

CONOLLY & ASSOCIATES

Review of Workforce Safety & Insurance Management and Human Resources

Report to the Board of Directors

Conolly & Associates

3/5/2008

Table of Contents

Section	Description	Page
A	Overview of Review	3
B	Key Recommendations	5
C	WSI Culture and History	10
D	WSI Performance	16
E	WSI Benefit	26
F	WSI Management Turmoil	32
G	Claims Processing Controversy	38
H	IT System Replacement Concerns	62
I	Board Governance	67
Appendix 1	Recommended Organizational Charts	89
Appendix 2	Consultant Bios	96

A. Overview Of Conolly & Associates Review of WSI

Conolly & Associates¹ (“CA”) has undertaken an independent review of Workforce Safety & Insurance (“WSI”) management and human resources on behalf of the WSI Board of Directors (“Board”).

Governor John Hoeven requested the independent review to help the WSI Board address its management related internal governance and, human resource issues, and to ensure that management is focused on the agency’s mission of serving North Dakota’s workforce. The Board concurred with the request and retained CA. CA reviewed the current and past performance of WSI’s executive or senior, and midlevel management, its organizational structure, and its human resource and other governance activities. Because of recent controversies, CA focused particular attention on the relationship WSI management has had to the development of claims administration policies and the role it has played in the implementation of those policies on a day-to-day basis. CA distinguishes its work from that of another third party contractor who has been retained to conduct a separate, retrospective claims audit and analysis of WSI’s workers’ compensation claims actions and determinations.

The objective of this project is to identify immediately the key organizational problems within WSI, and provide recommendations for addressing them that will enable the Board and WSI to take corrective action in an expeditious and orderly manner.

¹ Richard Baum, Neal Conolly, Jack Plunkett and Kevin Ryan completed this review as a virtual consulting practice. A biographical summary of each consultant is attached at Appendix 2.

A1. Methodology

CA was asked to provide a comprehensive report within its approved budget and a highly constrained time frame. To that end, we engaged and interviewed WSI senior and middle management and staff, and external WSI “stakeholders” and interested parties, to review operations in the WSI office, and to review projects and initiatives. We also made an immediate recommendation to the Board that it appoint an Interim CEO from outside the organization.

CA was not engaged to audit, or to test the accuracy of WSI reserves or data or statistics. Where necessary and appropriate to its study and recommendations, CA utilized and relied upon data provided by WSI. We did not audit or examine WSI financial statements or particular parts thereof and did not rely upon data or summaries which could not be reconciled or was deemed unsuited for the purposes addressed; rather, we relied upon data supplied by management from WSI data bases.

B. Key Recommendations

B1. Recommendations To Change Management at WSI

B.1.a. WSI's Board Should Immediately Recruit An Interim CEO ("ICEO") To Restore Trust And Faith in the Capability of Executive Management and Charge the ICEO To Make Immediate and Necessary Executive and Senior Management Employment Decisions

The Board should immediately retain an Interim CEO who is familiar with the culture and institutions of the state of North Dakota and who has demonstrated public or private sector management and leadership skill, and political sensitivity. The Board should direct the ICEO to make immediate management choices and separations where he or she deems appropriate to restore a sense of trust among the management and staff. The ICEO should assist the Board to establish an orderly and effective process for selection of a long term CEO, maintain momentum and work with all members of the Board for consensus to restore public and staff confidence in WSI.

B1.b. WSI's Senior Management Structure should be Modified

WSI's executive management structure should be modified to enable it to relate more directly to the company's day-to-day operations and workforce. The ICEO should consider reducing the size of the executive committee from seven to five positions, retaining on the committee the Injury Services, Employer Services and Law positions and adding to it two new positions: a Chief Financial Officer and Administration Officer. The current Strategic Planning role should be absorbed within the CFO function at a middle management level. The existing Communications function should become a middle management position under

the new Administration Officer. The existing Leadership role should be eliminated, with its primary functions incorporated as responsibilities within the Communications and HR functions under the Administration Officer. Each of the executive committee positions should be endowed with policymaking authority within their discipline, subject to the ultimate authority of the CEO. Each member of the executive committee should have leadership, strategic and succession planning responsibilities.

B1.c. HR Leadership Must Be Strengthened and Trust and Confidence Restored in the Function

The HR function must be made relevant to WSI's operations. Stronger HR communication with the functional divisions of WSI, and HR leadership along with increased expertise will raise its profile within the organization and reestablish its governance accountability. These actions will move HR toward greater credibility in the eyes of the management and staff.

B1.d. Internal Audit Must Be Reviewed to Reestablish Its Independence and Objectivity and Restore Its Trustworthiness Within the Organization

The Board should review the Internal Audit function to ensure that lines of authority, reporting obligations and confidentiality duties are fully understood and accepted. The Board should address the effectiveness of the incumbent in order to restore the function to perceived objectivity, trustworthiness and organizational stature.

B2. WSI Should Adopt Management Performance Benchmarks to Continuously Measure WSI's Effectiveness in Terms of Benefit Delivery and Level of Benefits in Comparison to Border and Similarly Situated States .

The Board should direct WSI to adopt appropriate and well recognized benchmarks to continuously monitor WSI's performance in the delivery of claims benefits and the level of benefits that the North Dakota workforce receives in comparison to border and similarly situated states. WSI's well regarded QA staff has the capability to make the same comparisons, provided external expertise should assist in the design of the appropriate comparisons and facilitate data access protocols as may be required.

B2.a. Executive Management Should Closely Monitor Claims Issues in Relation to Evidence Based Medicine and Degenerative Disease and Aggravation Issues

Executive management should keep abreast of issues involving integration of evidence based medicine into WSI's claims administration process. The CEO and the executive committee should continuously monitor issues relating to aggregation claims and claims impacted by degenerative disc disease as the same intersect with evidence based medicine. WSI should clearly articulate internally its policies regarding acceptance and handling of such claims, and Executive, Legal and Claims personnel should work toward consensus and clear understanding of the requirements of proof that exist and that are emerging using evidenced based medicine. Issues that emerge should be proactively addressed and monitored. The CEO, whether interim or long term, should attend claims staff meetings periodically to hear claims challenges and issues directly from staff.

B3. Hardship Cases Should be Referred to the CEO

We believe that the CEO should be advised of any case that has hardship attributes and that the same should be referred to his/her office for further review and determination to assure that the claim is being handled appropriately, and with recognition of the importance of public confidence in WSI. The CEO and the executive committee should define the parameters of hardship cases and remedies with flexibility. In the event the facts and arguments appear to be equally balanced, the benefit of the doubt should continue to go to the injured worker.

B4. WSI Should Restructure Its Review, Hearing and Appeal Process

WSI has come under external criticism with respect to its November 2007 decision to terminate its contract with the State Office of Administrative Hearings, and to retain private attorneys to act as WSI hearing officers. The appearance of a lack of independence warrants a restructuring under the present statute. We believe OIR should have the right to forward a disagreement over a reviewed case to the CEO directly in lieu of creating an independent appeal process through legislation. WSI should revisit its decision to disassociate from the State Office of Administrative Hearings if satisfactory performance standards can be negotiated.

B5. WSI's Board Should Mandate Executive Officer Review of the IT Systems Project

The Board should require that the CEO and WSI's executive committee closely review the progress of WSI's IT replacement Systems Project and assess the likelihood of a potential conflict between the expectations of WSI line personnel and the deliverables set forth in the contract. Given the magnitude of the cost involved (\$11.5 to \$14

million), a high level executive officer should be designated to report continuously upon the status of the deployment of the system and the abilities of the vendor to deliver replacement functionality on the contract.

B6. WSI's Board Must Increase Mandatory Meetings, Increase Board Compensation, Require In Depth Continuous Reporting Regarding Key Financial, Human Resource and Claims Management Matters

The Board should consider as a goal (1) increasing the number of its mandatory meetings from four to six per year; (2) reaching consensus with its stakeholders, the Governor and the Legislature to help to further professionalize the Board and to have future Board appointments to vacancies include persons experienced in insurance, financial reporting and accounting, law, and information technology, and to obtain support in establishing substantial board member compensation to attract and maintain qualified Board members; and, (3) require in depth continuous reporting from the CEO regarding key financial, human resource and claims management matters currently confronting the organization.

B7. WSI Should Seek To Become Licensed and Subject to Examination and Regulation by the North Dakota Department of Insurance

WSI should seek to establish itself as a fully licensed insurer in the State of North Dakota subject to the regulatory authority of the North Dakota Department of Insurance ("DOI"), and subject itself to reporting requirements and examination of its business and market conduct, and claims settlement practices.

C. WSI Culture and History

C1. WSI Statutory Authority and State Fund Overview

Workforce Safety & Insurance (“WSI”) is a public “organization” established in 1997 under North Dakota Century Code Chapter 65-02-01, administered by its board of directors (“Board”). The Board appoints a director of the organization who serves at the pleasure of the Board and is subject to its supervision and direction. The organization is established for the purpose of administering the workforce safety and insurance law established in Title 65 and Chapter 65-01 of the Century Code.

The WSI organization is required to establish a system of personnel administration based upon principles and methods determined by the organization and governing position classification, pay administration, transfer of employees, discipline of employees, and removal of employees. Biennially, the director must request the state auditor to select a firm with extensive expertise in workforce safety and insurance practices and standards to complete a performance evaluation of the functions and operations of the organization. The evaluation must determine whether the organization is providing quality service in an efficient and cost-effective manner; evaluate the effectiveness of safety and loss prevention programs; and evaluate whether the Board is operating within the law and its by-laws.

The WSI is one of more than two dozen state workers’ compensation insurance funds or similar workers compensation organizations operating in the United States. These organizations fall into one of four categories: (1) “exclusive”; (2) exclusive with the alternative of self-insurance; (3) insurance subdivisions or agencies of the state

“competitive” with private sector carriers; or (4) mutual insurers and/or privatized entities competitive with private sector carriers.

WSI is an exclusive, or what is sometimes referred to as a “monopoly” fund from which all employers in the state of North Dakota must procure their workers’ compensation insurance. Exclusive funds exist in North Dakota, Puerto Rico and Wyoming, and in ten Canadian provinces that operate through monopolistic provincial subdivision workers’ compensation boards. Exclusive state funds that allow the alternative use of authorized self-insurance exist in Washington, Ohio and West Virginia. (West Virginia will become a competitive mutual in July 2008.) Exclusive state funds generally develop their own rates and experience. Their administrative costs are generally lower than those found in competitive state funds or private insurers.

