATION

The above-captioned matter came on for hearing before Administrative Law Judge Jon L. Lunde, commencing at 9:30 a.m. on Monday, October 22, 1990 at the Offices of the Minnesota Department of Commerce, in St. Paul, Minnesota. The hearing was held pursuant to a Notice of and Order for Hearing and an Order Revoking Certificate to Self-Insure and Notice of Right to Hearing which were filed on September 27, 1990 and an Amended Order Revoking Certificate to Self-Insure and Notice of Right to Hearing filed on October 3, 1990.

Gregory P. Huwe, Assistant Attorney General, 1100 Bremer Tower, Seventh Place and Minnesota Street, St. Paul, Minnesota 55101, appeared on behalf of the Minnesota Department of Commerce (Department). Paulette Kane Flynn, of Felhaber, Larson, Fenlon and Vogt, P.A., Attorneys at Law, 900 Meritor Tower, 444 Cedar Street, St. Paul, Minnesota 55101, appeared on behalf of HealthEast.

The hearing was completed on October 23, 1990. The record closed on November 13, 1990, when the last authorized brief was filed.

Notice is hereby given pursuant to Minn. Stat. 14.61 that the final decision of the Commissioner of the Minnesota Department of Commerce shall not be made until this Report has been made available to the parties to the proceeding for at least ten days, and an opportunity has been afforded to each party adversely affected to file exceptions and present argument to the Commissioner. Exceptions to this Report, if any, shall be filed with the Thomas H. Borman, Commissioner, Minnesota Department of Commerce, 133 East Seventh Street, St. Paul, Minnesota 55101.

STATEMENT OF ISSUE

The issue in this case is whether or not HealthEast's authority to self-insure its workers' compensation liabilities should be revoked due to its general financial condition and declining net worth.

Based upon all of the proceedings herein, the Administrative Law Judge makes the following:

FINDINGS OF FACT

1. HealthEast is a Minnesota nonprofit corporation which was incorporated in April 1986. It was formed pursuant to an affiliation agreement between Health Resources, Inc. (HRI), Baptist Hospital Fund, Inc. (BHF), and Bethesda Lutheran Medical Center (BLMC). In 1987, St. Joseph's Hospital joined the affiliation.

2. Under the affiliation agreement each affiliate is controlled by HealthEast. As the parent corporation, HealthEast provides overall direction and leadership to the affiliates who, through sponsoring organizations, are the voting members of HealthEast and provide candidates from which HealthEast's Board of Directors is selected. Dept. Ex. 2, 6.

3. HRI, BHF, and BLMC were all losing money or projecting losses prior to their affiliation. The goal of affiliation was to eliminate excess facilities and services in the St. Paul area and make their combined operations profitable.

4. Among other things, HealthEast operates hospitals, nursing homes and a medical transportation service. It employs approximately 4,800 persons in the St. Paul area where it has approximately 50 percent of the market.

5. Soon after HealthEast was formed it applied for self-insurance authority from the Commissioner of Commerce (Commissioner) in order to reduce its costs. At the time of its application, HealthEast controlled five hospitals in the St. Paul area: St. John's Eastside Hospital, St. John's Northeast Community Hospital, Midway Hospital, and Mounds Park Hospital. HealthEast's other health care services were provided by legal entities that it directly or indirectly controlled. Dept. Ex. 1, 1.

6. In support of its application for authorization to self-insure its workers' compensation liabilities, HealthEast filed combined financial statements for BHF, BLMC and HRI for the fiscal year ending August 31, 1986. At the end of the fiscal year, HealthEast's net worth was nearly \$57 million, exceeding statutory requirements then in effect by a wide margin. Its assets and liabilities at the end of the fiscal year were as follows:

Assets	\$184,780,745
Liabilities	\$127,865,120
Net Worth	\$ 56,915,625
Current Assets	\$ 30,680,321
Current Liabilities	\$ 25,702,670
Working Capital	\$ 4,977,651
Current Ratio	1.19 to 1
Long-Term Debt	\$101,761,912
Long-Term Debt to Equity Ratio	178%

At the end of the 1986 fiscal year, HealthEast's expenses exceeded its revenue by \$3,661,116. The deficit was primarily attributable to interest expenses HRI

incurred in connection with the construction of St. John's Northeast Community Hospital.

