12-1999

A Study of issues related to privatization of workers' compensation in Nevada

Kathryn A. Mack
University of Nevada, Las Vegas

A STUDY OF ISSUES RELATED TO PRIVATIZATION

OF WORKERS' COMPENSATION IN

NEVADA

by
Kathryn A. Mack, B.S.

A professional paper submitted in partial fulfillment
of the requirements for the degree of

Master
In
Public Administration

Department of Public Administration
University of Nevada, Las Vegas
December, 1999

ABSTRACT

A Study of Issues Related to Privatization of Workers' Compensation in Nevada

by
Kathryn A. Mack

Dr. Leonard Goodall, Committee Chairman
Professor of Public Administration
University of Nevada, Las Vegas

The key purpose of this study is to examine and evaluate current legislative initiatives for reform of workers' compensation in Nevada. The examination will focus on issues relating to open competitive markets, market pricing, privatization of a state fund, and cost controls that have affected workers' compensation in the state.

The methods used in this paper include an in-depth examination of legislative statutes that have been enacted to control spending. Also, included is a review of literature that relates to privatization of state funds, and issues that are inherent in the transition from a state agency to private enterprise.

Key findings of this study indicate that workers' compensation is an issue that most states are addressing in their respective legislatures. Use of managed care, changes in claims processing, fraud detection, and reductions in benefits are some of the methods being used to control spending. For Nevada, $2.2 billion in unfunded liability prompted immediate legislative action. Consequently, the once monopolistic workers' compensation program was opened to competition in July, 1999. Ultimately, the state fund will become a private enterprise on January 1, 2000.

Privatization of workers' compensation in Nevada is important because it sets a precedent for future privatization of other state agencies. Many factors are considered in this type of transition, including employee resistance, acceptance by the unions, withdraw from the state personnel act, and change of culture from a state monopolistic agency to a customer service oriented business. Finally, a strong financial base is necessary to compete in the private sector. While appropriate steps have been taken to address the issues, there are many variables that will come into play as the transition progresses. Apparently, the company is on its way to success during this change. However, the researcher recommends that the issue be re-evaluated in the future to determine if subsequent issues have been resolved and if the state fund can survive in the competitive market.

TABLE OF CONTENTS

ABSTRACT	ii
ACKNOWLEDGMENTS	iv
CHAPTER 1: INTRODUCTION	5
Purpose	7
Research Questions	8
Significance of the Study	8
Definition of Terms	9
CHAPTER 2: BACKGROUND	13
History of Workers Compensation	13
Workers Compensation in Nevada	14
Review of Legislative Initiatives	17
CHAPTER 3: REVIEW OF RELATED LITERATURE	25
Workers' Compensation in Neighboring States	25
Movement from Public to Private Sector	27
Privatization: What is it?	30
CHAPTER 4: METHODOLOGY	34
CHAPTER 5: THE CASE STUDY	36
Factors that Contributed to Nevada's Problems	36
Transition from Public to Private	43
Barriers to the Transition	44
Actions toward Privatization	46
Outcomes Measures of Reform	49
CHAPTER 6: CONCLUSIONS	52
Recommendations for Further Research	55
APPENDIX 1: Workers' Compensation Comparison, 1999	57
APPENDIX 2: Nevada Workers' Compensation Time Line	58
APPENDIX 3: Interview Questions—Douglas D. Dirks	59
REFERENCES	60
VITA	64

ACKNOWLEDGMENTS

It is with sincere appreciation that I recognize several individuals for their assistance with this paper. First, I would like to thank Dr. Leonard Goodall for serving as the Chairman of my graduate committee. He has been a great help in the preparation and presentation of this professional paper. A heartfelt thanks you to Karen Grant-Head, Esquire for her assistance in writing this paper. During the course of the work, we have had many stimulating conversations about workers' compensation and the changes that are taking place in the industry. Her knowledge of the company, legislative initiatives, and inner workings of the company have helped me to get the heart of the issues. Mrs. Grant-Head was my reader, and many of her suggestions have been incorporated into this paper. Next, a special thanks to my supervisor at Employers Insurance Company of Nevada, Karen Kloepfer. She has been ultimately supportive and a positive influence throughout the writing of this paper. Ms. Kloepfer often served as my sounding board, and because of her longevity with the company was able to provide valuable insight into the progression of events that lead to privatization. Lastly, I am indebted to my family, Joseph, Edward, June, and Michael who, throughout this ordeal, have given me the encouragement to move ahead. During those times when I could not sit at the computer another hour, one of them would give me the strength to "write just one more page."

CHAPTER 1

INTRODUCTION

Workers compensation is specialized insurance purchased by employers to provide medical care, disability compensation payments, and rehabilitation services for their workers who are injured on the job. Approximately nine out of ten people in the nation's work force are protected by workers compensation insurance (Insurance Information Institute, Web site, 1999). Since 1913 the state legislature has mandated that Nevada employers provide this coverage for their employees. Consequently, Nevada legislators have examined the issue of workers compensation benefits in every legislative session since the statutes (Nevada Revised Statutes: Chapters 616 & 617) enactment.

Today, workers compensation reform is one of the "top five issues legislators love to hate," according to John B. Lennes, Jr., VP and Director of Workers Compensation for one of America's largest lobbying organizations, Alliance of American Insurers (Roberts, 1997). Introduction of reform initiatives in state legislatures often becomes an exercise in futility. Legislators are faced with the task of understanding and deciding workers compensation issues related to provision of medical care, ratings for permanent and partial disability and compensibility, as well as having to deal with special interest groups who want to influence their decisions.

Special interest groups are major stumbling blocks to getting reforms enacted. As such, many program reforms that would reduce costs and save employers and insurers money, end up as little more than watered down compromises among various interest groups (Roberts, 1997).

One of the problems in addressing the concerns of special interest groups relates to the contrasting and conflicting opinions from each group. Neither governors nor legislators look forward to workers compensation reforms because of the political division and debate that is inevitable. Legislators clearly realize that no single plan is either completely right or wrong. Even when legislators enact significant reforms, interest groups like the medical society may oppose the changes suggested by business interests (Robert, 1997). For legislators, workers compensation reform is often a lose-lose proposition.

Research indicates that the decisions and actions that legislators have taken regarding workers compensation have swung broadly over the past decade. In the late 1980s most insurers faced financial crisis. This crisis initiated statutory reforms to curb the growth in claim costs. The new laws addressed all aspects of the workers compensation system, from medical care costs, treatment plan and the return to work process, use of deductibles, and increased emphasis on fraud prevention, to the encouragement of residual markets that have increased competition with a view to controlling costs while maintaining benefits. These favorable reforms have drawn more insurers into the marketplace and the increased competition has had the beneficial effect of forcing rates down (Insurance Information Institute, Web Site, 1999).

Between 1992 and 1997, more than thirty states passed significant workers compensation legislation. Today, there are state run workers compensation insurance programs that compete with private insurers (competitive funds) in at least twenty states. Many states have authorized pilot programs implementing cost saving strategies. Five states do not permit commercial insurers to underwrite workers' compensation (Appendix 1). Only North Dakota, Ohio, Washington, West Virginia, and Wyoming continue to have a monopolist system where the state is the sole provider of workers compensation insurance (Association of State Compensation Insurance Funds, Web Site, 1999).

Studies reveal that reforms have been relatively successful (Ostermiller, 1998). Nevertheless, because of litigation and rising loss ratios, legislators are looking in other directions as the new millennium approaches. The current reform method of choice is toward open competitive markets. In an open market environment competition determines pricing. Another option under consideration is privatization of state funds. A survey from the Council of State Governments indicates that the major impetus for privatization are cost savings, flexibility and less red tape, higher quality of service, increased innovation, increased political support, and speedy implementation of claims (Chi & Jasper, 1998).

Purpose

Nevada's workers compensation system is undergoing dramatic and sweeping changes. The focus of this study is to examine and evaluate current legislative initiatives for reform, with an emphasis on issues relating to open competitive markets and market pricing, privatization of the state fund, and cost controls that have effected workers compensation. The researcher will offer perspectives on the success or failure of Nevada's reform initiatives and a vision of what Nevada's workers compensation program may look like in the new millennium.

Research Questions

In order to focus the analysis the following research questions will be addressed:

* What is privatization?
* Can a state agency compete with private industry?
* Can a state fund convert itself into a private provider of workers' compensation insurance?
* If so, what are the challenges of that conversion?

Significance of the Study

In 1995 the Nevada legislature enacted statutes that would open the workers compensation market to outside insurance companies beginning in 1999. Nevada's once monopolistic workers compensation fund became a player in the competitive market on July 1, 1999. Legislation enacted in 1999 reflects the Governor's belief that in an open market there is no need for the state to operate an insurance company and that the best opportunity for success in the competitive environment is for workers' compensation to be a private company. Thus, Senate Bill 37 (SB37), effective on July 1, 1999 converted State Industrial Insurance System (SIIS), d.b.a. Employers Insurance Company of Nevada (EICN), the former state run insurance fund, into a private mutual insurance company with the state of Nevada as its sole interest holder. In 1993, the Governor appointed a chief executive officer that reports directly to the Governor's office until the final phase of the conversion is completed. On January 1, 2000 a further metamorphosis would occur, when upon proclamation by the Governor, the public mutual insurance company would become a domestic mutual insurance company and thus no longer a state agency. The state would transfer its mutual interest to the policyholders (Nevada's employers) of the company. The policyholders would then elect the new board of directors (D. D. Dirks, memorandum, April 30, 1999).