WSI shares several characteristics with other state funds. All state funds must provide insurance to every business in their state required to purchase workers’ compensation coverage for employees, including businesses that are so called “residual” and commercially uninsurable because of high risk work classifications. Secondly, whether they are agencies or subdivisions of a state, or independent companies, state funds are with limited exception “not for profit”. Court decisions or statutes in many jurisdictions, but not all, have determined that the assets, reserves and surplus of the funds are not public monies, but are the property of employers who are insured by the funds. Thus, state fund assets are generally considered to be held in trust for the benefit of insured employers and their injured workers.

State fund organizations generally limit their insurance underwriting to workers’ compensation insurance, and share a governance structure that utilizes a board of directors appointed by the state government. Such appointment insures Federal tax exemption under Internal Revenue Code of 1997 Section 501(c)(27)(B), which requires

that more than one-half of the fund's board of directors or oversight body be appointed by an executive branch official, by the state legislature, or by both.

State funds that are licensed and regulated by their state insurance commissioner are subject to the same regulatory requirements as private insurers, including requirements governing surplus and reserves, market conduct and claims settlement practices. Their financial status is accounted for as required by the state regulator of domicile who must follow the standards adopted by the National Association of Insurance Commissioners ("NAIC"). The NAIC is a fifty state association that works to establish uniform model laws and standards for insurance company solvency, market practices, and financial examination. Because the Congress of the United States has left the power to regulate insurance companies exclusively to the States, the NAIC model law approach serves to provide an important element of uniformity to the regulatory scheme.

The reserves and financial health of most state funds are measured by independent accounting and actuarial firms, who are expert in workers' compensation statutory accounting. State funds, so regulated, can be more readily compared or benchmarked on a national or regional basis with respect to their performance and financial health.

In North Dakota, the Legislature maintains ultimate authority over the WSI organization, the level of workers' compensation benefits, and the ability to reform any part of the statutory structure for eligibility. The WSI, under the direction of its Board, has primary responsibility for administration of the workforce insurance safety law.

C2. WSI Culture and the Strength of WSI

As we began this review, we were made aware of the public controversy that has surrounded the WSI over the past year. Much of the controversy has involved, among other things, assertions that the WSI management and its workforce as a whole has performed poorly, ostensibly placing the company among the ranks of the least effective state funds in the nation. To test the validity of these assertions, we developed a set of measures whereby we could compare the WSI's performance against national standards. We then reviewed that performance to determine the quality and effectiveness of the state's workers compensation delivery system. Based on our review, we determined that the WSI has, overall, evidenced effectiveness, stability and strength in its delivery of workers compensation benefits. In particular, we found that:

- Workers' compensation claim litigation in North Dakota is now at a historical low.
- The WSI has an adequate surplus to cover the future cost of all incurred claims.
- Premium levels in North Dakota are at the lowest level premium rates of any state in the United States.²
- North Dakota's benefits paid at .88 per \$100 of payroll place it 33rd in the nation, despite having the lowest premium in the United States.³

² 2006 Oregon Department of Consumer and Business Services Workers' Compensation Premium Rate Ranking Summary, where WSI ranks 1st with the lowest premiums in the United States in 51 jurisdictions, with North Dakota premium at 20% of Alaska [the highest]; 30% of Montana; 40% of Minnesota; 60% of South Dakota.

³ Workers' Compensation Benefits, Coverage and Costs, 2005, published by the National Academy of Social Insurance – August 2007. By comparison West Virginia is 1st at 3.39; Montana 2nd at 2.11; Iowa 26th at 1.10; Minnesota is 32nd at .89; and South Dakota 40th at .83.

- Injured worker and employer surveys show a very high satisfaction rate with WSI's administration of claims and its employer services.⁴

Moreover, measured by customary key standards and ratios applied to workers' compensation carriers throughout the United States, WSI's numbers are particularly favorable. While no single number or ratio is indicative of administrative or fiscal responsibility or strength, comparison of key ratio's which show above average performance with similar regional systems is a good indicator of an efficient and well run workers' compensation organization.

A review of the AASCIF Fact Book (which lists 23 state funds updated through 2005) shows the average state fund operating ratio or cost relative to its premium income at 24.5%. WSI's ratio for the same study was 20.3% indicating that WSI was 20% less costly to operate than the average state fund. WSI's operating ratio during its most recent fiscal year was an even better 16.2%, a significant achievement, and a ratio that compares favorably with most private insurers as well as state funds.⁵

The ratio of WSI's surplus to its net premium is also very strong at approximately 4 to 1, particularly when compared to Arizona's well run competitive state fund at 2.2 to 1; Utah's at 1.5 to 1; Montana's at 1 to 3; and Wyoming's at a negative -1 to 1.

WSI has been able to achieve its favorable ratios, while pricing its insurance policies at a gross underwriting loss, based on solid investment returns and its low cost structure i.e. at a ratio of 9.6 of premium to 10 of losses paid out. By comparison, most small state AASCIF funds report a gross underwriting profit, with losses paid out being

⁴ DH Research and Business Intelligence Survey injured worker and customer service survey conducted January 2007

⁵ For example, GEICO as a part of the Berkshire Hathaway Group, is a well regarded national and comparable non-broker and direct marketer of property casualty insurance, had an underwriting expense ratio ranging from 17.3% to 18% in its last three reported years. See <http://www.berkshirehathaway.com/2006ar/2006ar.pdf>

less than and below their net premium income: compare Colorado at 5 premium to 4.4 losses; Montana at 8 premium to 6 of losses; Utah at 2.2 premium to 1.6 of losses; and Wyoming 1.6 premium to 1.1 of losses.

D. WSI Performance

We have reviewed statistics for the purpose of evaluating the performance of the management of WSI, with one indicia of measuring performance by using a macro methodology. By comparing available indicative statistics from organizations somewhat similar to WSI, we have arrived at a broad scoped evaluation of WSI's performance.

We have considered two aspects in this evaluation:

1. General expense: What is the cost of administering workers compensation benefits in North Dakota compared to the cost of doing so in other States? An insightful approach would be a comparison to somewhat similar operations. This leads us to other State Funds. It must be kept in mind that all State Funds are not similar: some are significantly larger while others have small shares of the workers compensation market, some operate in a competitive climate while others, like North Dakota, are monopolistic. Nevertheless we believe the comparison aids in developing an evaluation of the overall efficiency of WSI.
2. Claim characteristics: Do the generally available claim characteristics support the assumption that claims are being handled in a fashion compatible with other jurisdictions? We have primarily depended on a selection of surrounding States on which to base our evaluation.

Due to the time constraints and scope of this review, a full performance analysis was not contemplated to be within the purview of our assignment. However, sufficient data is available to develop an estimate of the overall efficiency of the WSI operation.

D1. Expense of Operating WSI

State Funds in many states are regulated by the Department of Insurance and as such must file annual statements with their insurance department. As a result, data is available concerning what portion of the premium collected is used in administering the system. Keeping in mind that there exist dissimilarities, such as the payment of commissions to agents, State Funds, as a group, nonetheless, can form a valid comparison for WSI.

We have available data from the following State Funds: Arizona, California, Colorado, Hawaii, Kentucky, Louisiana, Maine, Minnesota, Michigan, New Mexico, Oregon, Rhode Island, Texas and Utah.

The following table shows that WSI operates incurring cost and expense at about one-half the premium percentage of other State Funds.

	State Funds ⁶	WSI ⁷
Gen Expense and Unallocated Loss Expense	28%	16%
Allocated Loss Adjustment Expense	12%	4%
General Expense and all Loss Adjustment Expense	40%	20%

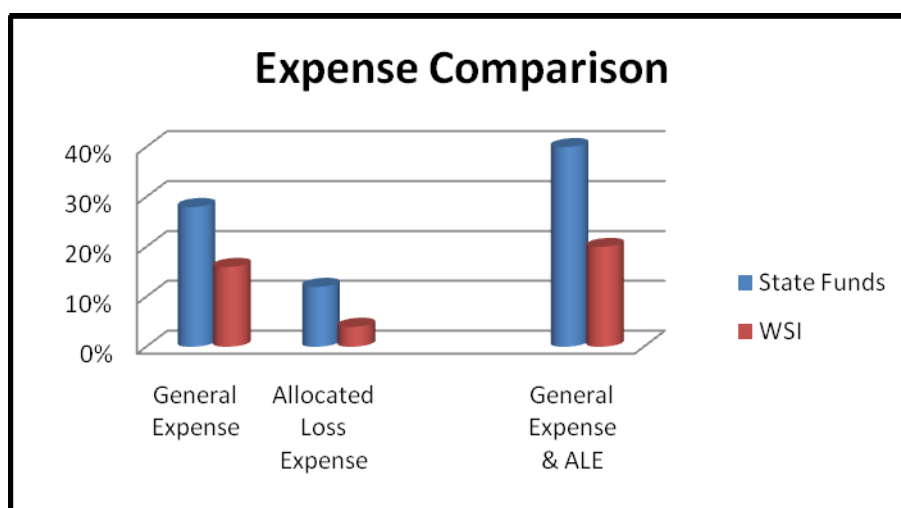
Source: WSI and NCCI's report *Workers Compensation Detail Claim*

Characteristics

⁶ The data available for the listed State Funds was for years 2002 through 2005, except for Arizona, California and Colorado which were available for only 2002 through 2003. The data can be found in NCCI's latest Detail Claim Study.

⁷ WSI data are for the years 2002 through 2006. Because of the consistency of the data, the difference in years does not present a statistically significant problem.

Even considering the differences in State Fund characteristics, it is apparent that WSI is operating at considerably less expense than other workers compensation insurers of a somewhat similar nature.



Source: WSI and NCCI's report *Workers Compensation Detail Claim Characteristics*

The management of WSI showed remarkable business acumen in the area of reinsurance. Beginning in December of 1999, they entered into a reinsurance agreement with one of the country's largest reinsurers, Munich American. Through November of 2002, when the contract was terminated, they had paid \$4.7 million in premiums. As of November 30, 2007, they had ceded \$24.2 million in losses to Munich American. Through this one management decision they were able to save WSI approximately \$19.5 million.