7. Based on a review of HealthEast's 1986 financial statements and operating efficiencies HealthEast projected to cure its revenue deficit, a Departmental financial examiner concluded that HealthEast met the financial standards for workers' compensation self-insurance authority. On May 1, 1987, the Commissioner authorized HealthEast to self-insure under Minn. Stat. Ch. 79A and Minn. Rule pt. 2870.1100 (1986).

8. In order to gain administrative and operative flexibility, implement efficiencies and obtain operating cash, HealthEast restructured all of the affiliates' debts in November 1987. Restructuring involved the issuance of approximately \$140,000,000 in tax-exempt revenue bonds by the St. Paul Housing and Redevelopment Authority -- Hospital Facility Revenue Bonds (HealthEast project), Series 1987. The Bonds are subject to a Master Trust Indenture and Supplemental Trust Indenture No. 1 (Indenture) dated November 1, 1987 between HealthEast and Marquette National Bank of Minneapolis (Trustee).

9. Among other things, the Indenture contains a debt service coverage provision requiring HealthEast to have annual net income slightly larger than its debt service obligations under the Bonds -- approximately \$19 million. The failure to earn sufficient annual income under the debt service coverage provision constitutes a default and authorizes the Trustee or a specified percentage of the bondholders to call (accelerate) HealthEast's payments under the Bonds. Dept. Ex. 3, 11-12.

10. For the fiscal year ending August 31, 1987, HealthEast experienced an operating loss of approximately \$11 million and net loss of approximately \$18 million. However, its net worth increased by nearly \$3 million to \$60,016,000.

11. For the fiscal year ending August 31, 1988, HealthEast had an operating loss of \$18,023,000 and a net loss of \$35,017,000. Its net worth decreased from \$60,016,000 to \$22,693,000. Dept. Ex. 5, 1. Also, HealthEast's earnings for purposes of the debt service coverage provision in the Indenture, measured by net income, was only 76 percent of the required debt service amount. The net income shortfall placed HealthEast in default under the Indenture and authorized the Trustee or the bondholders to accelerate HealthEast's indebtedness. The nonoperating losses HealthEast incurred during the 1988 fiscal year included a one-time refinancing loss of approximately \$9 million and extraordinary relocation losses of approximately \$7 million.

12. In the audited financial statement and report covering the fiscal year ending August 31, 1988, HealthEast's auditors (Deloitte, Haskins & Sells)

concluded that HealthEast's default required that its Bond indebtedness be reclassified as a current liability. The auditors also concluded that HealthEast's ability to continue as a "going concern" would be in substantial doubt if the Trustee or the bondholders accelerated HealthEast's debt. Dept. Ex. 3, p. 2.

13. In the spring of 1989, after the Department received HealthEast's financial statements for the 1988 fiscal year, Departmental staff contacted HealthEast for additional information. The staff requested information

concerning HealthEast's default, its 1989 operating budget, and an actuarial study of its projected workers' compensation liabilities. Also, due to concerns about the adequacy of HealthEast's security fund deposits under Minn.

Stat. 79A.04, the Department froze interest income on HealthEast's security fund under the statute.

14. On November 3, 1989, a Consent Order was issued which required HealthEast to increase its security fund deposit and to file its 1989 financial statements on or before December 31, 1989. Ex. E. No action affecting HealthEast's authority to self-insure was taken and on January 13, 1989, that authorization was renewed. Ex. A.

15. For the fiscal year ending August 31, 1989, HealthEast's losses continued. It had an operating loss of \$17,966,000 and a net loss of \$21,059,000. Its net worth continued to decline, falling from nearly \$23 million to less than \$2 million (\$1,367,000). Dept. Ex. 5, 1. HealthEast also remained in default under the Indenture due to its failure to meet the minimum income levels contained in the debt service coverage provision. HealthEast's net income was only 61 percent of the minimum required under the Indenture and the Trustee and the bondholders were authorized to accelerate its obligations under the Bonds. As a result of HealthEast's continuing default under the Indenture, its auditors concluded that its ability to continue as a going concern was substantially in doubt. Dept. Ex. 4, 1-2.