Although tracking the progress of Employers Insurance Company of Nevada as it makes its way through the social and legal morass of converting to a private insurance company is interesting, the real significance of the present research is its analysis of potential what changes in workers compensation generally. The paper will examine the ways the movement to privatize impacts employers, workers, and taxpayers of Nevada.

Definition of Terms

Throughout the paper, the researcher discusses privatization of workers compensation, and types of state insurance funds. The current section will give a limited definition of privatization; however, the concept will be discussed more thoroughly in Chapter 3. There are also references to the types of workers compensation funds used by other states. The definitions provided in this section gives the reader a sense of the essentials necessary for understanding the nature of how a mutual insurance company may be formed.

In its broadest sense, privatization is the transfer of assets or services from the tax supported public sector to the competitive market of the private sector. Privatization has been identified as a means of improving financial performance and enhancing customer satisfaction, which are important values when providing government services. Privatization programs aim at increasing efficiency through competition, deregulation, and improvement of customer service, at strengthening the capital market and stimulating employee productivity, as well as allowing the state to reduce its liabilities (Cunha & Cooper, 1998).

Mutual insurance is that form of insurance provided by mutual companies. There is no capital stock and policyholders are the owners. An essential characteristic of a mutual insurance company is collective and entire ownership and control by its members, all of whom must be policyholders. A mutual company may collect cash premiums from members in advance or it may assess member fees to pay losses and overhead. An insurance company can be mutual, however, even though policyholders are not subject to assessment. To be a mutual insurance company, it is also essential that the company provide insurance to its members substantially at cost.

Prior to July 1, 1999, Nevada's workers' compensation fund was an *exclusive state fund*. States with exclusive funds require all employers to either procure their workers' compensation insurance from the state fund, or, in some jurisdictions, to self-insure. Exclusive state funds develop their own rates and experience by using the services of in-house actuaries or actuarial firms.

Administrative costs are low because they do not issue renewal policies and have no significant marketing programs.

After July 1, 1999, Nevada's workers compensation program became a *competitive market fund*. Competitive funds provide a ready market to employers for this insurance. Depending on the state, employers may insure with the state fund, a private carrier, or be self-insured. In Nevada, this is called "three way" coverage. Competitive state funds offer an available market that is not dependent on the size of the employer's premium, nature of business, or loss history. Most competitive funds return surpluses as dividends to policyholders. Overhead expense ratios of both exclusive and competitive funds are consistently lower than expense factors for private carriers (Association of State Compensation Insurance Funds, Web Site, 1999).

Both exclusive and competitive state funds offer employers advantages that private carriers do not. In addition to offering a constant, reliable, and economical source for workers' compensation insurance, state funds excel in the service area. Claims management is an example of an area in which state funds typically excel. The prompt delivery of benefits to injured employees together with evaluations of liability result in savings to employers and the best possible result for the injured person and his or her family. State funds have experienced staffs to monitor treatment and control medical costs. As a result, state funds have a significant market share in virtually every state where they are located.

State funds do not operate at taxpayer expense. All state funds are, by law, self-supporting from their premium and investment revenue. As nonprofit departments of the state, or as independent nonprofit companies, they are able to return surplus assets to their policyholders as dividends or safety refunds. This reduces the overall cost of workers' compensation insurance. Numerous court decisions have determined that the assets, reserves, and surplus of the funds are not public funds, but are the property of employers who are insured by the funds.

The majority of state funds, as nonprofit organizations, pay no income taxes. Few, if any, private insurers providing workers' compensation insurance pay income taxes. Many state funds do pay sales tax together with real and personal property taxes. State funds, for the most part, are subject to the same regulatory requirements as the private companies, in terms of surplus and reserves. Major independent accounting and actuarial firms validate the financial position and reserves of these funds (Association of State Compensation Insurance Funds, Web Site, 1999).

CHAPTER 2

BACKGROUND

This chapter provides the reader with a historical background of workers compensation from the 1100's to today. In addition, it will provide a limited review of workers compensation in Nevada with an emphasis on the factors that prompted legislators to enact statutory reforms. Finally, legislative reforms that were enacted to curb rising costs will be investigated.

History of Workers Compensation

The following history of workers compensation is taken from Larson's Worker's Compensation – Desk Edition, the legal authority on workers compensation. While Larson's reviews workers compensation from a legal prospective, in this instance it is being employed to present a historical overview of workers compensation.

A few instances in ancient law may provide the first examples of workers compensation dating from about the 12th century. However, for the purposes of this study interest begins in the 19th century. Under common law at that time, employers were to provide a reasonably safe work environment. If an injury occurred, the employer was not obligated to pay compensation and the only recourse for the employee was to take the employer to court. If the employee could afford legal assistance, the employer had several defenses that made it difficult to collect damages. The defense of contributory negligence, suggested that the employee could be at fault to some degree. Another defense was the fellow-servant doctrine, which stated that the fault lay with a fellow employee or employees. Finally, the “doctrine of assumption of risk,” stated that the employee knew he was engaged in a dangerous occupation and therefore, assumed the risk, if he was injured.

Workers compensation was the first social insurance system in the United States and was developed as a consequence of the high rate of industrial accidents in the 19th and early 20th centuries. The system was modeled after a European policy that originated in Germany during the 1800s. Under the program, the right to bring legal action was exchanged for a system of benefits that were paid for all injuries arising out of and in the course of employment. The costs were allocated to the employer because the hazards associated with employment were considered a cost of doing business. The German approach became popular in the United States and between 1911 and 1920 all but six states had passed workers compensation statutes.

Workers’ Compensation in Nevada

The following description of workers’ compensation history in Nevada is based on information on the Nevada Legislative Web page (Nevada State Legislature, Web site, 1999). Nevada was one of the first states to enact workers’ compensation laws. The original act was adopted in 1913, and a complete revision was drafted in 1947. Most of the laws have been amended regularly since 1913. Douglas Dirks, CEO of Employers Insurance Company of Nevada (EICN) opined that the State of Nevada began providing workers compensation because there were no private insurance companies available to do the job. In 1913, Nevada was the "Wild West" and insurance companies were not based West of the Mississippi. Unlike the Eastern states, where there was industrialization, urbanization, civilization and a ready supply of insurance companies, it was left to the States in the West to provide this service.

In 1979, self-insurance was authorized by the Nevada legislature for qualified employers. Self-insurance allows qualified employers the authority to offer workers' compensation coverage directly to their employees without using the state fund. Prior to this legislation, the only provider of workers compensation had been the state run Nevada Industrial Commission (NIC). During the 1981 legislature NIC was completely restructured and ceased to exist. The State Industrial Insurance System (SIIS) began operation as the state-run workers compensation carrier. The Department of Industrial Relations (DIR) was created as the primary regulator for SIIS and self-insured groups. DIR was also responsible for the oversight of medical fee schedules and creating panels of treating and rating physicians. The DIR Commissioner of Insurance reviewed and approved premiums, was responsible for certifying self-insured employers and regulated third-party administrators.

Unlike many other states, the early and mid-1980's were not a difficult time for Nevada's workers compensation system. There were no significant problems, dividends were being paid to policyholders, premium rates were constant, and benefits were among the best in the Western states. From 1984 through 1988, SIIS paid over $50 million in dividends to policyholders (Hughes, 1997). In 1988, a series of rate increases took effect and injured workers began to express concern about the manner in which claims were being handled. A legislative performance audit was conducted and in 1991 statues were enacted to resolve many of the issues identified in the audit. Legislation aimed at corrective action included promoting safety on the job to lower premium rates, streamlining the process for filing, hearing, and appealing claims, and increasing protection against fraudulent claims.

In April 1992, SIIS announced that it was experiencing financial difficulties and invested assets were being sold to cover current expenses. The true financial picture was not discovered until KPMG Peat Marwick prepared an audit of the financial records in 1993-1994. The results of this audit were staggering; the state fund had over $2 billion in unfunded liability (Hughley, 1997). Unfunded liability is the amount of money that will be spent on claims over the next 60-80 years. These claims are paid to injured workers or their families in the form of pension payments, survivor benefits, wages for time lost on the job, medical benefits or disability payments. Without large increases in premiums, it was expected that the agency would be unable to pay claims by Fiscal Year (FY) 1996. Although, reform measures enacted in 1991 had helped to reverse the trends, not enough had been done.