D2 Comparative Claim Characteristics

In evaluating management through a review of the statistical performance of WSI, it is not sufficient to examine WSI expenses. A most important measure is the treatment of the injured claimant. Data used for this purpose is scarce, but several indicative data elements are available from NCCI's *Workers Compensation Detail Claim Characteristics* that can assist in the evaluation of how North Dakota fares compared to other States in handling workers compensation claimants.

The first statistic is the length of time between the date of injury and the date when the first benefit is paid.

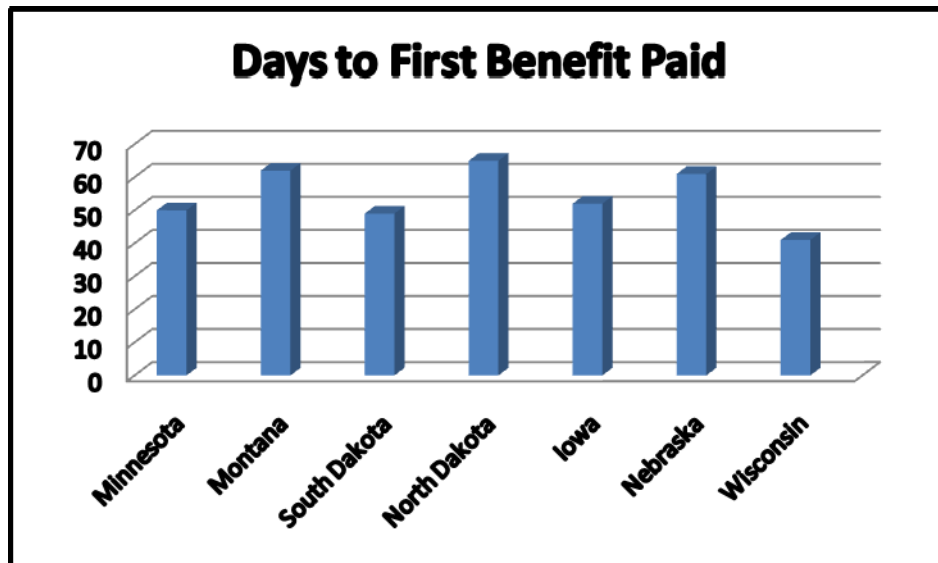
Although North Dakota is approximately the same as the countrywide average for the most recent period, it ranks as the highest in the number of days taken to deliver the first benefit payment when compared to surrounding States. Montana and Nebraska are relatively the same, while the remaining states in our analysis are significantly better.

		First Benefit Paid	
Minnesota		50	
Montana		62	
South Dakota		49	
North Dakota		65	
Iowa		52	
Nebraska		61	
Wisconsin		41	
Countrywide *		66	

Source: WSI and NCCI's report *Workers Compensation Detail Claim Characteristics*

- The Countrywide is the average of all states for the most recent period

WSI's performance measured by the timing of the average first claim payment, because WSI is currently performing on an average basis, should be reviewed in detail by management with the goal of improving performance in benefit delivery.



Source: WSI and NCCI's report *Workers Compensation Detail Claim Characteristics*

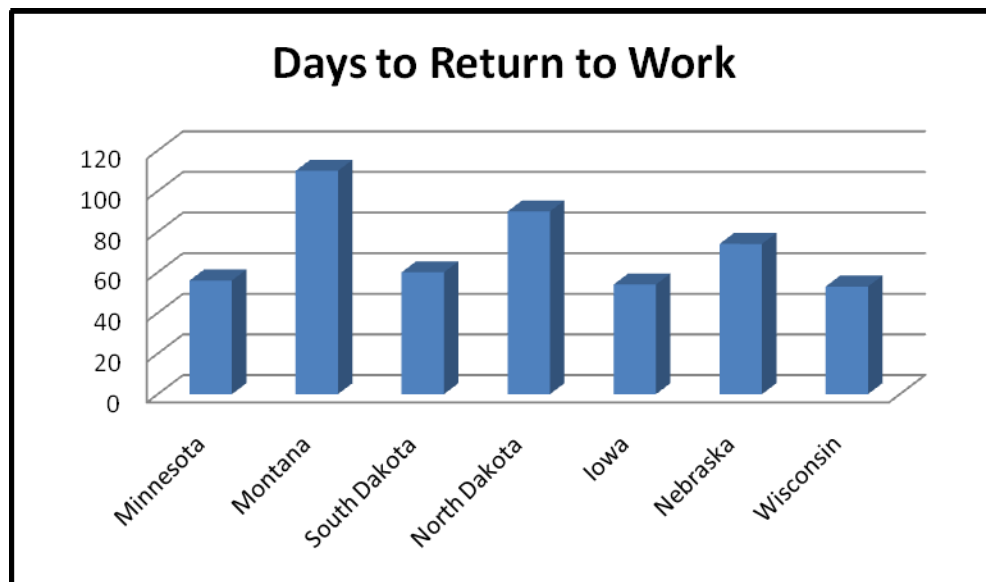
A second aspect of the workers compensation system is the important characteristic of return to work. Most experts would consider that a return to work as one of the ultimate goals of the workers compensation system. The healing process depends on the proper medical treatment and the rehabilitation that WSI offers to the injured worker.

North Dakota workers are returning to work slightly longer after their disability than are workers countrywide on average.

		Return to Work	
Minnesota		56	
Montana		110	
South Dakota		60	
North Dakota		90	
Iowa		54	
Nebraska		74	
Wisconsin		53	
Countrywide		86	

Source: WSI and NCCI's report *Workers Compensation Detail Claim Characteristics*

Management should continue to work to improve the rehabilitation efforts to decrease the period it takes to return to work. However, the makeup of the workforce and the resulting types of injury, the relative older age of the North Dakota workforce, all may be causative factors for its relatively weaker ranking.



Source: WSI and NCCI's report *Workers Compensation Detail Claim Characteristics*

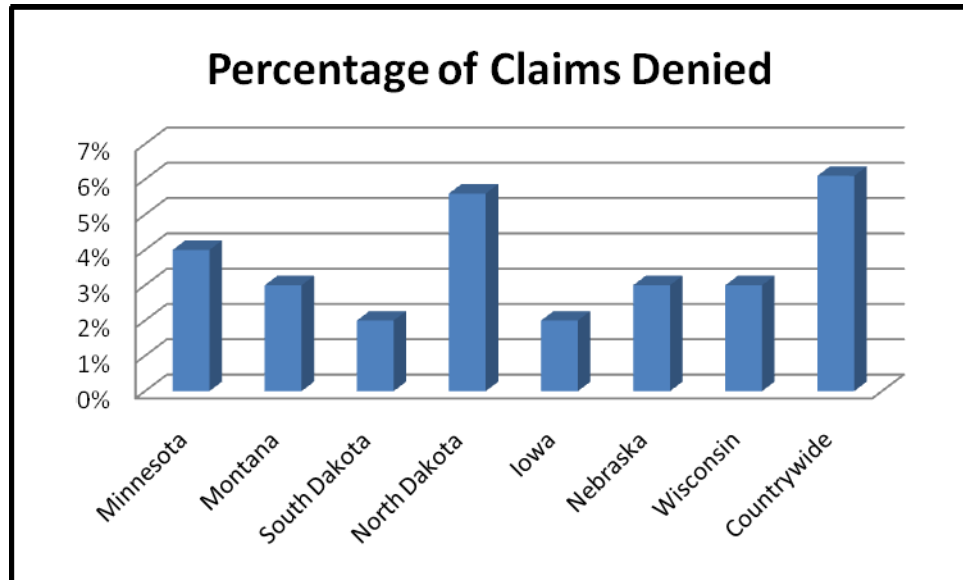
Recent reports have highlighted an alleged above average claim denial rate as a claim practice that has been investigated in other sections of this report and by another coterminous review by a separate consulting organization, Marsh. That circumstance involves the assertion that there is a systematic, unwarranted claim denial process. The data below shows that, for surrounding States, North Dakota has a higher percentage of claims denied.

		Denied
Minnesota		4.0%
Montana		3.0%
South Dakota		2.0%
North Dakota		5.6%
Iowa		2.0%
Nebraska		3.0%
Wisconsin		3.0%
Countrywide		6.1%

Source: WSI and NCCI's report *Workers Compensation Detail Claim Characteristics*

Oklahoma had the highest denial rate at 17%; Alaska was not far behind with a rate of 15%. Michigan had a rate of 12%, while Missouri and Illinois had equal rates of 7%.

For the nation as a whole, however, WSI shows a denial percentage that is less than, and thus deemed less contentious than the countrywide average.



Source: WSI and NCCI's report *Workers Compensation Detail Claim Characteristics*

D3. Conclusion

Although WSI's operating characteristics, namely its cost of doing business and the efficiency of its operation, show it to be less costly and more efficient than similar organizations, comparison with surrounding states shows a number of areas in which it can improve.

E. WSI Benefits

Although it is the responsibility of the legislature and not WSI to define benefits, the question as to the level of benefits in North Dakota has been linked to WSI management. It has been asserted that North Dakota's benefits are the lowest in the country based on an "actuarial study"⁸ which at best is a flawed assertion..

Comparing the level of benefits across states is a daunting task and to perform that function in a manner that is not supported by actual data, is not only misleading, but dangerous. As the National Academy of Social Insurance, a highly regarded assembly of Workers Compensation academics and practitioners, stated in its study⁹ on benefit adequacy across states, " an appropriate study of adequacy compares the benefits disabled workers actually receive with the wages they lose because of their

⁸ During our review we encountered reference by various interested parties and WSI's James Long, PhD, to a writing entitled "Workers Compensation State Rankings Manufacturing Industry Costs and Statutory Benefit Provisions 2007 Edition" by Actuarial & Technical Solutions, Inc. [the "Study" by "ATS"] Reference was made to a summary in Charts [5 & 11] in the study that refers to "States with the *Lowest* Statutory Wage Replacement Benefit Provisions" purporting to Rank North Dakota as "1" the lowest.