16. Due to the losses HealthEast incurred in the 1989 fiscal year, a consultant was hired pursuant to the Indenture to help it improve earnings. Between February and December 1989 recommendations made by the consultant were implemented. To effectuate a turnaround, management structure was streamlined, new management reporting mechanisms were adopted and operating losses were reduced. Also, steps were taken to collect accounts receivable faster and new, more lucrative provider agreements were negotiated.

17. On March 1, 1990, Frederick J. Putzier, HealthEast's vice president and general counsel, wrote to the Commissioner. In his letter, Putzier alluded to HealthEast's recurrent losses, its diminished net worth and the \$6 million loss HealthEast budgeted for 1990. However, Putzier stated that HealthEast expected to cure the default under the Indenture and was ahead of budget in March. He requested a meeting with the Commissioner to alleviate any concerns the Commissioner might have regarding HealthEast's ability to pay workers' compensation claims. Ex. F.

18. On March 30, the Department demanded that HealthEast provide the Department with its current operating budget, monthly cash flow balance statements, and quarterly financial statements (unaudited). Also, Department staff inquired of HealthEast's willingness to obtain "aggregate excess" insurance to cover a portion of its expected worker's compensation losses. Ex.

G.

I/ Generally speaking, aggregate excess insurance covers all annual workers' compensation payments made in excess of a specified sum for occurrences (accidents) occurring during a specified time period.

19. On June 20, 1990 a meeting between representatives of HealthEast and the Department was held to discuss HealthEast's financial condition. The discussion related to the intangible assets included in HealthEast's net worth, HealthEast's cash flow, and recent improvements in earnings. Departmental representatives restated their desire for HealthEast to obtain aggregate excess insurance. HealthEast initially hesitated to do so because of the additional costs involved. It did, however, offer to make a cash deposit of \$3 million to its security fund. Departmental staff members took the position that aggregate excess insurance was statutorily required and that a cash deposit was not an acceptable surrogate.

20. Excess worker's compensation insurance for HealthEast would cost approximately \$2.6 million annually. Ex. HH. That is about \$670,000 more than the projected cost of self-insurance. HealthEast is financially able to obtain excess insurance without jeopardizing its financial condition.

21. On June 25, 1990, HealthEast was advised by the Commissioner that it must purchase aggregate excess insurance with a coverage limit of no less than \$3,500,000 in order to remain self-insured. Also, HealthEast was advised that it must obtain an actuarial opinion regarding its projected workers' compensation liabilities as of June 30, 1990. Ex. I. On June 28, 1990 HealthEast notified the Commissioner that it would obtain the excess insurance demanded in the June 25 letter. Ex. J.

22. On July 10, 1990 the Commissioner notified HealthEast that it must file the actuarial opinion estimating its future worker's compensation liabilities by July 23, 1990 and obtain excess insurance coverage effective July 16, 1990. Ex. K. On July 13, 1990 HealthEast notified the Department by letter that aggregate excess insurance would be obtained as of July 16, 1990. In that letter HealthEast noted that it was in full compliance with the debt service coverage provision in the Indenture for the 9-month period ending May 31, 1990, and that its net worth was in excess of \$2 million. HealthEast also notified the Department that it expected to cure its default under the Indenture by August 31, 1990 and that its auditors would then remove their "going concern" reservation on its 1990 financial statements. Under the circumstances, HealthEast stated that the book value of its goodwill should be recognized in determining its net worth. Ex. L.

23. Northstar Risk Services, Inc. subsequently certified to the Commissioner that it had received a check for \$2.7 million from HealthEast as a deposit premium for the aggregate excess insurance coverage required by the Department. When HealthEast presented the insurance policies to the

Department, it was requested to provide an attorney's opinion that the reinsurance contracts met statutory requirements. In August 1990 two attorneys' opinions were presented to the Department. The attorneys concluded, among other things, that the reinsurance contracts constituted excess insurance for purposes of section 79A.03, subd. 4 and a reinsurance program for purposes of section 79A.03, subd. 3.

24. On August 21, 1990 the Department requested changes in the reinsurance contracts between HealthEast and the aggregate excess insurer (Signet Reinsurance Company). Ex. P. On August 21 HealthEast's attorney issued an opinion that language changes requested by the Department were redundant and unnecessary. Ex. Q.