As a result of the revelations about SIIS's condition, statutes enacted in 1993 impacted every aspect of workers' compensation from procedural changes to fraud; benefits to managed care, as well as strengthening of penalties for violations of laws. Included were provisions for implementation of managed care, employer deductibles, and more aggressive pursuit of fraud by employees, employers, and health care providers. Because the 1993 deficit was equal to or larger than the entire state budget at that time, it was imperative that changes be made thoroughly and swiftly. Legislatively, SIIS was given flexibility in 1993 to do whatever was necessary to turn the company around with the exception of removal from the State Personnel Act. When the state-selected board of directors was fired and the Governor took over responsibility for the agency, Douglas D. Dirks was appointed Chief Executive Officer and things started to change. Legislative initiatives allowed the agency to have more control over its budget, full time equivalent (FTE) positions, and over technological systems and mandated that officers of the company reported directly to the Governor. Financial constraints were modified and workers' compensation began to be operated from a more business like prospective.

In 1995, further changes took place, with statutes enacted that would open the market to competition in 1999 and finally, privatization. A more complete examination of the reform statutes follows.

Review of Legislative Initiatives

Numerous bills have been passed in an attempt to reform workers compensation in Nevada. Appendix 2 is the workers' compensation reform time line depicting passage of pertinent reform measures. Many of these bills directly impacted the cost of providing compensation to employees, such as medical costs, benefit amounts, and time frames for receiving benefits. However, employer practices were examined and changes made in areas of safety, fraud, and education.

Senate Bill 7 (1991) was enacted to resolve many of the issues identified in the legislative performance audit of 1988. The intent of the statute was to reform workers compensation by promoting safety and education. Procedural changes were designed to speed up processing of claims, delivery of benefits, and payment of providers. Specifically, the bill called for case management of extended lost time claims; and established guidelines for vocational rehabilitation, disability ratings, and lump sum settlements.

Worker safety and education strategies were implemented for those employers with high rates of occupational injury or premiums. Employers were required to establish safety programs and were offered incentives for providing the safest working environment. Newly hired employees were given orientations setting forth the rights and responsibilities of employers and employees to promote safety in the workplace.

Regulatory procedures strengthened the oversight of self-insured and third party administrators. The bill prohibited local government from issuing business licenses without receiving notification from SIIS that coverage was in place or the employer was exempt. In effect, this statute helped reduce the number of uninsured employers doing business in the state.

The Legislative Committee on Industrial Relations was established. This interim committee reviewed laws, regulations, and implementation of provisions of the act. The committee was responsible for making recommendation to the 1993 legislature, and would be dissolved upon convening of that session.

In 1993 there were 9 bills passed regarding worker's compensation. Senate Bill 316 was the most sweeping and significant of the bills. SB 316 was a comprehensive measure that reformed compensation programs and enacted cost savings provisions to deal with the financial situation of SIIS. It included items that limited or reduced the payment of benefits, limited reopening claims, and established a right for subrogation recovery. A special fraud unit was established with the authority to investigate and prosecute criminal fraud.

Methods for calculating payment of temporary total disability (TTD) benefits were frozen for 2 years, payments for preexisting conditions were prohibited, and factors for computing permanent partial disabilities (PPD) were reduced. The bill established a list of physicians used to determine TTD benefits, allowed SIIS to contract with managed care organizations (MCO), by establishing selection requirements, minimum numbers contracts in Clark and Washoe counties, and independent evaluations of MCOs and other medical care providers using established utilization review procedures.

SB 316 froze the medical fee schedule until October 1, 1995, with the proviso that DIR could grant exceptions. Employees were required to choose their treating physician within the MCOs. The bill limited vocational rehabilitation services, and payments, and nearly eliminated emotional stress as a compensable injury.

The bill affected employers as well. They were required to establish a written safety program and implement its operation within 90 days. Failure to do so, resulted in a 3% to 15% premium penalty. An employer paid deductible was established which started at $100 and went as high as $1000 for employers with extensive loss histories.

Significant to SB 316 was that it abolished the SIIS Board of Directors and allowed the Governor to control the agency until July 1, 1997. This move enabled SIIS to operate more like a private insurance company by removing it from the State Budget Act. However, employees remained part of the State Personnel Act. The Governor was required to report results of reforms to the Legislature in the 1995 session. In effect, this legislation set the stage for future privatization of workers' compensation.

Assembly Bill 552 (1995), authorized "three-way insurance" beginning on July 1, 1999. In "three-way" an employer could choose one of three ways to provide workers compensation coverage. Employers can insure its workers through the state insurance fund, such as SIIS/EICN, private insurance carriers or through self-insurance.

While reforms enacted in 1993 helped to improve the financial condition of SIIS, the Governor, and the 1995 Legislature determined that further reform measures were necessary. Changes were implemented in other programs and enhancements were made to existing statutes such as fraud, subsequent injury, and assessment of penalties on insurers that violated prohibitions against certain claims management practices (Workers Compensation Newsletter, August 1995).

The 1997 Legislative Session produced several bills that were designed to help ensure the competitive environment operated efficiently and that SIIS enters the market with a reasonable chance of successfully competing with national and multinational insurance companies (Workers Compensation Newsletter, August 1997). Assembly Bill (AB) 609 separated the state fund into two accounts, "extended claims," and "current claims." The "extended claims" account received $650 million in invested assets. Projections indicate that these funds along with interest and other revenues should be sufficient to pay claim liabilities incurred prior to July 1, 1995. The "current claims" account will be used to pay liabilities for claims incurred on or after July 1, 1999. In essence, the "extended claims" fund is part of the $2.2 billion in unfunded liability. Separation of the fund allows for future sale of the unfunded liability (Workers Compensation Newsletter, August 1997).

AB 609 set premium rates for all insurers in the workers compensation market. The bill restricts, for the first four years of the open market, the percentage by which insurers may reduce premiums below levels established by the Commissioner of Insurance. The four-year delay in allowing the open market was to give SIIS the opportunity to further improve its financial condition so that it could more effectively compete in the competitive market. (Workers Compensation Newsletter, August 1995).

The State Insurance Commissioner appointed the National Council on Compensation Insurance, Inc., (NCCI) as the advisory organization to develop rates for Nevada's competitive market and assigned risk market (residual market). Many of Nevada's workers' compensation laws have been replaced by general insurance laws and by NCCI rules. NCCI rules change classifications, formulas for experience rating, minimum premiums, cancellation practices and dispute resolution methods.

In addition, AB 609 changed procedures for claim closures under $500, acknowledged electronic transmission of certain documents related to claims, transferred the authority to set salaries from the Governor to the Manager of SIIS, and transferred regulatory functions from SIIS to DIR. Significant other statutes were passed in 1995 related to administration, new or expanded coverage, drug testing, appeal process, and other workers' compensation plans. Legislation in 1995 provided many of the basic operational statutes necessary to operate worker's compensation in an open competitive market.

In 1999 SB 37 was passed. SB 37 effectively allows for privatization of the state fund. It specifically describes the steps which must be taken for the creation of a domestic mutual insurance company and allows for other lines of property and casualty insurance to be sold in Nevada. The statute describes certain events that must occur before the Governor can issue the proclamation that will transfer assets to the successor organization. The criteria include:

- Sufficient amount of reinsurance be obtained for the "extended claims" account
- Appropriate steps be taken to establish a domestic mutual insurance company
- Favorable ruling from the IRS that establishes a domestic mutual insurance company is not a taxable event

- Commission of Insurance determination that domestic mutual insurance company qualifies to do business in Nevada

Upon the Governor's proclamation, all of the money in the forms of premiums, other money, records, real property and securities of the state fund will be transferred to the domestic mutual insurance company. Funds for money to be paid for the purpose of providing workers compensation will continue to be held in trust. Successor organizations are prohibited from using the money held in trust from being used to transact other property or casualty insurance. Finally, the Governor will appoint an advisory committee to adopt the initial bylaws (Legislative Council Bureau, 1999).

SB 37 deals extensively with the issue of employees. Included in the bill is a provision for state employees to retain reemployment rights with other state agencies for 24 months. Employees will be given 60 days notice of layoff, pension buy outs of employees nearing retirement, and retraining for employees who may be laid off before January 1, 2002. The statute required that the company provide up to $2 million for this retraining (Legislative Counsel Bureau, 1999).

The bill establishes the Office for Consumer Health Assistance (OCHA). The purpose of this office is to respond to inquiries related to health care and workers compensation, assisting consumers and injured employees in understanding their rights and responsibilities under health care plans and industrial insurance policies and investigating complaints. OCHA must present an annual report to the Governor including types of complaints, number of resolutions; geographic origin of inquires and types of assistance provided (Legislative Counsel Bureau, 1999).

In addition, the bill changes the industrial insurance benefits received by injured employees. Changes include reporting of pre-existing medical conditions, allowing closing of claims under $300 in a more timely manner and changes to rehabilitation services available to injured workers.

CHAPTER 3

REVIEW OF RELATED LITERATURE

This chapter provides a review of the literature related to the study. The chapter first examines workers compensation reforms in neighboring states. The next segment of this chapter provides information on the movement from the public sector to the private sector. Finally, the chapter examines issues related to privatization and discusses whether a former public sector bureaucracy can compete in the private sector.