We contacted ATS and learned from them that the Study did not:

- Look at actual benefit payments
- Reflect how the benefits are administered
- Reflect how the law is administered
- Reflect the medical portion of the system (which is 60 percent or more of the payments in many states)
- Use actual benefits paid to injured workers
- Reflect the type of employment in each State

The same comparison was actually made, according to the Study by "...an expected average cost per case for wage replacement benefits ... determined in accordance with the applicable workers compensation statute. ..indicating the state with the lowest indicated statutory cost per case."

In substituting hypotheticals for data and unsubstantiated assumptions for actual claim information, the study's conclusion can be best categorized as unwarranted and unsupported musings. We told Mr. Long that the conclusion asserting lowest benefits in North Dakota from the Study by ATS is simply untrue, and is unsupported by data.

⁹ *Workers' Compensation: Benefits, Coverage, and Costs*, 2005, page 17.

injuries...Such data are not available on a consistent basis across states. Aggregate benefits relative to aggregate covered wages could be high or low in a given state for a number of reasons unrelated to the adequacy of benefits that injured workers receive.”

Nonetheless, unlike the aforementioned “actuarial study” the academy reviewed available data and with substantial caveats placed North Dakota at or above the level of eighteen States in 2005 for Workers’ Compensation benefits paid per \$100 of covered wages.

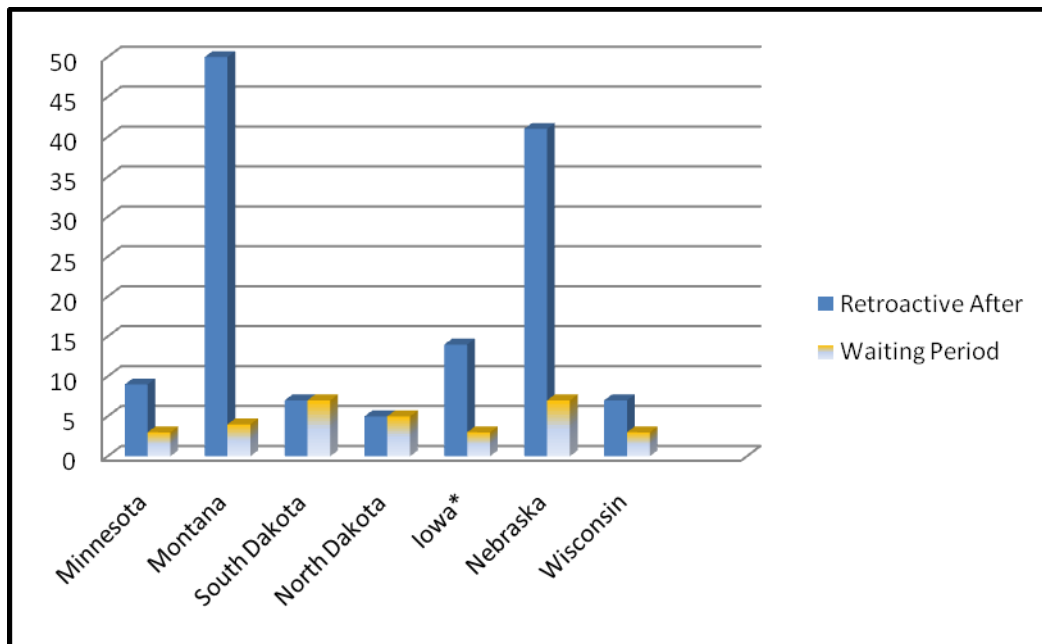
Nevertheless, in order to avoid reaching erroneous conclusions about WSI based on flawed data or no data, we recommend that the WSI Board direct a continuing review be commissioned comparing important aspects of North Dakota’s law governing benefit amounts and payments to the laws of border and similarly situated States. Such a review is well within the capability of WSI’s well run QA group although external expertise could assist in the design and data access protocols necessary for the same..

The first aspect of any Workers’ Compensation claim deals with the number of days an injured worker must wait before he or she can claim benefits. A related aspect is the number of days a worker must be injured before receiving benefits retroactively.

	Waiting	Retroactive
	Period	After
Minnesota	3	9
Montana	4	50
South Dakota	7	7
North Dakota	5	5
Iowa	3	14
Nebraska	7	41
Wisconsin	3	7
Wyoming	3	9

Source: *2007 Analysis of Workers’ Compensation Laws* U.S. Chamber of Commerce

North Dakota is lower than two of the other six States in the waiting period category, a positive aspect for an injured worker, and has the most liberal of the seven States for the retroactive provision.



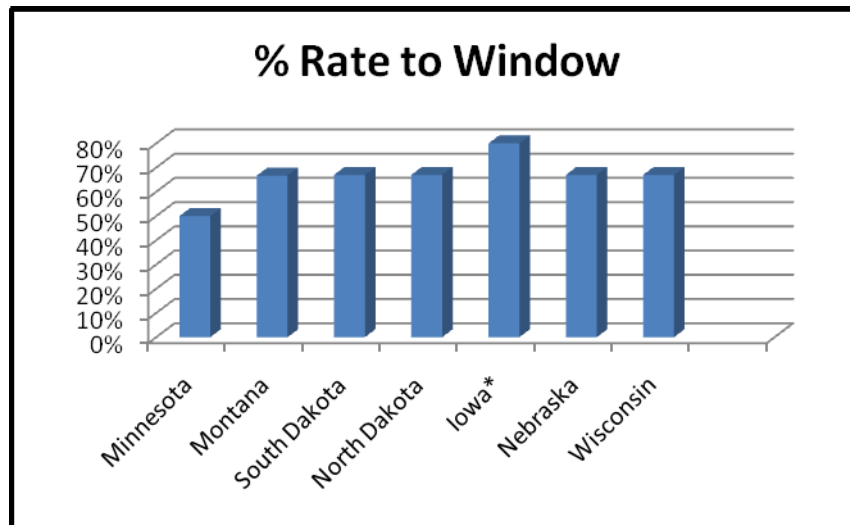
Source: 2007 Analysis of Workers' Compensation Laws U.S. Chamber of Commerce

Another important provision of the workers compensation benefit law is that of the percentage of wages that is awarded as a benefit to the widow of a fatally injured worker.

		% Rate to Window
Minnesota		50%
Montana		67%
South Dakota		67%
North Dakota		67%
Iowa*		80%
Nebraska		67%
Wisconsin		67%
*Percentage is of spendable wages		

Source: 2007 *Analysis of Workers' Compensation Laws* U.S. Chamber of Commerce

Most states have 66 2/3% as the percentage of wages for these claims. North Dakota does as well, while one of the other six states is above and one below that amount.



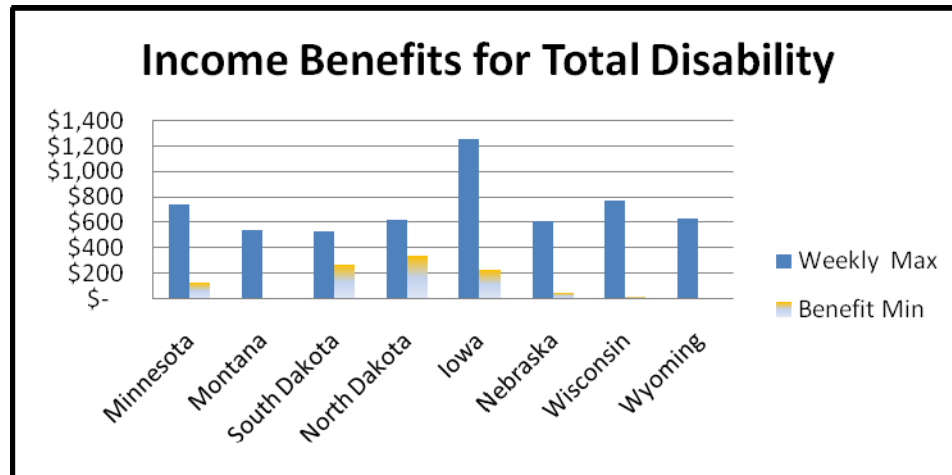
Source: 2007 Analysis of Workers' Compensation Laws U.S. Chamber of Commerce

Another important benefit issue is the maximum and minimum allowable benefits for total disability. State laws specify limits as to weekly benefits that are paid to an injured worker. The payments themselves are calculated as a percentage of the workers average weekly wage.

Income Benefits for Total Disability		
	Weekly	Benefit
	<u>Max</u>	<u>Min</u>
Minnesota	\$ 750	\$ 130
Montana	\$ 545	
South Dakota	\$ 533	\$ 267
North Dakota	\$ 624	\$ 341
Iowa	\$ 1,264	\$ 232
Nebraska	\$ 617	\$ 49
Wisconsin	\$ 777	\$ 20
Wyoming	\$ 638	

Source: 2007 Analysis of Workers' Compensation Laws U.S. Chamber of Commerce

While North Dakota is in the middle of the seven states for the allowable maximum weekly benefit, it has the highest minimum benefit in the seven states. Two states, Montana and Wyoming do not have minimums.



Source: 2007 Analysis of Workers' Compensation Laws U.S. Chamber of Commerce

E1. Conclusion

A review of the data and pertinent aspects of the North Dakota workers compensation benefit provisions shows that North Dakota is neither the most generous in providing workers compensation benefits nor the lowest. The most respected and prestigious workers compensation study group, the National Academy of Social Insurance, has arrived at this same conclusion. To conclude otherwise in the absence of additional empirical evidence will create unwarranted concern about WSI management and could lead to damaging policy decisions to the current system. A well constructed performance and benefit study, performed continuously or periodically, will provide a factual basis that does not now exist to consider the North Dakota benefit structure in comparison to other relevant states.

F. WSI Management Turmoil

The current and recent public controversy about WSI has been fueled in part by the public perception, particularly during the last year, that executive or senior management at WSI was or is in turmoil. Our review confirms that the WSI senior management has been wracked by dissention and division, mistrust, disloyalty and destructive behavior that has, in turn, fanned the flames of controversy. While we did not seek to uncover every historical action that has lead to the current perception, we did identify certain key actions that have contributed directly to significant internal dissention and given rise to public reports concerning poor leadership and morale.