25. on August 23, 1990 HealthEast's financial statements through July 1990 showed net income of approximately \$2.5 million and net worth of nearly \$4 million. Ex. R.

26. On September 5, 1990, HealthEast's representatives met with the Commissioner to discuss the revocation of its authority to self-insure. At that meeting, HealthEast's net worth, its improving financial condition, and the expected audit opinion removing the going concern reservation contained in prior financial statements were discussed. On September 6, 1990 HealthEast again offered to deposit additional security for its workers' compensation liabilities. Ex. T.

27. During the summer of 1990 the Self-Insurers' Advisory Committee (Committee)^{2/} reviewed HealthEast's financial condition to determine if it was qualified to self-insure. At a formal meeting on August 29 the Committee concluded that HealthEast was not qualified to self-insure and that its authorization to do so should be revoked. Dept. Ex. 8. On September 7, Steve Letak, Committee Chair, advised the Commissioner that even if HealthEast's default were cured and its net worth exceeded statutory minimums, the Committee's view was that HealthEast's negative tangible net worth, high debt levels and prior losses jeopardized self-insurer funds and that HealthEast should not be permitted to self-insure until it has several years of significant earnings. id. The Committee did not consider the extent to which its concerns could be addressed by HealthEast's acquisition of aggregate excess insurance or the amount of insurance needed for HealthEast to remain a self-insurer.

28. On September 12, 1990 the Commissioner notified HealthEast that its proposal to increase its security deposits was not a satisfactory substitute for an acceptable financial condition and that the Commissioner did not believe that HealthEast was qualified to self-insure. The Commissioner also expressed concern with HealthEast's large operating losses in 1988 and 1989, its large debt to net worth ratio and its negative tangible net worth. The Commissioner asked HealthEast to notify the Department by September 19 if it would voluntarily withdraw as a self-insurer. Ex. U. HealthEast subsequently notified the Commissioner that it would not voluntarily withdraw from the self-insurance program.

29. On September 21, 1990 the Commissioner issued an order revoking HealthEast's authorization to self-insure. Revocation was made effective October 1, 1990. Pursuant to a subsequent stipulation between HealthEast and the Department, an amended revocation order was issued on September 27, 1990. Under the amended order revocation of HealthEast's authorization to self-insure was effective October 7, 1990.

30. Beginning in the fiscal year ending August 31, 1987, HealthEast's financial condition began to deteriorate and during the 1988 and 1989 fiscal

2/ The Committee was formed pursuant to Minn. Stat. 79A.02 to advise the Commissioner with respect to whether or not an applicant to become a private self-insurer meets statutory requirements.

years its financial condition worsened significantly due to operating losses which reduced its net worth below statutory minimums.

31. HealthEast's financial condition beginning with the fiscal year ending August 31, 1987 is reflected in the following:

"(\$000 Omitted) 31-90	8-31-87	8-31-88	8-31-89	7-
Assets	207,853	257,161	230,963	
233,859				
Goodwill	1,450	8,599	7,649	
9,562				
New Worth	60,016	22,693	1,367	
3,848				
Net Worth/Assets	28.9%	8.8%		
0.6%	1.6%			
Long-Term Debt	113,644	49,166	44,440	
43,006				
L-T Debt/Equity	189.4%	216.7%	3250.9%	
1117.6%				
Short Term Debt	7,090	147,129	143,959	
143,394				
S-T Debt/Equity	11.8%	648.3%	10531.0%	
3726.5%				
Total Debt/Equity	201.2%	865.0%	13781.9%	
4844.1%				
Fixed Charge Coverage	-91.2%	-144.7%	-28.9%	
116.5%				
Cash Flow Debt Service	-5.6%	-11.2%	-	
3.2%	2.0%			
Long Term Liab.	115,460	50,212	45,206	
43,396				
L-T Liab./Equity	192.4%	221.3%	3306.9%	
1127.8%				
Short Term Liab.	32,377	184,256	184,390	
186,615				
S-T Liab./Equity	53.9%	812.0%	13488.7%	
4849.7%				
Gross Receipts	220,295	261,527	309,378	
331,751				
Operating Income	(11,041)	(18,023)	(17,966)	
1,804				
Net Income	(17,510)	(35,017)	(21,059)	
2,438				
Cash & Equiv.	0	1,271	0	
25,753				

Current Assets	16,824	46,165	49,114
63,737			
Current Ratio	52.0%	25.1%	26.6%
34.2%			

Department Ex. 5.