Workers' Compensation in Neighboring States

The difference between "reform" and "tinkering" seems to depend on whether one supports or opposes the changes. Virtually every state makes some changes in its compensation statutes annually (Chelius, 1986). Clearly, the early and mid 90's were devoted to controlling the spiraling cost of providing benefits and services to employees, as well as keeping cost down for the employers.

Many states enacted workers' compensation reforms during the early part of this decade, resulting in at least $3.5 billion annually in cost reductions (Ceniceros, 1998). Our neighboring states; Arizona, California, Oregon, and Utah were implementing legislation in an effort to control costs in their states (Ostermiller, 1998). The major areas needing reform were: increasing legal and medical costs, fraud and abuse, growth of stress claims, growth of vocational rehabilitation, counterproductive pricing arrangements, and inadequate benefit levels (Roberts, 1997). Further analysis revealed other areas ripe for reform included administrative issues such as reorganization, expanded educational and safety outreach programs, and use of electronic commerce as a means of streamlining workers compensation (Kilgour, 1998).

According to the Nevada Workers' Compensation Newsletter, (December 1995), Oregon's Director of Workers' Compensation acknowledged that reform measures adopted in 1987 made it possible to reduce premium rates for the sixth consecutive year. Additionally, Utah regulators approved a 10.1 percent decrease in basic premium rates in 1995. Arizona approved an 11.5 percent reduction in premiums in 1995, which is expected to save the employers $83 million.

In 1998 Oregon rates were reduced an average of 15.6%, the eighth consecutive year of rate reductions and insurance costs had been cut in half since 1990. Oregon's Governor John Kitzhaber considers decreases in work-related injuries and use of managed care as the contributing factors for the cost cuts (Workers Compensation Newsletter, January, 1999). California is stepping up efforts to reduce employer premium fraud by identifying employers whose coverage may have lapsed and other employers within industries with high costs. The project will focus on improving new employers' knowledge about requirements of state law (Workers' Compensation Newsletter, July 1998).

Some literature suggests that while initiatives such as anti-fraud programs, drug-free workplace credits, and safety program mandates are easier to enact. Such programs may not be the most effective from an employer cost-savings standpoint. Roberts (1997) further contends, “fee schedules, utilization management and managed care are initiatives that will save the workers compensation system money, but are quick to raise hairs with various interest groups” (p. 8).

Movement from Public to Private Sector

Governments are entering the private sector from many directions. From the U.S. Postal Service to the Department of Defense programs as well as education and welfare programs are being scrutinized at municipal levels for opportunities to privatize. Public sector administrators are being pressured to become more operationally efficient. Public officials are demanding efficiency, and private service providers are presenting extremely attractive alternatives that only add to the pressure on public service providers to improve (Lassiter, 1997).

It is rare for a person or activity to move from the private sector to the public sector, less so from the public to private. The privatization of a state enterprise, insofar as it entails the replacement of a statutory relationship by a contractual one, entails arrangements covering numerous transitional stages. In some cases these even preserve the statutory employment status of existing staff, while new staff are hired on a purely contractual basis. Thus, there may be marked differences in the employment status of people working together in the same enterprise (Champlin, 1998)

Employee acceptance, resistance to change, financial structure, and customer service are some of the main concerns in the transition from public to private sector. Concern for employee acceptance is important and appears to be the largest barrier to the transition (Lassiter 1997, Rama 1997, Sunoo 1998, and Mitchell 1997). Human resources take care of its civil servants. In the past, civil servants, on every level, expected lifetime job security. Employment was tied to time, not to performance. In the era of downsizing and privatization two things are of paramount importance: downsizing must be humane and employee outplacement is critical to the success of the transition. Most reductions should come through buyouts, early retirement, outplacement, and other voluntary attrition (Sunoo, 1998).

Lassiter (1997) suggests that communication is the key to employee acceptance. He contends that many leaders focus on the operational processes, automation, and technology. When in fact a more successful approach involves addressing "people issues" associated with the change in operations (p. 2). Use of communication between management and the union can build a clear and common understanding of their purpose. Martin Rama (1997), in his article *Efficient public sector downsizing*, promotes a voluntary approach to reducing public sector employment. Specifically, severance pay is offered to encourage redundant workers to quit and thus overcome their resistance to downsizing, restructuring, and privatization (p. 2).

Resistance to the changing environment and culture of the organization can be a challenge for management. In order to make an organization more efficient and competitive, change is not optional but mandatory (Lassiter, 1997).

The key to success in most forms of business is understanding the customers' needs and meeting them. Keeping up with the customer's changing demands, delighting the customer and winning customer loyalty have all been the subject of recent management bestsellers. This can only happen with a well-motivated and happy workforce, which suggests that a principal aim of every corporation should be to satisfy its employees and, in turn, its customers (Jones, 1997). The private sector drills this concept into its employees, because if the customer is not satisfied, then the business will not make money. Millheim (1999) said,

> One of the things emphasized more in private sector management is walking in the customer's shoes, really trying to understand the customer's motivations and needs so you can use that understanding to better your business position. In the public sector, we can become too narrowly focused. We do not practice enough of "thinking out of the box" (p.4)

While acceptance by employees plays a major role in the successful transition from state to private sector other issues are equally as important. Before a city or state decides to privatize some of it services, several factors should be considered. Mitchell (1997) states:

> Three factors should be explored prior to privatization: First, the cause of the problems that privatization is expected to solve must

> be identified; second, the scope of activities privatization will embrace should be determined; and finally, the measurements that will govern privatization must be established (p.2)

Mitchell (1997) reports that “privatization is often seen as an easy solution to dealing with problematic aspects of administration, however, agencies may turn to it to solve an issue that may not have been examined in depth” (p.4).

There is rising awareness, even among politicians, that competition and privatization produce better results than government monopolies. Nevertheless, privatization may not be an option for many government agencies, and it may not be advisable for some state-owned enterprises. It may be especially unfeasible on political grounds, at least until the government shows that it can overcome labor resistance (Rama, 1997). In some instances it is competition, not privatization, that improves services.

Privatization: What is it?

Privatization, a word that was not in dictionaries 20 years ago, is now called competition in government circles. Governments have engaged actively in privatization efforts for over three decades. These efforts have diffused into virtually every other function performed by government (Daley, 1996). Government entities or agencies that have privatized have routinely experienced cost savings from 10 to 40 percent and with the middleman of government removed, even greater efficiencies are possible (Reed, 1996). Privatization of former government operations around the world has totaled more than $86 billion in savings in 1996—an all time record high (Moore, 1997). Moore (1997) reports that "World Bank Researchers examined the performance of 61 privatized operations in 18 different countries, they found that the privatized companies increased their output by 27 percent and profitability by 45 percent. Two-thirds hired more workers after they were spun off from government; overall employment rose 6 percent" (p.5).

Privatization has come into favor as a result of citizens' and elected officials searching for a more cost efficient way to provide public services (McGillicuddy, 1996). According to a survey completed by the Council of State Governments (GSC), privatization of government services has been on the rise over the last five years. Half of the respondents in the study related cost savings as a motivator for change. State agencies are privatizing activities in order to do more or better with less money. Agencies turn to private providers to avoid red tape, implement programs more quickly, and fill voids in personnel or expertise. In addition, the support of political leadership contributes to increased privatization activities. The survey indicates that proponents of privatization are governors and their staff, agency managers and legislative agency staff. Outside parties, such as interest groups, and private consultants, also support privatization. Typical opponents are state employee associations and elected officials (Chi & Jasper, 1998). Privatization is neither a fad nor a limited tool. It has demonstrated staying power and proven itself useful in an extensive array of service areas (Daley, 1996).

Proponents insist that the public sector is more effective than privatization. For example: from the period 1967-1999, output per employee year has gone up 1.4 percent on an average annual rate of change basis. These rates are far above the net productivity growth record of the private sector in this period (Goodsell, 1994).

However, critics of privatization say that it may not be the best way to reduce government and save taxpayers money. There may be corruption, inefficiency, and safety issues to address when insuring that privatization is the best option.

Proponents of privatization ignore examples of inefficiency, waste, and corruption in the American experience with defense, construction projects, and health-care. These corrupt practices and unwanted costs can emerge when there is money to be made in winning government contracts (Morgan & England, 1988). Some forms of privatization assume high levels of oversight by technically skilled and competent government regulators, however proponents of privatization tend to be strong advocates of deregulation. Deregulation hinders the public sector's capacity to monitor or assess performance of contractual work being done by private companies (Miller & Simmons, 1998).

A British poll done 1983 regarding privatization of the Underground rail system showed that privatization has never been wildly popular, and that is has been getting less so as time goes by. The study found that 43% of people wanted more privatization; by 1992 that was down to 24% and the last years poll found just 19% were in favor of privatizing the Underground (The Economist, 1998).

Efforts to justify or condemn privatization empirically have produced decidedly mixed results. No accumulation of research in the field will yield anything other than probabilistic findings (e.g., privatization tends to work) and equally plausible counterfindings (privatization tends not to work) (Miller & Simmons, 1998). So the debate continues and in Nevada the proof will be in the success or failure of the workers compensation privatization efforts.