We should observe that, notwithstanding the on going controversy regarding the performance and employment status of WSI's senior managers, WSI continues to perform well in the day to day administration of North Dakota workers' compensation system. The vast majority of WSI program staff are well trained, understand their jobs and responsibilities, perform as team players, and are lead by a strong group of mid level supervisors and managers. Most of the managers and staff at WSI have continued to work well and hard, despite senior management's mistakes and the ever-present distractions and adverse publicity occasioned by those mistakes. WSI is not in danger of collapse nor are its most important constituents, injured workers and their dependents, and North Dakota employers in any danger of disruption of the attention and service they expect.

F1. Recent Management History

In April 2004, the WSI hired from out of state, a director who had significant workers' compensation and exclusive state fund experience and credentials, to become WSI CEO. Three years later, in April of 2007, the WSI Board placed this same

CEO/director on administrative leave after a criminal indictment had been filed against him personally. The charges included by way of example: a charge that the state driver's license data base had been misused at the CEO's direction and charges that the CEO had improperly managed or used WSI/public funds. While all charges were subsequently dismissed, some are still being pursued for reinstatement upon appeal to the North Dakota Supreme Court. The CEO separated from WSI with severance pay granted by a majority vote of the WSI Board in December 2007.

Needless to say, the controversy surrounding the most recent CEO has not had a positive impact at WSI.

F2. Divide and Conquer Reorganization and Turmoil in Employer Services

During the course of our interviews, we were repeatedly advised of a series of senior management actions at WSI that have become internally legendary, and are widely cited as the seminal cause of staff and supervisory fear, distrust and emotional scarring at WSI. These same actions are universally regarded as mistakes, and as symbols of the kind of management action or inaction that has produced today's turmoil, and which has wounded many of the staff and supervisors and managers remaining at WSI. We note that of the five current members of the Board we had the opportunity to meet and interview, none was ever made aware of the details of what we learned.¹⁰

One year into his tenure, and during the summer of 2005, the CEO held a management "summit" meeting with 28 attendees, with ten selected by then current Vice Presidents, ten alternates and several other persons selected by the CEO or with his approval. Four teams were created from the attendees to identify WSI management

¹⁰ In the order of our interviews: Ed Grossbauer, Mark Gjovig, Acting Chair; Terry Curl, Bobbie Ripplinger, Audit Committee Chair, and Brad Ballweber. We have also reviewed two years of Board minutes.

issues and to define solutions, with an outside consultant hired to facilitate each team. Committee presentations addressing WSI management ultimately suggested the deletion of multiple senior positions, with a stated goal of making a “flatter” organization.

The process included the demeaning and occasional humiliation of members of then current management by subordinates, and ultimately created a sense of favoritism and “inclusion” as well as “exclusion”. After the summit several well-respected Vice Presidents were demoted with three ultimately leaving the WSI, and only one existing senior executive keeping her position. Three new senior executives from outside the organization were subsequently hired.

A follow-up and “secret” retreat was held in the fall of 2005 with two dozen invitees who the CEO believed accepted and represented his vision for the organization. All participants were sworn to secrecy about the meeting. Participants were told to put their past grievances in a barrel and then to burn them collectively. The CEO also told them to “grab a ticket to get ready for a great ride” and gave each of them a copy of motivational book he personally autographed. WSI staff and supervisors who did not attend the meeting did not learn of its outcome, but word of its occurrence spread quickly as did a fearful perception among the staff, supervisors and managers that a large reorganization was coming. The CEO offered no communication with respect to any impending changes.

Earlier in May of 2005 the CEO elected to reorganize his executive committee in an apparent effort to “flatten” the organization, but hired a number of senior executives from outside North Dakota, including a new “Chief” of Employer Services (See Section I.1.1 infra). Employer Services (“ES”) encompassed most of the traditional and integral policyholder business functions of WSI’s workers’ compensation organization including: underwriting of existing and new business, premium auditing, collections, loss

prevention and safety, and the WSI “Grant” program. Later in the fall of 2005 the new ES Chief began to hold private meetings with a select group of subordinates, whom he challenged to define their vision for a new ES structure.

At year end the ES Chief held a meeting of ES management and staff which the CEO attended. The Chief presented his vision for the new ES, and a new organization chart. The chart contained job titles and reporting lines, but few of the newly titled jobs were recognizable as to function. There was no information as to scope or activity of the newly titled jobs, nor job descriptions or salary grades. Each attendee was told that their current job no longer existed, and was given 24 hours to select a future job by choosing one or more of the charted positions. When one employee inquired about the job in which he had been working prior to coming into the meeting and which did not appear on the chart, the ES Chief responded with the observation: “Maybe your job was not that important.”

The CEO was said to have commented during the meeting that he had “never seen this process before, but it has potential.” In reply to a question about how to select a position that had no job description, the ES Chief is reported to have replied: “If you have passion it should not matter whether you have experience.” As a result of the process, within several days the ES Chief chose three supervisors who had no technical expertise in the field they were to lead and who had no prior supervisory experience. The staff and managers, most of whom had families to support, were frightened and upset. Furthermore, affected employees desperate to learn more about their circumstance advised that they could not get any meaningful assistance or reassurance from the HR department as to the implications of the reorganization. Within three months more than a dozen experienced managers and staff left the organization.

In 2006, after the “reorganization”, ES service to external customers quickly eroded. For example, the timing for coverage applications processed within 14 days

declined from 91% in January to 31% in December. Payrolls processed in 14 days declined from 96% in January to 27% by March of 2007. Production in ES was also impacted by an over-riding directive from one of the new ES managers, described as a bully with no supervisory experience and wholly uninformed about the functions supervised. The directive required all staff to prioritize their work day setting as their first daily priority, the detailed documentation of their job activities—so that the same document would allow anyone to perform that job function, regardless of qualification. The functional day to day ES business activity was relegated to a secondary priority.

To keep up with WSI's daily ES workload, work was completed in a clandestine fashion by those who were experienced but now out of their former positions. Staff worked together secretly to assist those who had no experience with the task they were now reassigned, and in many cases took work home. Trained and competent staff were transferred from their trained activity and demeaned, while unqualified and untrained staff took their places.

Many of the staff who lived through the ES reorganization consider themselves emotionally scarred, and have little trust in the management who did not intervene to stop the chaos and anguish. We interviewed a number of ES personnel who explicitly believe that HR and some of the current senior managers were in a position to stop what was happening to ES supervisors and staff, but who would not confront the CEO. We were told that the WSI mission statement, which invokes reference to "passion" is anathema to many ES staff, as it serves as a constant reminder of statements made repeatedly during the reorganization to the effect that untrained people can do anything if they have "passion."

Ultimately, more than a year after the reorganization, certain members of his senior staff confronted the CEO and insisted that he terminate the Chief of ES immediately. Although the CEO agreed, and ultimately acted to discharge the Chief of

ES, the termination was not immediate as promised, generating further dissention and anger and mistrust. The ES reorganization has subsequently been reversed by the interim management, although many competent and qualified staff members left WSI, and many remaining staff members have lingering resentment to senior WSI senior managers and to HR for what they suffered.

F3. Impact of ES Reorganization

As noted earlier, we heard details of the ES reorganization upon multiple occasions and at multiple levels of the organization, both within ES and from staff within the Claims department who genuinely believed that something similar could happen to them. We fully credit the truth of the reports we received as to the actions taken in the ES reorganization.

From our discussions with current Board members it appears that none were made aware of the methods used to reorganize the ES function, despite their having been sanctioned by the CEO. We regard the approach to reorganization taken as unprecedented, either in the insurance or business world. We also see it as the primary source of long term scarring and distrust among the ES staff and the rest of the organization.

The 2005 retreats and the ES reorganization have a significant place in the context of understanding the turmoil that has more recently emerged at the WSI at senior levels of management. As noted above, these events produced a profound sense of fear and distrust of senior management throughout the organization. In light of that distrust, we believe there is an immediate need to replace those current leaders who are regarded as ineffective and un-trusted with restorative new leadership. We again note that the vast majority of WSI's workforce performed the daily business of the organization effectively throughout these experiences and continue to do so today.

G. Claims Processing Controversy

G1. Claims Allegations

As was noted above, early in our examination we were made aware of assertions by the media and allegations by two senior managers that WSI has engaged in a conscious effort to deny otherwise compensable claims. In particular, these assertions alleged that WSI had adopted a policy to discourage claimants by systematically delaying Claim department decision making and arbitrarily contesting cases. To assess the validity of these allegations, we interviewed both WSI staff and external interested parties regarding the role senior management has played in the claims handling process, focusing our inquiry on whether WSI management is clearly committed to the WSI's mission of serving the workforce of North Dakota.

We also met with a senior representative of the Governor, and with legislative members from both the North Dakota House and Senate who each spent a significant amount of their individual time to provide their perception of the WSI and the matters in controversy, as well as to provide anecdotal references to their own experience in representing constituents and their views and frustrations, both positive and negative, of the WSI and the controversy.¹¹

We also met with representatives of organized Labor who provided us with a written critique of North Dakota's Workers' Compensation benefit laws.¹² Finally, we met with Sebald Vetter who advocates on behalf of injured workers and faithfully attends WSI Board meetings. In our interview process with each of these persons, we

¹¹ Ryan Bernstein counsel to the Governor; Senator David O'Connell; Representative Merle Boucher; Representative Rick Berg; Senator Joel Heitkamp.

¹² Made available to us by David Kemnitz of the AFL CIO who is an articulate supporter for a change in Workers' Compensation benefits law, and who met with us at length and made the critique available for our review, for which we are grateful.

made a concerted effort to obtain credible evidence of any facts orally proffered in support of or in opposition to the assertion that WSI has failed North Dakota's injured workers and their dependents.

G2. Claims Management Review Methodology

During the course of our study, in addition to the persons identified above, we have interviewed the current Chief of Injury Services, the Interim Chief of Injury Services, the Claims Director, and all six Claims unit supervisors. These WSI people manage most of the approximate 100 people who do the Claims work for the WSI.

We also interviewed the Medical Services Director, the Return to Work Coordinator, and the UR Nurse supervisor as well as the former WSI Claims Director, the General Counsel, the Chief of Support Services and the Internal Auditor. We have also met with individual WSI Claims analysts. Without prior notice or we attended a live Claims medical triage meeting with the WSI Medical Director and the WSI Pharmacy Director (both doctors), and multiple claims representatives and nurses who attended the same meeting held in Bismarck and also attended through video conference in Fargo.

