

FLASH REPORT!

SCIF SALE: It Might Happen

EXCLUSIVE

By J Dale Debber

In a move that is startling for its Obama like speed and secrecy Governor Arnold Schwarzenegger, or at least his surrogate staffers Susan Kennedy, Cynthia Byrant and David Crane have not only had language crafted - and a process developed- for selling California's State Compensation Insurance Fund, they have attempted to use the Department of Finance to keep their fingerprints well hidden. **They are proposing (in clear and specific language we'll bring you in a moment) that the Department of Finance sell various assets of State Fund. And, in what can only be called an act of extreme Chutzpah which appears to belie their true intentions, they have specifically excluded the California Department of Insurance and the Attorney General from the process.**

What's more, this concept, without language, was accepted by the democrats in Conference Committee on the budget on June 17th and is likely to part of the democrat's budget bill. **The Governor's staff through the Department of Finance has convinced the democrats into thinking it will raise \$1B for this budget. It won't.**

Here is the rest of the inside story as only *Workers' Comp Executive* can bring it to you:

"The Director of Finance is hereby authorized to act as agent for the state and, in that capacity, to sell a portion of, or otherwise obtain value for, the State Compensation Insurance Fund's assets and liabilities."

This is the story of bureaucrats absent any insurance knowledge, acting without regard for the affects of apprehension on the workers' comp marketplace. The lack of market stability and predictability over the long term which will be created by such a plan, according to industry players, will drive carriers to invest their surplus elsewhere. **It has the high probability of creating another workers comp crisis in an already troubled market.**

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The plan evolved, according to sources, through a series of a few meetings held in the Horseshoe in which a number of people from the Department of Finance were involved, lawyer [Jim Woods of Dewey & LeBoeuf](#), and, we understand, others. Mr. Woods had not returned our call in time for this Flash.

The language was drafted by Department of Finance personnel apparently with the help Mr. Woods. The draft is focused on process and the legal aspects. The strategy appears to defer discussion from the "if" to the "how." **Further the strategy is to help balance the budget with a proposed \$1B asset that does not really exist.**

The idea was sold to the Democratic leadership, over the objections of Labor Federation lobbyist Angie Wei and other labor leaders. Labor proposes that funds be borrowed from State Fund.

And the drafters involved State Fund's Board, appointed by the Governor in some interesting and ethically questionable fashions. First, they order the board to cooperate:

"b) Prior to releasing any Notice of Request for Qualifications, a majority of the State Compensation Insurance Fund Board of Directors shall concur that the assets and liabilities that are identified by the Director of Finance in subdivision (a) are appropriate for disposition."

Then the (Governor's) State Fund Board is immunized, as it were, from its fiduciary responsibilities:

"(4) For purposes of Section 11772, any action by the board of directors related to any transaction contemplated by this article, plus, but not limited to, any approvals of such transactions, shall be deemed to be in good faith."

In other states such raids on the assets of State Funds have been put down. Colorado is one recent example. But, it appears the lawyers are trying to preempt constitutional challenges to the "taking" of policyholder's assets. The Governor's people are going to argue that the Board can do whatever it wants and since it is deemed to be acting in good faith there is no recourse to the policyholders. Words do not ethics make.

However, insurance lawyers who asked not to be named, have pointed out some of the holes in the thinking of Susan Kennedy, Cynthia Byrant and their followers: The potential unintended consequence of the sale proceeds going to the General Fund the lawyer says, could be viewed as repeal by implication of the liability of the State in the event SCIF becomes insolvent. **In other words, if this is a partial taking then the State could be liable for "severance damages." In other words if SCIF is**

impaired after this transaction, even at some future date, then the State has to come up with the cash to make it solvent again.

That is not a 1:1 proposition. And it is not a legacy Workers Comp Executive can imagine this Governor wanting to leave. The question is will anyone on his staff bother to inform him of it.