CHAPTER 4

METHODOLOGY

This qualitative study uses a comparative case study method to analyze past legislative initiatives to determine if the proposed legislation in Nevada will be effective. Open competition in this market will effect changes in policy and procedures, staffing and benefits to both employers and employee to list only a few. Privatization of workers' compensation is a concern because Employers Insurance Company of Nevada is the first state agency to entirely privatize its services. The effectiveness and success of the conversion will set precedent for future privatization in other state agencies.

As an employee of Employers Insurance Company of Nevada, the researcher is a participatory observer in the process of EICN's conversion from a state agency to a private company. All actions taken toward privatization have a direct impact on the researcher. Information about the transition is supplied to employees through the use of the company's Intranet, as well as memorandum issued by the CEO. The opinions expressed in this paper may be biased toward the positive aspects of privatization due to the day to day interaction the researcher shares in the process.

The research began by examining literature that related specifically to workers compensation reform and privatization. Then a review of current legislation was completed. Finally, personal and telephone interviews were conducted to ascertain a more personal perspective on the topic. The researcher interviewed:

- Chief Executive Officer of Employers Insurance Company of Nevada, Mr. Doug Dirks;

Analysis included discussion of the major issues in the transition from public to private sector, as well as barriers to this transition. Questions are included in Appendix # 3.

John Creswell, in his text Research Design: Qualitative & Quantitative Approaches, describes several steps for systematically analyzing qualitative textual data. The steps include such things as reading through all material, jotting down some important points, picking one document and beginning to go through it, making lists, categorizing material, and sorting the data. This information was found to be extremely helpful and assisted through completion of this professional paper.

CHAPTER 5

THE CASE STUDY

Factors that Contributed to Nevada's Problems

The State Industrial Insurance System, doing business as Employers Insurance Company of Nevada, formerly known as Nevada Industrial Commission has been serving Nevada's employers and injured workers for over 86 years. EICN is a full service workers' compensation company providing claims management, loss prevention consulting and rehabilitation services to employers within the State of Nevada. The company employs over 900 people statewide, with offices in Carson City, Elko, Las Vegas, and Reno and serves 47,000 policyholders.

During the start up of Nevada's workers' compensation program, the state legislature lent the agency $2,000. Within the first few years the money was repaid and the fund became self-supporting. Premiums, underwriting activities, and investment income continue to be the primary sources of revenue. EICN is a $385 million company that is self-funded by the premiums received from policyholders and does not receive financial support from Nevada taxpayers or the state general fund (Employers Insurance Company of Nevada Web site, 1999). The workers' compensation fund had been an exclusive state fund until July 1, 1999, when it converted to a competitive fund.

Employers are the policyholders and the company's insurance services department has teams of specialists assigned to employers based on the type and size of the business. Service teams provide assistance by providing policy information and updates, information about obtaining coverage, policy documents, and proof of coverage, audit services and account information. Employers are also informed of industry-specific programs, have access to a statewide computer network for account information, classification, rate and program information and information about changing statutes, regulations, and policies. The company offers seminars, educational programs, and printed material to its policyholders.

EICN provides a wide range of other services including claims management, loss prevention, rehabilitation services, ombudsman, fraud programs, and training classes. The Claims Services Department uses innovative strategies and advanced technology to provide fast, efficient service when a claim is filed. Employers Insurance Company of Nevada uses techniques recommended and proven effective by industry experts to assure the best care, the best recovery, and high overall satisfaction with administration and resolution of all claims filed (Employers Insurance Company of Nevada, Web site, 1999).

Premiums for coverage are determined by rating employers. There are several rating methods, however, for the purposes of this paper only three will be discussed. Employers can be class rated, experience rated or retrospectively rated. Class rated employers pay a rate per $100 of payroll that is based on the industry or industries in which they are engaged. Payroll can be assigned different rates for different classes of employees. For example the premiums assessed for clerical workers is lower than for construction workers based on the difference in wages. Over half of the employers are class rated and pay less than 10 percent of premiums received by insurers (Chelius, 1986). Experience rated employers have their class premiums modified to reflect two factors: loss experience during the recent three-year period compared to the amount the insurer would have expected to pay if the employer was an average employer in the same industry. The loss experience is the expected losses the employer could incur. This type of rating is complex and is usually reserved for larger employers. Finally, retrospective rating bases the employer's premium on the loss experience during a policy period, subject to certain conditions. Employers whose premiums exceed $100,000 may be admitted to a retrospective rating plan, in addition to being experienced rated (Chelius, 1986).

In the 1980's several factors began to effect the performance and finances of EICN/SIIS. For example: rising health care costs, population growth in Las Vegas valley, conservative financial investments, and inadequate mechanism for predicting future cost of claims were behind the changes. Rising health care costs were addressed by Nevada's legislature with the implementation of many of the statutes previously reviewed in this paper.

Because of rising costs, the Legislature approved statutes that allowed for use of Managed Care Organizations to contain costs of medical care. A list of providers was developed and distributed to all employers. Providers agreed to accept a fee schedule payment system to further control costs. A panel of physicians was assembled to complete partial permanent disability ratings. The physicians are assigned cases on a rotating basis; this practice eliminates physicians who were not experienced in the rating system from performing an evaluation. Claims are being medically managed with the use of RNs to oversee progress and to perform a quality assurance function. Employers were prohibited from changing physicians numerous times during treatment.

Chief Executive Officer of EICN, Douglas D. Dirks discussed several issues during a personal interview on October 7, 1999. He believes that SIIS/EICN suffered the fate of many state agencies during the period of exponential growth in the late 1980 and early 1990's, the inability to hire personnel to keep up with the workflow. Nevada has a biennial budgeting process and full time equivalent (FTE) positions are projected 2 years into the future. The need is based on projected service delivery and state revenues. Most state agencies are only allotted a minimal number of new FTE positions each biennium. Mr. Dirks believes that the inability to hire appropriate numbers of employees to process claims, manage employer accounts, and process paperwork led to inefficiencies in the system. As the population increased FTE employees were not approved appropriately to provide adequate, efficient, and effective service. To make matters worse, the fact is that too few people were working on systems that were 20 years.

Mr. Dirks compared EICN's problems to those being experienced by Nevada's Department of Motor Vehicles (DMV) today. As an example, as the population increases there is a need for more staff at the DMV. The state population has doubled; however, in 1999 DMV staff was only increased by

20%. Public perceptions are negative and employee morale plummets and eventually the system fails. When a government agency finds itself in this position it cannot respond fast enough.

Like DMV, SIIS/EICN was tied to the state personnel act and could not hire or fire employees as need dictated. Ultimately, this led to another problem—poor customer service relations. Employers and injured workers were not getting the kind of service they felt they deserved. There were increasing complaints about benefits being late, employer accounts being mismanaged and overworked staff making poor decisions about the claims they were able to evaluate. D. D. Dirks (personal interview October 7, 1999) is of the opinion that state workers have a different mindset and are not necessarily customer service oriented. Dirks said:

> People are put into boxes by the state personnel system. In that box you have job duties, and that is all you do. If a customers needs something else, in the state system there is usually a handoff. Out of my box into someone else's. In a competitive environment you have employees that know it is out of their box, but are responsible for the follow through. They either do it or find someone who can and then make sure that it the job gets done. State service doesn't encourage that and in fact, penalizes it, and in some cases prevents it from happening.

However, contrary to their poor public image, most civil servants are hardworking and talented. The problem is that they have been trapped in a system that punishes initiative, ignores efficiency, and rewards big spenders (Goldsmith, 1998 and Cunha & Cooper, 1998).

In addition, the agency was having difficulty with cash management strategies in the late 1980s and early 1990s. The investment experience was bad due to the political influence rather than a business influence. State or public investment strategies are extraordinarily conservative. Minimum percentages can be invested in high risk, high return area such as the stock market. State investment options are dictated by statute and these options are usually low risk, low return options, such as municipal bonds, and certificate of deposit. In workers' compensation, investment earnings must be high enough to provide revenue to pay claims during the years covered by statute. As a result of the conservative growth strategies of the state, workers' compensation funds had to spend down principal to pay debt.

An advantage to a private company is that the investment strategies can be more aggressive and investments can be made in high risk, high return options such as the stock market. According to Dirks, the most important functions of the CEO is to invest the premium dollars in order to earn income to satisfy all future obligations, build enough surplus to have a cushion, and develop capital to do different things (D. D. Dirks, personal interview, October 7, 1999). Using a 10-year historical experience and comparing the company with 850 similar organization, EICN was in the 65th percentile prior to 1993, with 1 being the best and 100 the worst. During the last 5 years the company has been in the 11th percentile. Investment earning increased from 6% to 12% (D.

D. Dirks, personal interview, October 7, 1999). These changes helped to fund the public-sector deficit and alleviate the constraints on financing under which companies operate, owing to the restraining of government expenditures and consequent financial borrowing controls imposed on public sector enterprises (as described by Bishop in Cunha & Cooper, 1998).