We sought facts at every opportunity to determine WSI's attitude toward claimants, and asked pointed questions concerning the same during the course of each of our interviews and meetings with the claims specific individuals mentioned. We took the same approach in our meetings with other WSI personnel and officers who might have insight regarding the WSI philosophy and practice in the handling of workers compensation claims. We have on every occasion asked, and pressed to find any facts which would tend to support a claim that there is any negative WSI management practice or attitude toward the handling of claims. We did not, however, perform an

objective review of any particular WSI claims, nor did we consult with or intrude upon the Marsh retrospective study of WSI claim files

We have particularly looked for any facts or suggestion of facts that WSI management encourages a policy or practice that would deviate from the legal standards for the adjustment of workers compensation claims as established in the Century Code.

G3. Claims Findings

Overall, we were impressed with the knowledge and articulation of the Claims professionals and staff, and their credible assurances that they adhere to the principle that taking care of the injured worker is of paramount importance at WSI. We often heard the phrase that "the tie goes to the worker." In our discussions we found the WSI Claims staff to be open and spontaneous, and their comments were made with what we perceived to be genuine sincerity. There is clearly a focus upon bringing the injured worker to proper and maximum medical improvement, and to getting a claimant back to work as soon as practicable with proper medical treatment.

We learned that there has been debate within the organization regarding the appropriate interpretation of the "objective evidence" standard found within the Century Code, and reconciliation of the same with notions of historical and customary North Dakota medical practice. The WSI Claims management is cognizant of the current national trend in the workers compensation industry toward the use of objective and fixed standards for medical treatment, such as the American Medical Association Guidelines, and similar objective standards for appropriate treatments, time for healing and for disability, etc., standards which have been adopted in many jurisdictions in the last ten years.

We are aware that Claims staff do have, in complex cases, occasional difficulty in getting information or answers to questions, as some providers or medical offices would prefer not to have to answer questions relating to objective standards, or resent the extra time and paperwork that the same cases require. WSI has hired fifteen nurses and a staff MD as well as a PHD Pharmacologist to help facilitate communication with busy medical professionals, with the intent of advocating for the best possible outcome. These efforts are not always appreciated or successful.

To be sure, Claims staff agreed that the need for objective evidence may cause a delay upon the acceptance of some cases. Where the objective medical evidence is lacking, efforts to obtain the same evidence, can and often will result in delay. However, we could find no one in WSI Claims who believes that management has ever directed delay in the acceptance of cases as a practice or strategy to discourage a claim. To the extent that the organization has had open discussion and debate about problems with objective evidence, we see the same as an indication of proper management and internal communication to reach the right approach under the law – such internal openness and communication must continue to be encouraged. We found no evidence of a top down direction to achieve any particular financial outcome, rather, we saw claims staff who are comfortable in openly taking a position upon their claims, and who have ready resort to experienced supervisors, nurses and Doctors, who strive to work as a team. Finally we were also advised by Claims staff that the legal department has acted as a backstop, to insure consistency and adherence to the Century Code.

We have been told by a number of external stakeholders and interested persons whom we interviewed, and by two senior WSI officers, that they had heard or they believe that there is, in fact, a practice at WSI to tighten or restrict the way that WSI has handled its claims with the intent of denying legitimate coverage. We requested, but were provided with no specific examples to support these allegations or beliefs, nor

provided with facts of any WSI actions or conduct taken in the handling of a claim that was inconsistent with the Century Code.

We are certainly aware of multiple complaints made in the public debate concerning WSI, regarding the requirements for compensation eligibility that are contained in the Century Code, and will comment upon the same in greater detail. WSI is perceived by some to be the de-facto writer of the workers compensation statutes within the Century Code. There are surely complaints about WSI claims decisions that arise in extended or complex cases, where eligibility for benefits terminates due to time or application of non-compliance rules relating to vocational rehabilitation and/or return to work. The policy issues that such complaints implicate are not, however, indications of conduct that sustain a claim that WSI violates the law.

We believe that the WSI Claims Department performs well using customary claims metrics, and that it appears populated with well trained staff and an attentive Claims management. We are impressed with the work ethic of the people who are employed in WSI Claims, and with their understanding of what is expected from them under the law and by WSI management and stakeholders.

G4. Evidence Based Medicine

WSI has incorporated Evidence Based Medicine ["EBM"] in its claims process. EBM is part of a decade plus emerging approach to diagnosis and treatment in occupational medicine in the United States and Canada, and is not the creation of WSI or imagined anti-claimant insurance entities. EBM is "the conscientious, explicit and judicious use of current best evidence in making decisions about the care of the individual patient. It means integrating individual clinical expertise with the best

available external clinical evidence from systematic research."¹³ That WSI has adopted and uses EBM is at the center of the broader controversy regarding its claims practices. Evidence based guidelines include those known as the American College of Occupational and Environmental Medicine (ACOEM). Such guidelines were first developed to scientifically address medical issues common to most occupational medicine systems. For example, approximately 30 percent of occupational claims did not have specific diagnoses. The same guidelines were developed from research that began in 1992.¹⁴

In July of 2005 WSI adopted the Work Loss Data Institute's Official Disability Guidelines – Treatment in Workers Comp (ODG) to objectively gauge the prescribed treatment and expected disability duration for workers' compensation claims being adjusted at WSI. WSI's adoption of ODG was consistent with several US States¹⁵ and Canadian Provinces in adopting the ODG, as it is a well recognized and accepted database for the application of evidence-based medicine in workers' compensation.

¹³ David Sackett MD. 1996 Duke University Medical Center Library, ©2004 Edition, <http://www.hsl.unc.edu/services/tutorials/ebm/whatis.htm> quoted as: EBM is the integration of clinical expertise, patient values, and the best evidence into the decision making process for patient care. Clinical expertise refers to the clinician's cumulated experience, education and clinical skills. The patient brings to the encounter his or her own personal and unique concerns, expectations, and values. The best evidence is usually found in clinically relevant research that has been conducted using sound methodology. (Sackett D, 2002)

The evidence, by itself, does not make a decision for you, but it can help support the patient care process. The full integration of these three components into clinical decisions enhances the opportunity for optimal clinical outcomes and quality of life. The practice of EBM is usually triggered by patient encounters which generate questions about the effects of therapy, the utility of diagnostic tests, the prognosis of diseases, or the etiology of disorders.

Evidence-based medicine requires new skills of the clinician, including efficient literature-searching, and the application of formal rules of evidence in evaluating the clinical literature.

¹⁴ Both the ODG and ACOEM guidelines drew heavily on work begun in 1992 by the State of Colorado, which was the first state to develop evidence-based workers' compensation practice guidelines.

¹⁵ More recently ODG was adopted by Kansas in January 2008; by California's DWC, its workers' compensation adjudicatory body which adopted the ODG post surgical guidelines in November 2007 after adopting the ODG pain guidelines in August 2007 in addition to ACEOM guidelines; ODG was adopted by Texas in January 2007

ODG is used to provide supporting medical evidence for claims approval of treatment and disability recommendations. ODG is updated annually and provides integrated treatment and disability duration guidelines.¹⁶

Notwithstanding negative inferences from WSI's Internal Audit Manager about the use of ODG, which innuendo we find to be unfounded, WSI's use of objective disability guidelines to evaluate supporting medical evidence, and for approval of treatment and determination of disability, is not "dirty" or a "secret", nor is it whimsical or arbitrary—rather, objective medical findings are expressly called for by N.D.C.C. § 65-01-02(10) and the North Dakota Supreme Court.

A "compensable injury" [in North Dakota] is defined as "an injury by accident arising out of and in the course of hazardous employment which must be established by medical evidence supported by objective medical findings." N.D.C.C. § 65-01-02(10). **See Swenson v. Workforce Safety & Insurance Fund, North Dakota Supreme Court No. 20070049, September 5, 2007.**¹⁷

¹⁶ See: <http://www.worklossdata.com/WLDI%20Brochure-2007final.pdf>

¹⁷ In holding that a claimant must prove a compensable injury by objective medical evidence, the North Dakota Supreme Court also determined that "objective medical evidence" may include a physician's medical opinion based on an examination, a patient's medical history and the physician's education and experience. **Swenson, Id.** A claimant must prove by objective medical evidence that he suffered a compensable injury. Objective medical evidence may include a physician's medical opinion based on an examination, a patient's medical history, and the physician's education and experience. **See Id.** In turn, WSI has the responsibility to weigh the credibility of medical evidence and resolve conflicting medical opinions. Confronted with a classic "battle of the experts, WSI may rely upon either party's expert witness. However, although WSI may resolve conflicts between medical opinions, the authority to reject medical evidence selectively does not permit WSI to pick and choose in an unreasoned manner. WSI must consider the entire record, sufficiently address the evidence, and adequately explain its reasons for disregarding evidence presented to it by the claimant. N.D.C.C. § 28-32-46(7). **See Id.**

In addition, the North Dakota Supreme Court has declined to establish a presumption entitling a treating doctor's opinion to "great weight." However, the Court has recognized that a long-term physician-patient relationship may provide the treating doctor with a more comprehensive view of the claimant's medical history and condition. **See Id.**

Thus, the WSI may not discount a treating physician's opinion because it lacks the support of another scientific authority, such as a treatise or a published report of a study. Neither the statutes governing Workforce Safety & Insurance nor case law has imposed such a requirement on those offering medical opinions as evidence in a workers compensation case. On the contrary, the Court has clearly stated that a physician's medical opinion may be based on an examination, a patient's medical history,

G5. WSI's April 11, 2007 Discussion of EBM and ODG Is Neither Dirty nor a Secret

On November 5, 2007, the Internal Audit Manager ("IAM") wrote a two-page letter to the Board of Directors in which, among other things, she referenced minutes of an April 11, 2007 meeting involving senior management and the claims department. (See Sec. I.1.3.2 *infra*). In the letter, she suggests that the meeting was part of a vague conspiracy to keep secret from the Board information about WSI's use of EBM and ODG to inappropriately deny claims. The April 11, 2007 meeting, which the IAM describes elsewhere as a "dirty little secret", was in fact an open discussion among operations personnel at all levels regarding how best to resolve issues that had arisen in the claims department. As such, it was the antithesis of a conspiracy: The names of each attendee and the minutes of the meeting documented well who attended and what was said, as follows:¹⁸