According to earlier documents, it is State Fund's book of business that is the asset most up for sale. In the Governor's May Revise they want to balance the budget with a \$1B infusion from the sale. Quoting the revise: "\$1 billion- Sell a Portion of the State Compensation Insurance Fund (SCIF). Seek a private entity to purchase a portion of SCIF's Book of Business, **with the SCIF remaining as the insurer of last resort.**"

If such a sale occurs the funds will go directly into the general fund and not to the policyholders which arguably own them. Funds will be taken from an already financially questionable State Fund and given to the general fund leaving policyholders rights -and State Fund's balance sheet - in even worse shape.

"11885.7. (a) The Director of Finance shall deposit all proceeds of any sale of, or any funds achieved through any other disposition of, the State Compensation Insurance Fund's workers' compensation insurance assets and liabilities under this article, less any costs related to that transaction, into the General Fund."

But this is a two year plan and allows the Department of Finance to spend undeterminable money out of the current budget for some future event. The recipients of this government largess are likely to include attorney **Jim Woods of the law firm Dewey & LeBoeuf**, mentioned above, and a host of consultants in various aspects of insurance who will serve to receive commissions and fees from [working on] the sale.

"11885.9. (a) Notwithstanding any other law, the Director of Finance is authorized to enter into agreements with firms or individuals to act as advisers to the state in the transactions contemplated by this article. Section 14838 of the Government Code and Article 4 (commencing with Section 10335) of Chapter 2 of Part 2 of Division 2 of the Public Contract Code do not apply to any agreement entered into by the director with advisers pursuant to this section.

(b) Notwithstanding any other law, the Director of Finance is also authorized to enter into legal services agreements to obtain specialized legal advice related to the transactions contemplated by this article. Section 11040 of the Government Code and Section 6072 of the Business and Professions Code shall not apply to the legal services agreements entered into by the director pursuant to this section."

This isn't a new concept, selling the State Fund. It arose briefly during Governor Pete Wilson's administration. **"But," said one old timer "Wilson could keep his whackos under control."**

The Commissioner of Insurance is relegated to the sidelines.

"11885.5. Notwithstanding any other law, the approval of neither the Attorney General, nor the Insurance Commissioner, nor the Director of General Services is required for execution and implementation of the sale or other disposition of the assets and liabilities of the State Compensation Insurance Fund or any other agreement authorized by this article."

While the Commissioner has been removed from in this transaction, he would need to see what, essentially, was left and, if in his opinion, the remaining company was impaired it sets up a considerable conflict given the legislative declaration that any action by the board is deemed to have been taken in good faith.

Effects on a Grander Scale

Allowing a legislature to impair a State Fund to solve an unrelated issue will help drive a stake into the heart of state regulation of insurance. This will offer proof to be used by a federal administration that states can't be trusted with the regulation of insurance. It helps make the case already being made in Washington.

Given the state of the state and the state of the workers' comp market - both of which are in doubt - driving private carriers out of the state will create a large inflow to State Fund thereby further straining its assets.

The sale of state's Fund's assets could be a positive thing if the idea were to use the concept to reduce State Fund to the size it should and could be. But such a move requires the careful consideration of the California Department of Insurance, State Fund's new management and Board, and should have goals carefully defined and publicly set forth at the beginning.

Such goals should include keeping the constitutional formation of State Fund while creating a leaner operation of say 1000 employees with a fresh culture. The depopulation of policyholders, the movement of the claims book to another entity, if such a thing is possible, the suspension of at least a majority of civil service rules and obligations allowing the carrier to operate more efficiently, and the availability of capital through bond offerings to be used to bolster surplus in the event of a market cycle that requires major surplus enhancement.

But such a plan is apparently too much to ask for from officials in the Governor's office who want to hide behind their departments and find new ways to seize the property of some 188,000 of California's small businesses who are insured by State Fund.

The entirety of the draft language can be found in our by [clicking here](http://ws1.wcexec.com/t/80718/31161/23561/0/).
<http://ws1.wcexec.com/t/80718/31161/23561/0/>

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