Lastly, SIIS/EICN did not have an adequate mechanism in place to predict the future cost of claims. The 1991 performance audit showed that claim reserves were virtually non-existent. “Reserving a claim” is the practice of auditing the claim at the beginning to predict the future medical and compensation costs that should be assigned to the claim. Prior to 1993 reserving was being done manually. Due to a lack of staff, the process was significantly delayed and claims were being paid and closed out before any projection of costs could be determined. The result was that the company had $600 million in assets and $2.8 billion in liability. The deficit was $2.2 billion. This figure is an actuarial guess. It is an estimate of what the liability is going to be for the next 60-80 years. Actuaries modeled that the immediate past was so bad that the liability went way up. Between low risk investments and inefficient claim reserving policies, more funds were being drained out than were being brought in.

Transition from Public to Private

When asked what he considered the major issue in the transition from public sector to private industry, D. D. Dirks (personal interview, October 7, 1999) said,

> In our instance [EICN], in my mind that biggest is the cultural change from a monopolistic setting to a competitive setting. And that is probably closely tied to being a state agency, because most state agencies would not be performing competitive services, but performing monopolistic services that only the government delivers. Making the transition from a monopoly to a customer service focus is tied to a lot of different things. Government isn't structured to reward employees for delivering quality service. The entire compensation program, the incentives, the way one motivates people doesn't reward delivering superior service.

Culture is defined as the set of important assumptions (often unstated) that members of a community share in common. These assumptions included beliefs about the world and how it actually works and value or ideals worth striving for (Cunha & Cooper, 1998). The cultural changes discussed by Mr. Dirks were not only employee related but of a business nature as well. The market was opening to group-self insurance and larger companies were already able to self-insure causing the state fund to lose employers at an alarming rate. The company was not able to underwrite or adjust prices for good or bad business. Slowly the company was being adversely selected so that only the smallest and worst risks would be what remained of the company's business. Without appropriate pricing mechanisms in place, the company would not have a product that could be afforded. As good risks, employers who paid large premiums left, the future of the company was rate increase after increase. All that would have been left was the small bad risk employers, which meant the company would continue to lose money. Consequently, Mr. Dirks prepared a plan to present to the new Governor that would open the market to competition. In the long run EICN would do better as the residual market without the pricing mechanism (D. D. Dirks, personal interview, October 7, 1999). At this juncture, privatization was not being considered. However, the newly elected Governor, Kenny Quinn is a pro-business Republican who believes there is a market for workers' compensation insurance, and questioned why the state had to provide this service. Governor Quinn wanted the unfunded liability removed from the state's budget and responsibility. The natural progression of change was to move to a private company, purchase reinsurance to cover the liability and take the state out of the business of workers compensation.

Barriers to the Transition

When asked, "What is the largest barrier to the transition?" Douglas Dirks (personal interview, October 7, 1999) said,

> Right now the largest barrier is the labor pool and it is unique to our situation. As part of the agreement to privatize, we put in place a re-employment package that I believe is fair and generous. It virtually guarantees…that not a single person should miss a paycheck. However,

people are leaving faster than we can replace them. This is particularly challenging, because we do not have an insurance industry to draw from. For the largest part, there is no insurance industry in Nevada. In the majority of cases the professionals that we do see, have been trained by SIIS/EICN.

On July 1, 1999, 35 percent of EICN's work force (300-350) people were in their 20-30's and had less than 5 years in state service. These were the individuals that Dirks considered his core workforce and in all likelihood would not be tied to the state personnel plan. It was not a surprise that employees with more years in civil service would take advantage of the re-employment and retirement options offered by SB 37, but the company did not expect to lose its younger workers. This unexpected loss of employee has led to the loss of institutional knowledge.

Actions toward Privatization

With the appointment of Douglas Dirks in 1993, many things started to happen at SIIS. First, came a dramatic change in the financial structuring of the company. There was a need to create a capital base and help to eliminate the $2.2 billion deficit. In most other state funds, the treasurer's office manages the money in short term, low risk investments. In 1994 a decision was made to invest EICN's assets like an insurance company and not a state treasury. Immediately, 10 percent of its assets were moved out of bonds and into stocks. This 10 percent increase, at a time when the stock market was rallying, created over $200 million in additional assets for the company (D. D. Dirks, personal interview. October 7, 1999).

Customer service was up for review. Several elements were considered when examining what needed to be done to improve customer service. The elements were: policy & procedure, equipment and technology, and employee training, and customer communication. Doug Dirks, CEO believes it is necessary to provide employees with the tools to do the job. First and foremost, policies and procedures had to be updated. With the significant changes in Nevada Revised Statutes, the technology that was being implemented, and changes in the customer base of the company, the entire procedure manual was revamped. The manual became more specific in its time-lines and tasks, lines of authority were changed, and in general a new way of doing business was created. The manual even received new name, Business Process Analysis (BPA).

Technological innovations were next on the agenda. An entirely new computer system was purchased. A network was developed and each employee was given new hardware and updated software. Email, scheduling, Microsoft Office, and Intra and Internet access were provided to all employees. Integrated systems improved employee communications, efficiency, and effectiveness when managing claims, employer accounts or other aspects of the business.

The company looked at other insurance companies to see what technology was being used for such things as file maintenance, call centers, and Internet access for customers. Several systems were developed as a result of this research. An imaging system was purchased to electronically store all claims files. In effect, each file was scanned into a computer, which would catalog the material for future reference. This system eliminated paper files. Every person in the company has access to every claim file through the computer.

Finally, with all the new technology, training for employees became a priority. Every employee was required to attend training. Training sessions included company policy and use of Intranet, Internet, email, scheduling, Microsoft Word, Excel, Access, and PowerPoint as well as the imaging and claims systems. These sessions were hands-on with trainers and computers in a classroom setting. Furthermore, all employees were required to attend sessions on customer service. Topics included defining good customer service, how to handle irate customers, stress management, and telephone techniques.

Certain departments, such as claims, were required to attend claims training classes. These classes instructed employees on the definition of a compensable claim, how to report a suspected fraudulent claim, the process of a claim through the system, and the requirements of staff relative to management of the claims. Marketing staff was also involved in customer service training, introduction to Internet technologies that would be available to agents and employers and other marketing techniques necessary to improving the overall customer service orientation of the staff. Training of 900 employees was a prodigious task; however, it was completed competently and efficiently. The initial time lost in training was gained when staff became more proficient at using the technology.

Then in February of 1993 the name was changed to Employers Insurance Company of Nevada. The premise is that employers are the primary source of revenue for the company and consequently, the company should be more employer oriented. The name change was a significant marketing concept, because the company was now an “employer’s insurance company.” The change was an effort to move away from the stigma of being a state agency, with connotation of allegiance to the workers.

The company continues to introduce new concepts such as E-Care, a program that improves service to policyholders by providing immediate access and assistance when filing workers’ compensation claim. E-Care is a comprehensive program that provides in-house medical case management, a customized exclusive provider network, and 24-hour toll free claims reporting.

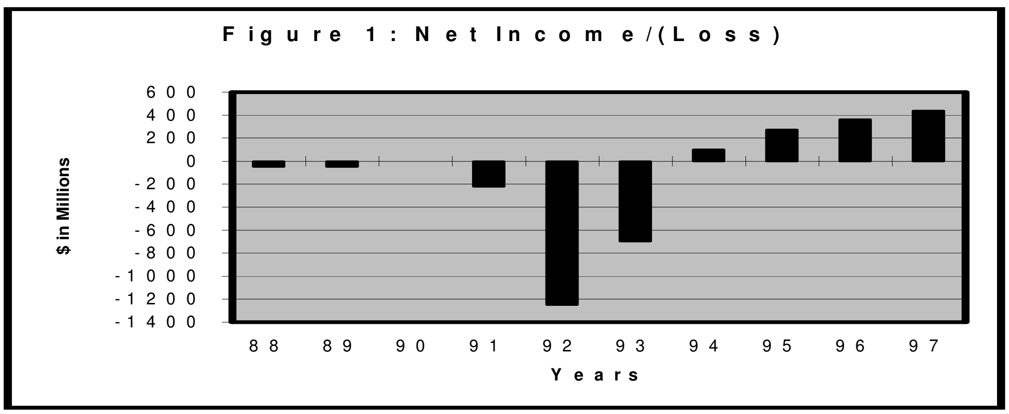
In an effort to enhance customer communication, EICN established a web site where policyholders can download forms, learn more about the services offered by the company and find answers to frequently asked questions. Eventually, the web site will be upgraded so that policyholders can access their claim information, pay premiums, and submit forms regarding claims.