The CEO opened the April 11 meeting outlining the troubling claims issue of how WSI should deal with degenerative conditions. He stated that WSI needed to consider not only NDCC Chapter 65, but case law created by the courts. He outlined a question: how to determine how to handle claims where degenerative conditions are involved, as the aging workforce and degenerative conditions is "the biggest scare" for workers comp carriers and how should WSI determine what percent should be ours? He said that other carriers settle the liability issue up front; nobody really knows what to do or how to handle these [degenerative] claims; that settlement is not the best approach—that [WSI] should almost never settle medical benefits; that no state laws state that degenerative conditions are not compensable, and his view that [law makers] stay away from "degenerative" because [degeneration of the body] is happening to all of us.

and the physician's education and experience, and the same may be based upon personal experience in treating patients, education, and examination of the claimant, and the same is not merely "anecdotal evidence". **See Id.**

¹⁸ Legal – Medical – Claims Meeting April 11, 2007

The “Ground Rules” for the meeting implicitly asked for opinion and debate and expressly required respect for others’ opinions; to keep an open mind; to be honest. The minutes, in fact, record open dialogue and exchange of view and opinions which in relevant part are excerpted as follows:

WSI’s staff MD stated that WSI needs to define the problem, and to determine more facts about degenerative diseases, such as: age groups, other demographics, type of labor, length of time in line of work, etc.

The General Counsel stated that WSI should have a more broad statement and develop a consistent, fair and medically appropriate adjudication system for those claims involving pre-existing conditions.

Counsel said that the “trigger statute” and the “aggravation statute” are two modifications to law in Workers’ Comp, and we [WSI] have become more aggressive at the edges.

Claims personnel stated a belief that past counsel defined “substantial” as 33% which wasn’t much, which is why many claims were accepted and current counsel has a different philosophy. If the philosophy is to be more aggressive on the edges, we need to understand what supports same, what it is based on, as medical evidence and the law must support the approach.

Counsel stated that claims are getting harder to defend, we are going to lose more and have bad results, we have shifted; that claims coming off of a two year TTD limit are coming out in a hostile legislative environment and we have to be absolutely certain of where we are going; that there has been a lot more digging for reasons to

deny when pre-existing conditions are involved, and chances of winning these are thinner, and when we point out the chance of winning is slim we want to do it anyway.

One claims member agreed that we are seeing much more “Let’s send it out and see if they appeal” and we are disposing of things that are marginal on the evidence hoping they will go away by themselves. Another claims representative stated people are afraid of making a decision and leaning toward more denials, making analysts and adjusters question their judgment and afraid to make decisions.

The head of Claims stated her opinion that some of the uncertainty came from audit recommendations indicating WSI does not ask the right questions, and her struggle with basing decisions on a treating physician opinion without any evidence – and her personal opinion was: degenerative disc disease should be aggregated at 50%; that we should require medical evidence instead of just medical opinion.

The meeting then shifted to an attempt to define what WSI’s philosophy should be, recited by different participants:

The General Counsel stated that there is a perception that we are going to take an aggressive approach to degenerative cases. One direction from the discussion may be to aggregate all degenerative disc disease cases, while another would be to conduct a more in depth review of claims with more tools and resources.

The senior Claims Supervisor stated that [WSI] needs to understand what we are looking for, why we are looking for it, and what to do when we find it.; what resources does Claims need[?]; more medical assistance from the staff MD or from nurses, but first we need to determine the philosophy, as there are mixed messages where the head of claims sees these cases [degenerative disc disease] as exceptions, whereas the CEO publicly states we are bending over backwards to approve and pay claims, to always err

on the side of acceptance, and tie goes to the injured worker, but we are not experiencing the same in our day to day practices, and inconsistencies are troubling and drive policy. Finally she noted that we [WSI Claims] are getting better at getting all of the information and doing a thorough investigation and documenting it up front.

Some conclusions were reached at the meeting, including the agreement to recognize degenerative disc disease in appropriate cases as an accepted diagnosis;

The director of QA noted that there is a committee that is working on process and changes for one particular Claims notice that the staff MD [previously] recommended that WSI stop using. There was also agreement that at the next Claims meeting [May 11] with all Claims staff, there would be a refresher on procedure to make sure Claims staff are asking the right questions. Adjusters need to know that they can add degenerative disc disease as an accepted diagnosis. Refreshers are needed on trigger and aggregate cases; a subcommittee would prepare something to share with the Claims staff at May 11 meeting.

Contrary to the characterization the Internal Audit Manager [“IAM”] made of this meeting to the WSI Board in her November 5 letter, and to the public at large in her email labeling documents and the meeting minutes evidence of a “dirty little secret”, it is our view that the minutes, in fact, evidence a vibrant and open discussion among the WSI CEO, senior management, legal staff and senior Claims management. Moreover, the participants addressed directly concerns over WSI’s philosophy and how best to handle difficult aggregation claims, impacted by degenerative disc disease. The meeting minutes document an open process in which the problem was identified, reviewed, addressed philosophically, and resolved through consensus. Specifically, they concluded that such claims needed new approaches but could be accepted in appropriate cases, and that more work including procedures and training were needed at WSI.

This kind of meeting is exactly what should occur whenever there is disagreement and need for change in a claims organization. Noteworthy on this subject is the absence of any documented follow up by the IAM post the April 11 claims meeting specifically regarding the actions of the Claims department with respect to its decision to institute new procedures and training.

G6. Claims Management Practice and Policy at WSI

In our review and interviews of Claims management, all supervisors and several staff members, we consistently asked where the WSI stands today upon the issues raised concerning treatment of North Dakota's workers. As was the case in almost all of our interviews, we found WSI managers and staff enthusiastically embracing the opportunity to tell us their point of view. We found no evidence of collusion or coercion, and were decidedly impressed with the candor and thoughtfulness of most of the people with whom we spoke.

WSI has very strong functional Claims directors and officers including but not limited to the technical fields such as medical services, utilization review, and return to work.

G6.a. IME's and MD's

We found it unusual that the total number of WSI ordered IME's [Independent Medical Reviews] performed in 2007, at only 110, is the subject of public controversy. In contrast with the more than 2,000 lost time cases accepted each year by WSI. The same number of IME's is very small upon a relative basis, particularly in comparison to most of the workers' compensation systems with which we are familiar. In many other jurisdictions IME's are routine, and not the exception that they clearly are in North Dakota. Moreover, IME's appear to be ordered reluctantly by WSI, and only in the more difficult or questionable cases.

An objective review of the WSI IME policy must take into account the few numbers of doctors who specialize in occupational medicine, and the geographic issues that obtain in a physically large state with limited specialty medical practices. We were told that WSI Claim practice is premised upon the belief that the vast majority of North Dakota's practicing physicians are trusted and they are also appreciated in regard to their advocacy on behalf of their patients—and we note that WSI has recently authorized a substantial average increase in the treatment fee schedule for physicians by more than 25%.

WSI Claims has been proactive in trying to develop a better rapport with the State's treating doctors and to overcome the impression that WSI is an adversary, by presently staffing with a physician and a pharmacologist, and fifteen nurses and three nurses who work in technical claims areas, who are better able to facilitate communication with busy medical practices, which have a natural and understandable reluctance to engage in paperwork and documentation and the perceived second guessing that occupational medicine entails.

WSI Claims believes that it has worked hard with the medical community to cause the acceptance and implementation of standard ICD9 diagnostic codes, which are necessary to further improve the efficiency and the consistency of its processing of claims. WSI clearly wants to improve the way it interacts with the North Dakota medical community, and there is undoubted opportunity for improvement in both perception and the fact of its effectiveness and efficiency in working with North Dakota's medical delivery system.

We note that WSI has a strong system for medical bill payment that processes currently and accurately a high weekly volume of medical bills [more than 13,000]. North Dakota medical practitioners might be surprised to learn that the same is not the case in many other states, where lengthy delays and limited technical capability creates serious and costly delay in the payment of medical bills. WSI may not get recognition or appreciation among the medical community for its significant achievement in this area

because its system of payment of bills works so well and current payment for medical services is presumed to be a standard.

G6.b. WSI Has Strong Claims Managers and Supervisors

In our interviews of WSI's Claims managers and supervisors, who have direct line authority for the decisions of the WSI on individual claims and who audit lost time claims, particularly the same in excess of 60 days, we heard a recurring view that WSI Claims philosophy is, in fact, that the benefit of the doubt should go to the claimant. The Claims staff believes that they are acting within the mandates of the NDCC. In addition, we were told that the WSI Legal staff independently reviews decisions for legal sufficiency, and will not hesitate to stop the issuance of a WSI administrative Order that they perceive to be erroneous.

The comments that follow support our impression that WSI Claims department is highly competent and focused upon improvement, despite the current controversy. WSI Claims adjusters while demoralized by public comment and controversy that generally condemns WSI, take their jobs and obligations to claimants seriously. WSI adjusters receive many positive letters from grateful claimants for the care and skill with which their claims are handled, and the positives are never publicized. Claims staff would like to return to the time when they were proud to tell the outside world that they worked for WSI, and not the present state where they identify their employer as "the State".

G6.c. Inconsistent Claims Leadership Replaced

Until recently, because senior leadership in the Claims function during the prior three years was not perceived as providing consistent management, teamwork and horizontal management developed ad hoc to compensate for the lack of direction. Claims staff and supervisors expressed to us their strong desire for senior leadership

that trusts them to do what they are trained to do, that does not attempt to micro manage or second guess their decision making --- leadership, in short, that provides clear expectations based upon the law, and reiterates that it is appropriate for Claims personnel to look for proper avenues to accept a claim and to delegate responsibility to supervisors.

The Claims supervisors and staff we interviewed were critical of past techniques of senior Claims management. Resort to “focus groups” and other new theories of management seen in the prior three years had the effect of undermining the role of supervisors, and destabilizing their authority. The situation in Claims morale is reported to be much improved under the interim management to date.