32. For the fiscal year ending August 31, 1990 HealthEast became profitable for the first time. Beginning in January it made a profit each month. Its assets at the end of the year consisted of \$32 million in cash, up from \$5.5 million in December 1989. This is a sufficient amount of cash to cover HealthEast's expenses for 53 days. The \$32 million figure does not include more than \$20 million HealthEast has in a debt service reserve fund required by the Indenture to cover one year's interest and principal payable under the bonds.

33. HealthEast's ratios of long-term and short-term debt to equity are very high -- from 30 to 100 times higher than normal. Multiples in excess of one or two are highly unusual. The ratio of short-term liabilities to assets

should be 1:1. That is, within a one-year period, a business must have the assets needed to meet its short-term liabilities. If it doesn't have enough assets, the business must rely on its net worth to meet those short-term liabilities.

34. Goodwill is an intangible asset that is realized in operations. Over time, it decreases net worth. HealthEast's good will at the end of the 1990 fiscal year exceeded \$11.8 million. For the most part, HealthEast's good will arose from the acquisition of two St. Paul hospitals and represents the difference between the amount paid for the hospitals and their book value (\$6.9 million). Another \$5 million consists of deferred financing costs.

35. Goodwill is generally considered in computing a company's net worth. In determining the net worth of a company in liquidation, however, good will is not considered in calculating that worth because it has no ready market value. When a company like HealthEast is a going concern, it is appropriate to assume that all its assets will be realized.

36. The words "negative tangible net worth" are not words of art having a fixed meaning under generally accepted accounting principles. They mean that a company's tangible assets are less than its liabilities.

37. Neither HealthEast's Trustee nor its bondholders accelerated its indebtedness under the Indenture when it was in default during the 1988 and 1989 fiscal years. HealthEast is no longer in default of the debt service coverage provision in the Indenture and questions concerning its ability to continue as a "going concern" will not appear in the auditor's opinion accompanying its financial statements for the fiscal year ending August 31, 1990. Since July 1990 HealthEast's earnings have been 61% greater than required by the debt service coverage provision in the Indenture.

38. HealthEast has never defaulted in the payment of any debts or workers' compensation claims. In fact, there have never been any delays in HealthEast's timely payment of workers' compensation claims. Ex. S.

39. The health care market in Minnesota is volatile in the sense that operating income can fluctuate quickly leading to operating losses. Profits usually move in a relatively narrow range, but wide variations can occur from year to year. HealthEast will be unable to sustain losses like those incurred in the 1988 and 1989 fiscal years until it has two or three years of profitable operations.

40. HealthEast's long-term debt, which is exceptional, arose from the allocation of the debt of eight hospitals to the five that HealthEast continues to operate.

41. HealthEast's budgeted workers' compensation costs, exclusive of investment income on money reserved to pay claims, were \$2.1 million in 1989 and \$1.8 million in 1990. For the 1991 fiscal year its budgeted costs are \$2.3 million. Investment income on funds reserved to pay workers' compensation claims amounts approximately \$500,000 annually. This income reduces actual workers' compensation costs. Self-insurers, like HealthEast, are protected from catastrophic losses by the Workers' Compensation Reinsurance Association (Association). The Association pays all costs of any accident in excess of

\$200,000 for which an employer is liable. Self-insurers can further reduce their exposure to liability by obtaining reinsurance coverage.

42. One-third of HealthEast's annual modified premium amounts to \$1,058,064 for purposes of section 79A.03, subd. 3. HealthEast's retention limit for purposes of that statute is \$200,000 annually.

43. HealthEast is not insolvent. For the fiscal year ending August 31, 1990 it had a net operating profit of \$2.6 million and net income of \$3.2 million. Its net worth at fiscal year end was \$4.6 million being \$3.3 million more than it was at the end of the 1989 fiscal year. HealthEast's cash and net worth increased every month in 1990.