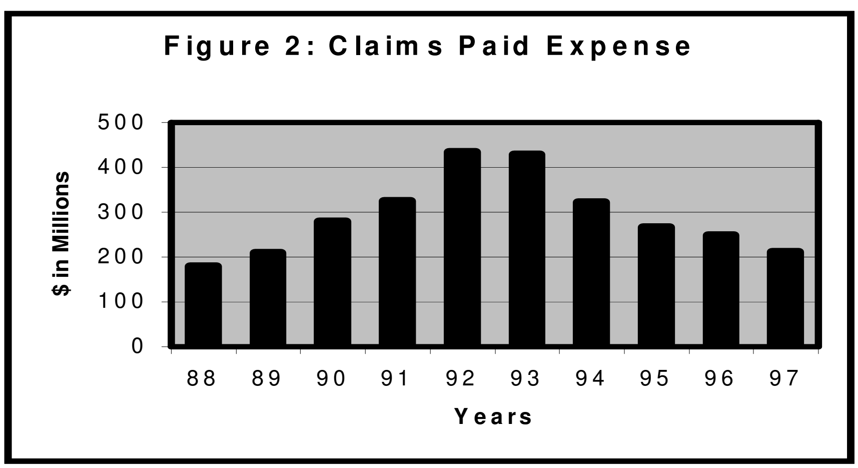
Outcomes Measures of Reform

Politically in the early 1990s, the movement in Nevada's workers' compensation was toward reform and creating a state fund that was financially stable. However, other options were being considered by Nevada's legislature. In 1992, the Legislative Counsel Bureau of the State of Nevada formed a subcommittee that examined the issue of privatization of governmental services. The Subcommittee discussed privatization as a mechanism for providing services. Some of the conclusions the subcommittee reached were: 1) government should not be called upon to provide services that private sector can provide more efficiently; 2) privatization is a possible alternative that should not be utilized in all instances, and 3) privatization is a viable alternative that can be utilized by government as a management tool (Nevada Legislative Council Bureau, 1992).

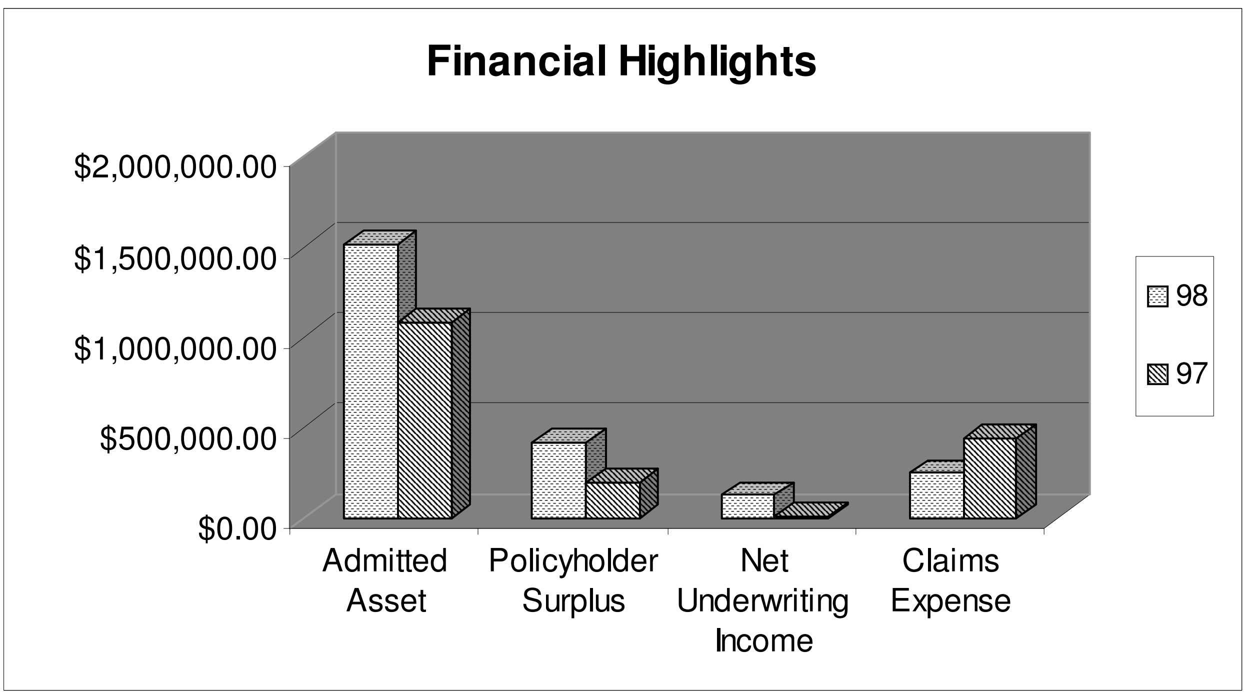
In Nevada the reform measures did play a significant part in the reduction of costs. The legislative reforms in 1991 and 1993 contributed to the improved financial condition of SIIS and helped to put an end of the out of control spending. Provisions to implement managed care to require employers to develop a written safety program, and tougher penalties on fraud, were among a few of the reforms that impacted workers compensation in Nevada.

Key performance indicators such as net income increased from a $(669,797) in FY 93 to $438 million in FY 97. The increase is related to increased premium revenues and investment income. On the other side, total claims expenses decreased from $428 million in FY 93 to $212 million in FY 97 (Figure 1 & 2). Moreover the number of total active claims dropped for three consecutive years.





Employers Insurance Company of Nevada's 1998 Annual report reflects continued improvement in the financial condition of the company. According to the report total assets increased 39.5 percent to $1.5 billion from 1997. The diversified investment portfolio increased 49 percent, more than $462 million in 1998 over 1997. Net income was $207.6 million in 1998 (D. D. Dirks, Letter to Employees, October 18, 1999). In addition claim expenses decreased 56.3 percent from $438 million in 1997 to $247 million in 1998. Underwriting income increased from $5.6 million to $125 million in 1997 and 1998 respectively (Figure 3). In April 1998, a 22 percent average rate reduction went into effect, which reflects a $115 million saving to employers.



CHAPTER 6

CONCLUSIONS

Public sector companies have values and goals quite different from those of private companies. The beliefs and values the proved successful in public companies will no longer insure success in private companies, since the external environment, the sources of income and the competitive strategies are not similar (Cunha & Cooper, 1998). Employers Insurance Company of Nevada has had to examine and modify its beliefs, values, external environment, competitive strategies, and sources of income to adequately compete in the private sector. Each of these systems has been analyzed, modified, or improved in an attempt to change the culture of the organization. D. D. Dirks (Press Release, July 1, 1998) said the transition to the new company's more competitive approach which resembles that of a private insurance carrier, has been in the works for over a year. Internal improvements and upgrades include: state-of-the-art computer and telephone systems, advanced personnel training in sales and customer service, claims imaging systems, reduced case loads for claims adjusters, and enhanced communication with policyholders.

When asked what he considered a successful transition, Dirks said,

> "We are going to lose ½ to 2/3 of our business. However, to me that has never been a measure of success, because we are not going to be a monopoly. Success will be that the remaining policyholders are sufficient

to give us critical mass to do the things we want to do. So success will be customer satisfaction and the ability to grow capital to do other things."

Hartung (1996) discussed that when studying high-performance organizations, ten universal principles can be found:

- Customer focus
- Selection and promotion based on qualifications to do the job
- Continuous general and specific training
- Engagement of employee participation and individual initiative
- Development of a true sense of teamwork
- Establishment of goals of continuous improvement
- Study of the public sector service delivery
- Development of an internal analytical capability
- Regeneration or reengineering

Efforts within the company can be seen relative to many of Hartung's principles. There is clearly a customer focus in the new company. The organization is focusing on the wants and needs of customers, both internal and external. Additionally, continuous general and specific training is being done. It is important to realize that in today's rapidly changing world, learning is a lifetime process, and if the company wants to compete it must train. Efforts are being made to encourage employee participation, encourage individual initiative, and create a sense of teamwork by its commitment to getting employees at every level involved through the use of problem-solving teams and task forces.

As of today, EICN has completed three of the four requirements necessary for the Governor's proclamation. The company has successfully obtained reinsurance for the "extended claims" account, effectively eliminating the $2.2 billion deficit. All steps have been taken to establish a domestic mutual insurance company, and the IRS has given a favorable ruling to the transfer of assets from the state fund to the domestic mutual insurance company. The only step that is yet to be completed is approval by the Insurance Commissioner that EICN is financially stable and meets the requirement necessary to sell insurance in the state of Nevada.

Finally, efforts have been made from a legislative standpoint to control costs of providing workers' compensation benefits to the citizens of Nevada. Implementation of MCO, changes in benefits, improved fraud detection and implementation of workplace safety requirements have attributed to lowering the expense of workers' compensation. Furthermore, opening the system to competition has spurred movement and growth away from a public bureaucratic mentality to that of an efficient private sector operation.

The findings of this study indicate that the legislature and EICN are effectively changing a state program into a company that will be able to compete in the private sector. Employee resistance and re-employment has been adequately dealt with by implementing a re-employment list in accordance with the State Personnel Act. EICN has a $300 million surplus and is financially sound. Technology has been updated to include systems that are similar to those being utilized in the industry. Finally, there has been a change in focus to a customer service and this ideal has been passed to employees, employers and workers' by means of training and marketing tools. EICN's business philosophy based on excellence, efficiency and expertise has proven successful and the company is in a strong position in the new competitive workers' compensation environment. All of these steps are steps in the right direction, however, there is still much to be learned and relearned.