44. The current ratio is the current assets of a company divided by its current liabilities. The current ratio reflects a company's ability to satisfy current liabilities without liquidating any long-term assets. In 1989 HealthEast's current ratio was .27; that is, 27 cents of assets for every dollar of liabilities. In 1990 HealthEast's current ratio was 1.45. A current ratio of 1.5 to 2.0 is the usual goal of business enterprises, but a current ratio of 1.45 is acceptable.

45. HealthEast's ratio of long-term debt to equity at the end of the 1989 fiscal year was 40:1. That is a very high degree of leverage and makes it difficult for HealthEast to deal with market swings resulting in operating losses. HealthEast needs a substantial amount of net worth to absorb and cushion any operating losses it may incur. If it does not have a sufficient level of operating income, its debt costs fall on net worth.

46. For the 1990 fiscal year HealthEast met all of the performance goals set by its consultants. Ex. CC. The consultants recommended that HealthEast accumulate \$10 million cash on hand, earn net income of 1 to 2 percent of net revenue, cure its default under the Indenture and have \$5 million for capital expenditures.

47. Hospital rating organizations evaluate the quality of hospital bonds using a variety of business indicators. The principle indicators (ratios) considered are the hospital's operating margin, excess margin, debt service coverage ratio and cushion ratio. For the 1990 fiscal year, HealthEast's ratios in all four categories improved.

48. HealthEast's long-term and short-term debt to equity ratios, its negative tangible net worth, the large operating losses it experienced in the 1988-89 fiscal years and the financial characteristics of the health care market pose a risk to other self-insurers in the state and create a risk to the full and timely payment of workers' compensation benefits to its employees.

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

CQNCCLUSIONS

1. The Commissioner and the Administrative Law Judge have authority to consider the issues noticed and to take the action proposed under Minn. Stat.

79A.05 and 14.50 (1989).

2. The Department provided timely and proper notice of the hearing to HealthEast and has complied with all other substantive and procedural requirements of statute and rule.

3. Under Minn. Stat. 79A.05, the Commissioner has authority to revoke a certificate to self-insure workers' compensation liabilities for good cause.

4. Under Minn. Stat. 79A.05 and Minn. Rule pt. 1400.7600, subp. 5, the Department has the burden of proof to establish good cause for revocation which burden the Department assumed in this proceeding.

5. In establishing good cause for revocation the Department is not required to show that HealthEast will experience financial difficulties in the immediate future; it need only establish that HealthEast's financial condition places other self-insurers at risk and that the prompt and full payment of workers' compensation liabilities is jeopardized.

6. HealthEast meets the minimal net worth requirements contained in Minn. Stat. 79A.03, subd. 3 (1989).

7. HealthEast does not have sufficient assets, net worth, and liquidity to promptly and completely meet all of its workers' compensation obligations due to the large operating losses it has experienced in recent years, the intangible assets included in its net worth, its unusually high long-term and short-term debt to equity ratios, and the volatility of the hospital marketplace.

8. The dramatic improvement in HealthEast's financial condition between the 1989 and 1990 fiscal years does not establish a reliable trend establishing with a reasonable degree of certainty that it can meet its workers' compensation liabilities in 1991.

9. HealthEast's net worth is not adequate to cushion large operating losses and such losses are likely in the future due to its recent experience thereby creating unacceptable risks to disabled employees and other self-insurers.

10. The aggregate excess insurance HealthEast agreed to purchase to reduce the risk of permitting it to remain a self-insurer is not sufficient to establish that it will be able to promptly and completely meet all of its workers' compensation obligations under state law.

11. The Department has established good cause for the revocation of HealthEast's authorization to act as a self-insurer of its workers' compensation liabilities.

Based upon the foregoing Conclusions, the Administrative Law Judge makes

the following:

RECOMMENDATION

IT IS HEREBY RECOMMENDED: That the Commissioner revoke HealthEast's authorization to self-insure its workers' compensation liabilities under Minn.

Stat. Chapter 79A.01.

Dated this day of January, 1991.

JON L. LUNDE
Administrative Law Judge

NOTICE

Pursuant to Minn. Stat. 14.62, subd. 1, the agency is required to serve its final decision upon each party and the Administrative Law Judge by first class mail.

Reported: Taped.

MEMORANDUM

Under Minn. Stat. 79A.05 the Commissioner is statutorily authorized to revoke a certificate to self-insure workers' compensation liabilities for good cause. The statute states, in part, as follows:

A certificate to self-insure may be revoked by the commissioner at any time for good cause. After revocation, the self-insurer may request a hearing. Good cause includes, among other things, failure to maintain a security deposit as required by this chapter, failure to pay assessments of the self-insurers' security fund, or the failure or inability of the employer to fulfill obligations under chapter 176 or this chapter. Good cause also includes failure to provide proof of renewal of the security 15 days before its expiration.

Rules promulgated by the Department clarify the "good cause" standard in the statute. Minn. Rules pt. 2780.0600 provides, in part:

The following shall constitute grounds for revocation of the authority to self-insure:

D. a deterioration of financial condition adversely affecting the self-insurer's ability to pay expected losses, including a worsening of the current ratio, a lessening of net worth, a net loss of income, or the failure of the self-insurer to meet the net worth

standards of part 2789.1200, subpart 1, or 2780.2200.

The net worth standard of part 2780.1200, subp. I reiterates the requirements in section 79A.03, subd. 3. The standard in part 2780.2200 applies only to group self-insurers and is inapplicable here.

Part 2780.1200, subp. 2 reflects the basic requirements of 79A.03, subd. 4 that self-insurers maintain sufficient assets, net worth and liquidity to promptly and completely meet their workers' compensation obligations. In determining if a self-insurer's assets, net worth and liquidity are sufficient, the Commissioner must consider:

whether the self-insurer's current ratio; its long-term and short-term debt to equity ratios; its net worth; financial characteristics of the particular industry in which the self-insurer is involved; any recent changes in the management and ownership of the company; any excess insurance purchased by the self-insurer from a licensed company or an authorized surplus line carrier, other than excess insurance from the workers' compensation reinsurance association; any other financial data submitted to the commissioner by the company; and the company's workers' compensation experience for the last four years.

Minn. Stat. 79A.03, subd. 4.

Minimum Net Worth-StandArd

The basic net worth requirements applicable to self-insurers are contained in Minn. Stat. 79A.03, subd. 3. That statute requires self-insurers to have and maintain a net worth of ten times the retention limit selected with the Workers' Compensation Reinsurance Association or one-third the amount of the self-insurer's current annual modified premium, whichever is greater. In this case, the minimum net worth HealthEast is required to maintain under the statute is \$2 million which is ten times the retention limit (\$200,000) selected with the Workers' Compensation Reinsurance Association. HealthEast's net worth, considering all its assets is in excess of \$2 million at this time. If its goodwill and other intangible assets are not considered in the computation of its net worth, however, HealthEast does not meet the statutory net worth requirement.

The minimum net worth standards all self-insurers to meet pursuant to Minn. Stat. 79A.03, subd. 3 are threshold standards. Under the statute, HealthEast must have a net worth of \$2 million. The Commissioner is required

to modify this requirement if HealthEast can demonstrate, through a reinsurance program, that it can pay expected losses without endangering its financial stability. The record shows that HealthEast is now in compliance with the requirements of subd. 3. At the end of its 1989 fiscal year HealthEast's net worth was below \$2 million. However, by July 31, 1990 its net worth was in

excess of minimal requirements. Although HealthEast has a "negative tangible net worth" its intangibles are valuable assets that must be considered in determining its net worth under generally accepted accounting principles. Because HealthEast is not insolvent or in a liquidation status they must be considered in determining HealthEast's compliance with the provisions of subdivision 3.