Recommendations for Further Research

According to Segal-George (1998) and Osborne and Plastrik (1998), there may be other ways to compete with the private sector without privatizing. Segal-George (1998) describes governmental specialization. This concept recognizes that certain governments can provide certain services in a more cost-effective and competent manner. This is particularly noticeable with highly specialized functions. Additional studies are needed to determine if this concept is as efficient or as effective as privatization.

Osborne and Plastrik (1998) suggest competitive bidding is the key to making privatization work. They advocate that when public agencies have been allowed to compete on a level playing field free from regulation, they sometimes offer the lowest bid and best service. However, there must be incentives and consequences for levels of performance (p.10). Further studies could be done that would examine levels of performance and cost savings between similar private and public services using both of these methods.

The researcher further recommends that EICN's transition to a private company be re-examined in one or two years. The Insurance Commissioner has effectively leveled the playing field for all insurance companies offering workers' compensation in Nevada by requiring that all companies charge the same premium rate for the next year. After that time, Nevada's worker's compensation market will truly become an open competitive market. Without those equalizing constraints the market should regulate itself, and the $2.2 billion question will be whether Nevada's workers' compensation state fund can survive as a private company.

Appendix 1
Workers' Compensation Comparison 1999
AFL-CIO

State	State Fund	State	State Fund
Alabama		Mississippi	
Alaska		Missouri	Yes
Arizona	Yes	Montana	Yes
Arkansas		Nebraska	
California	Yes	Nevada	
Colorado	Yes	New Hampshire	
Connecticut		New Jersey	
Delaware		New Mexico	Yes
District of Columbia		New York	Yes
Florida		North Carolina	
Georgia		North Dakota	Exclusive
Hawaii	Yes	Ohio	Exclusive
Idaho	Yes	Oklahoma	Yes
Illinois		Oregon	Yes
Indiana		Pennsylvania	Yes
Iowa		Rhode Island	Yes
Kansas		South Carolina	Yes
Kentucky	Yes	South Dakota	
Louisiana	Yes	Tennessee	
Maine	Yes	Texas	Yes
Maryland	Yes	Utah	Yes
Massachusetts		Vermont	
Michigan		Virginia	
Minnesota	Yes	Washington	Exclusive
		West Virginia	
		Wisconsin	
		Wyoming	Exclusive

Appendix 2
Nevada Workers' Compensation Reform Time Line

Appendix 3
Interview Questions for Douglas D. Dirks,
Chief Executive Officer
Employers Insurance Company of Nevada

1. What do you consider the major issues in the transition from a public agency to private enterprise?

2 How would you define a successful transition?

3. What mechanisms are in place to insure the success of the transition?

4. What is the largest barrier in the transition?

5. What performance/outcomes measures are being used to evaluate the success of the transition?

6. Competition is identified as a means of improving performance and enhancing customer service, do you believe that EICN will accomplish these objectives?

7. Literature shows that financial structure of an organization, employee buy-in and service delivery is important in the move to the private sector. How are we dealing with these areas?

8. Other than from a financial aspect, what were some of the other considerations for privatization of the agency?

9. What exactly does the deficit mean? Is it “on paper” or real dollars?

10. What exactly is the state getting out of this deal? Will the company purchase real estate, equipment, etc.?

11. From the time that it was determined that the company was bankrupt to the time the decision was made to go private, what happened?

REFERENCES

AFL-CIO. (1999) [Online]. Avaliable: http://www.aflcio.org/safety/compcomp.htm. [1999, June 11].

Associations of State Compensation Insurance Funds. (1999) [Online]. Available: http://www.aascif.org/orverview/workcomp.html [1999, September 15].

Champlin, Dell. (1998, June). The privatization of community: implications for urban policy. Journal of Economic Issues. 32(2), 9.

Chi, Keon & Jasper, Cindy. (1998). Privatization Activities in State Governments. Spectrum: The Journal of State Government. 71(3), 8.

Ceniceros, Roberto (1998, March 30). Reforms under seige in workers comp. Business Insurance. 32(13), 3.

Chelius, James. (1986). Editor. Current Issues in Workers Compensation. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research.

Creswell, John W. (1994). Research Design: Qualitative and Quantitative Approaches.Thousand Oaks, CA: SAGE Publications.

Campos E. Cunha, Rita & Cooper, Cary. (1998, December). Privatisation and the human factor. Journal of Applied Management Studies. 7(2), 201.

Daley, Dennis. (1996). The politics and administration of privatization efforts among local governments. Policy Studies Journal. 24(4), 629.

Dirks, Douglas. (1999, April 30). Letter to employees of Employers Insurance Company of Nevada.

Dirks, Douglas. (1999, October 7). Personal Interview. Las Vegas, Nevada.

The Economist. (1998, June). The end of privatization? (United Kingdom). 347(8072), 53.

Employers Insurance Company of Nevada (1999). [Online]. Available: http://employersinsco.com, [1999, September 26].

Employers Insurance Company of Nevada 1998 Annual Report.

Goldsmith, Stephen. (1998). Can-do unions: competition brings out the best in government workers. Policy Review. 88, 24.

Goodsell, Charles. (1994). The case for bureaucracy. Chatham, NJ: Chatham House.

Hartung, G. Chris. (1996, July). Institutionalized excellence: not just more pop government jargon? Public Management. 87(7), 25.

Hughey, Vance (1997, January). Workers Compensation in Nevada: A Program in Transition. Nevada Legislative Counsel Bureau.

Insurance Information Institute. (1999). Discussion of Workers Compensation. [Online]. Available: www.iii.org/media/issues/workers.html [1999, March 15].

Jones, Bodil. (1997, October). The customer and the almighty dollar. Management Review. 86(9), 6.

Kilgour, John C. (1998). A success story: workers' compensation reform in California. Compensation and Benefits Review. 30(2), 41-51.

Larson's Worker's Compensation-Desk Edition. (1998). Authority from Matthew Bender.

Lassiter, Ralph. (1997). The human component: helping employees adapt to more competitive operations. American City & County. 112(10), 34.

McGillicuddy, James. (1996). A blueprint for privatization and competition. Public Management. 78(11), 8-14.

Miller, Hugh and Simmons, James. (1998). The irony of privatization. Administration and Society. 30(5), 513.

Millheim, Dave. (1999, June). Public or private sector work: the eternal question. Public Management. 81(6), 18.

Mitchell, Alan. (1997, February). A model for municipal privatization. American City & County. 112(2), 21.

Morgan, D. and England, R. (1988). The two faces of privatization. Public Administration Review. 48(6), 979-987.

Moore, Adrian. (1997). Privatization on a roll. The American Enterprise. 8(6), 68.

Nevada Legislature. (1999). [Online]. Available: http://www.leg.state.nv.us, [1999, February 25].

Nevada. Legislature (1995, August). Three-Way Insurance Authrozied, Effective July 1, 1999. Workers' Compensation Newsletter. 3(1), 1.

Nevada. Legislature (1995, December). Events in Others States.Workers' Compensation Newsletter. 3(2),4

Nevada. Legislature (1997, August). 1997 Legislative Update. Workers' Compensation Newsletter. 5(1), 1.

Nevada. Legislature (1998, July). Events in Other States. Workers' Compensation Newsletter. 5(4), 4.

Nevada. Legislature (1999, January). Events in Other States. Workers' Compensation Newsletter. 6(2), 4.

Nevada. Legislature. (1992). Legislative Commission. Feasibility of privatizing provision of governmental services. Carson City: Legislative Commission of the Legislative Counsel Bureau.

Nevada Legislature. (1999). Bill Summary, Senate Bill 37. Research Division of Legislative Counsel Bureau.

Osborne, David and Plastrik, Peter. (1998). Reducing Government Bureaucracy. The Futurist. January-February, 1998, p10.

Ostermiller, Marilyn. (1998). Laboring Through. Best's Review- Property-Casualty Insurance Edition. 98(5), 9-19.

Rama, Martin. (1997, September). Efficient public sector downsizing. Finance and Development. 34(3), 40.

Reed, Lawrence. (1994). The Privatization Revolution. Ideas and Consequences. 46(10), 661-671.

Roberts, Sally. (1997). Complex issues, divisions make comp reform difficult.(Spotlight Report: Workers Compensation: Targeting the Central Issues). Business Insurance. 31(43), 3.

Segal-George, Marsha. (1998, April). "Government Lite." Chapter 2. Public Management. 80(4), p18.

Sunoo, Breand Paik. (1998, February). Reinventing Government. Interview with US Office of Personnel Management Director James R. Lachance. Workforce. 77(2), 60.

VITA

Graduate College

University of Nevada, Las Vegas

Kathryn A. Mack

Address:
9400 Mt. Cherie #102
Las Vegas, Nevada 89129

Degrees:
Bachelor of Science, Health Care Administration, 1997
University of Nevada, Las Vegas

Master of Public Administration, Public Administration, 1999
University of Nevada, Las Vegas

Professional Paper Title: A study of issues related to privatization of workers' compensation in Nevada.

Examining Committee:
Chairman, Dr. Leonard Goodall, Ph.D.
Committee Member, Dr. Karen Layne, D.P.A.
Committee Member, Dr. William Thompson, Ph.D.
Committee Member, Dr. Jeffrey Waddoups, Ph.D.