Asset, Net-Worth, and Liquidity

Under Minn. Stat. 79A.03, subd. 4 self-insurers must have and maintain sufficient assets, net worth, and liquidity to promptly and completely meet all their workers' compensation obligations. In determining if a self-insurer meets this requirement, the Commissioner must consider, among other things, the amount of the self-insurers long-term and short-term debt to equity ratios, its net worth, financial characteristics of the particular industry in which the self-insurer operates, and other financial data. The clear purpose of subdivision 4 is twofold: To protect the interests of disabled workers in statutory benefits, and to protect the interests of self-insurers who have a contingent liability for any benefits an insolvent self-insurer fails to pay. *S & S Industries, Inc. v. Director of Bureau of Workers' Disability Compensation*, 317 N.W.2d 625, 627-628 (Mich. App. 1982). The first purpose is plainly stated in the statute. The second arises by reasonable implication from concepts of fairness and the creation of the self-insurer's advisory committee. In order to protect the interests of disabled employees and the interests of other self-insurers, it is necessary for the Commissioner to scrutinize the financial condition of self-insurers to ensure that they have the ability to pay workers' compensation benefits. In making that determination, it is necessary for the Commissioner to evaluate the risks authorizing an employer to self-insure create. When a self-insurer's financial condition creates a significant risk the employer should not be given the privilege to self-insure its obligations.

In this case, reasonable cause exists for revocation of HealthEast's authorization to self-insure because its financial condition creates an unacceptable risk to disabled employees and other self-insurers. The Department showed that HealthEast experienced extremely large losses in 1988 and 1989 causing precipitous declines in its net worth. It is not in a financial position to absorb similar losses in the future because its net worth is at such a low level compared to the extraordinary amount of its long-term and short-term debt. If HealthEast sustains additional losses, even in smaller amounts than it sustained in 1988 and 1989, its ability to pay workers' compensation benefits would be impaired because HealthEast's minimal net worth is an insufficient cushion to absorb further operating losses. The risk that such losses will occur in the future is exacerbated by the volatility in the health care market in which HealthEast operates and the lack of any evidence that the operating losses previously experienced will not recur. The risk is compounded further by the amount of intangible assets included in the calculation of its net worth. Although their intangible nature is not

considered for purposes of determining HealthEast's compliance with the provisions of section 79A.03, subd. 3, it is appropriate to consider the extent of the intangible assets under subdivision 4.

In 1987, 1988 and 1989, HealthEast's financial condition steadily deteriorated. The deterioration is evinced by a worsening current ratio, a

precipitous decline in its net worth, and extremely large operating losses. Although the three-year deterioration HealthEast experienced was broken in 1990, it is appropriate to consider its experience over the last several years in evaluating its financial condition and the risks created by permitting it to remain self-insured. The Commissioner is not estopped from revoking HealthEast's self-insurance authorization because the Department did not seek revocation when its net worth fell below minimal standards in 1989 and is not required to base a decision on HealthEast's 1990 financial statements.

There is no doubt that there was a dramatic improvement in HealthEast's operating income between the 1989 and 1990 fiscal years. In addition, there is testimony that HealthEast's general financial condition improved during the 1990 fiscal year and testimony that its performance in 1990 is a reliable indicator of its performance in the future. None of the evidence or testimony presented on that issue is persuasive, however.

The operating losses that HealthEast experienced in the 1988 and 1989 fiscal years were not shown to have resulted from HealthEast's formation. Moreover, the improvements in HealthEast's operating income and overall financial condition in 1990 were not shown to be reliable indicators of its future performance and financial health. HealthEast's performance in 1990 is a positive sign but its losses the prior two years coupled with its low net worth and high debt levels place the interest of disabled employees and other self-insurers at risk. The risk is significant and not illusory. The existence of that risk makes it inappropriate to permit HealthEast to continue as a self-insurer. Self-insurer status should only be granted to employers in sound financial condition. The operating losses HealthEast has experienced raises serious doubts about its ability to meet its workers' compensation obligations and the risk should not be passed on to injured workers or other self-insurers to enable HealthEast to save money on insurance premiums.

If HealthEast experiences operating losses in 1991 its net worth "cushion" is insufficient to properly and completely meet its workers' compensation obligations in spite of the relatively large amount of cash it has on hand and the aggregate excess insurance it is willing to purchase. Consequently, in spite of the improvement in HealthEast's financial condition in the 1990 fiscal year, the Administrative Law Judge is persuaded that its authorization to continue as a self-insurer should be revoked. When a self-insurer has fluctuations in operating income of nearly \$20 million from one year to the next, has had operating losses of nearly \$18 million in two of its prior three fiscal years, does not have a net worth cushion which would enable it to sustain future operating losses of any magnitude, and has no sound evidence that those operating losses will not recur, its authorization to self-insure must be revoked in order to protect the interests of disabled workers and other

self-insurers.

J.L.L.

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