The supervisors were also very critical of WSI HR, including the lack of timely return communication, the absence of pro-activity, and their perception that HR lacks trust in their Claims supervisory performance evaluations.

WSI executive management requested and have obtained legislative authority for five additional adjusters who are now on staff, and the same will improve the handling of standard case loads. WSI has eighteen nurses in total and they are perceived as very effective and in demand, although often stretched thin, and we were told that the addition of three or more nurses could improve WSI’s performance and relationship with treating physicians and medical practices.

G6.d. WSI Claims Anecdotes and Legislation

During our interviews, several stakeholders provided us with anecdotal references to particular cases where individual WSI claimant was said to have had his or her case mishandled. In particular, in our meetings with legislators and third parties we were provided with details about constituent cases, or examples where WSI had either

made mistakes and been obliged to change its decision, or had been alleged to have been arbitrary for which there is still no recourse by the claimant.

With no release from a claimant, we are not able to comment about any individual case in our report. However, we can address at a general level complaints that we heard about similar cases, as there clearly seem to be several categories of difficult cases that consistently put WSI on the defensive due to a threshold hardship suffered by the claimant that is undeniable. The central characteristic of these types of claims is that they almost universally involve complex medical issues of causation or aggravation, and/or unresolved symptoms and/or subjective assertions of pain. For example, claims where there has been an extended and/or unresolved medical treatment, or a complication alleged to arise from the treatment, engender disputes as to the causal connection and relationship of the complication to the original injury. WSI may be correct in questioning or denying the claim, but the claimant often has an undeniable hardship, and may live in pain or in difficult financial circumstances.

Cases with difficult medical outcomes, where the claimant's treating physician agrees that there can be either a return to work or to a more limited duty work, often engender vocational rehabilitation which WSI tends to pursue to get the worker back to work. However, many injured workers resist vocational rehabilitation, or fail to complete the prescribed program whether by design or inability, and then lose their ongoing stream of indemnity payments from WSI. In the same hard cases WSI has often fully accepted the claim, and continues to pay for the medical benefits that are prescribed by the claimant's doctor, but WSI can often be simultaneously accused of abandoning the claimant.

In rehabilitation cases, WSI may ultimately discontinue indemnity benefits when the worker refuses or claims to be unable to return to modified duty – even though the treating doctor says the worker can. Claimants who have communication or social

limitations that inhibit their ability to do a different job, for example switching from manual to service labor, are often cited as victims of WSI, even though WSI complies with the rehabilitation statute. Yet it can be very difficult for a life time laborer, disabled from a physical occupation but released to a more sedentary duty, to easily return to work. A person with limited education and vocabulary, or sensitivity to the language and skills used in a sedentary job such as a call center or customer service job, may not be easily or ever employable, even if they acquire the rudimentary skills of the new job in vocational rehabilitation.

It seems to us that these hard cases and outcomes should not be cause for disparaging the WSI and its claims personnel, but examples of opportunities for legislative review to see if the law needs to be changed, or for some additional safety net to be created.¹⁹ The same social policy decisions—which WSI is not charged to make—belong to elected representatives.²⁰ It is unfortunate that many good people who work at WSI and who truly care about their responsibility to injured workers, suffer from unfair and unwarranted publicly expressed criticism where there is a ready means to fairly debate, and to make any necessary change in benefit structure.

To be sure, there is a perception and a view held by a number of legislators and stakeholders that the WSI at its executive and Board levels has been too fully engaged in advocating to lawmakers a position on qualification for benefits and levels of benefits, and that WSI should not do so. There is a fine line between WSI performing the legitimate and appropriate task of giving factual information to the legislature or to

¹⁹ We were provided with multiple suggestions for legislation including proposals to reverse almost every change in workers compensation law made since 1995, increases in benefits of many types, as well as restoration of PPI award values below 50%, and restoration of PPI awards below 16%, the separation of OIR from WSI, and the requirement of WSI hearings before the OAH.

²⁰ To his credit, Senator Heitkamp pointed us to a longstanding and serious political disagreement over the governance and control of the WSI that spills over and clearly divides the legislature in affecting change in the law regarding workers' compensation benefits, and he indicated that he understands that it is not the WSI staff and supervisors who perform well, and who should not be targeted in any debate.

advocate changes to improve the efficiency of the organization and its delivery of its services, and the perception that WSI improperly advocates on behalf of any particular interest group.

WSI senior management needs to be better aware of how perception is so easily deemed reality, and the same management must be alert to the injury that has and will continue to occur to the morale of its staff if management is perceived to be aligned with any particular interest group.

We believe that the CEO should be advised of any case that has hardship attributes and that the same should be referred to his/her office for further review and determination to assure that the claim is being handled with recognition of the importance of public confidence in WSI. The CEO and the executive committee should define the parameters of hardship cases with flexibility as circumstances warrant. In the event of equal weight of fact and argument, the benefit of the doubt should go to the injured worker.

G6.e. WSI Hearing and Appeal Process

Distinct from the systems in use in most of the states with competitive and/or mutual workers' compensation funds, but consistent with some exclusive Canadian provincial workers' compensation boards, WSI itself adjudicates and resolves disputes relating to its claim decisions. WSI's decisions are ultimately subject to judicial review. Since 1995 WSI has had a statutory mandated system of review for its claims decisions established by NDCC section 65-02-27. which created the Office of Independent Review ("OIR") within the WSI. OIR is mandated to be independent of the WSI organization claims department, and it must and shall provide assistance to a worker who has filed a claim upon request. OIR employees may not render legal advice or act as an attorney for the claimant. A claimant who has retained an attorney may not receive reimbursement

for the attorney unless the case is first submitted to OIR. OIR communications and the notes and impressions of OIR staff are confidential and may not be released.

OIR is distinctly housed in Bismarck apart from the WSI, and it has a staff of four to five WSI employees. OIR has handled review requests from a high of 531 in FY 2000 to a low of 383 in FY 2004, 428 in FY 2005, 384 in FY 2006 and 397 in FY 2007. OIR intervention results in a change or modification in the decision of the WSI Claims decision in percentages that in the last three years have run from 20 to 13% upon an annual basis. WSI Claims does not agree with the recommendation of OIR a “significant” amount of the time—although exact statistics have not been kept to measure that outcome.

In FY 2007 there were 223 hearing requests made to continue to controvert a case after review by OIR, out of the total 397 cases that were submitted to OIR indicating a conclusion rate for cases submitted to OIR of more than 40%. Of the 223 cases that proceeded to a hearing and were resolved (189) 62 or one third were affirmed; 50 or 25% were reversed; 43 or more than 20% resulted in a stipulation or a new order. The same results appear to be consistent with prior years. These results indicate that although OIR has been effective in addressing some significant percentage of the 40% of the cases that conclude after OIR intervention, surely a material percentage of the cases it sees are later reversed or result in a new order. As such, a material number of the cases where OIR had a disagreement with WSI Claims result in either a reversal, or a stipulation, or a changed order.

Our interviews with the OIR director and the staff at the OIR office suggest that there is presently a well intentioned and independent approach taken by the same WSI employees, who through their director have a direct report to the WSI Board. However, OIR staff are appointed by the WSI CEO. They also acknowledge that in order to be effective that they must learn to work with WSI Claims and that they cannot expect to

be afforded credibility if they become overly contentious. They presently have access to the WSI claim file, although they are barred from the WSI attorney work product performed upon the file. OIR staff, when presented with a wish list that would entitle their recommendation to either a presumption, or to a mandatory reversal of the decision of WSI Claims, said neither option would be a panacea—and could lessen their effectiveness at persuasion, and harden the give and take that they now have with WSI Claims.

Nevertheless, we heard substantial criticism from stakeholders and third parties regarding the effectiveness of OIR, and a recommendation that OIR be removed from the control of the WSI and placed independently under the control of another state agency or directly under the Governor—organized labor in their white paper have cited the fact of the non-independence of the OIR and its staff, and the ever present danger that OIR is just another layer of bureaucratic frustration for claimants. Worse, the critique points out that claimants who must pass through the OIR in order to reserve any right to an attorney's fees recovery from WSI, are in peril of being given biased and incorrect information that cause them to abandon claims that should not have been denied by WSI.

We learned that WSI actively sought guidance from other systems, and attempted to model the OIR upon relevant aspects of similar monopolistic systems found in Canada. Thus, in Saskatchewan at the Workers Compensation Board the office of Worker Advocate exists to assist with questions about benefits, but appeals are directed first to the case manager at the WCB, then to an Appeals committee, and finally as a last resort to the WCB Board Members or a medical question to a Medical Review Panel—where a bona fide medical question exists such as when a physician or chiropractor disagrees with a medical position taken by the WCB. The medical panel includes a chair chosen by the provincial medical association and two physicians of appropriate specialty chosen by the claimant from a list provided by the WCB.

In Manitoba a Review Office conducts an independent review de novo of a claim decision in contest. The review process is informal permitting additional submissions by the claimant, and is similar to the WSI OIR, provided that a decision of the Review Office is binding. Manitoba provides a further appeal to the Appeals Commission, which is separate and independent of the WCB with commissioners appointed by the Lt. Governor for specific terms—with hearing panels consisting of public, worker and employer interests. The Appeal Commission is said to be a non-adversarial inquiry forum.

In Alberta a review from the decision of a case manager proceeds to a supervisor, and then to a Dispute Resolution and Decision Review Body. Decisions from the same body are reviewed by the Alberta WCB Director.

Our review of the OIR concludes that any change in structure is presently restricted by statute so a change must be directed by the Board of the WSI. Following the options that exist in the Canadian provincial models, WSI could make the decision of the OIR binding, or afford a presumption that decisions that OIR seeks to reverse would ultimately flow to either the CEO or to the WSI Board. Any of the same changes would be within the authority of the WSI Board.

OIR's statistics, and advice that their recommendations are not followed a significant amount of the time, as well as seven years of records of hearing outcomes tracking a change the decision of WSI Claims, suggest that the WSI Board consider a change in the OIR program. It would seem that the director and CEO, who has the responsibility for assuring that the WSI fulfills its responsibility to injured workers, is the most reasonable choice as the final arbiter of any disputed outcome—rather than affording the OIR staff with the unilateral ability to reverse a Claims decision. Affording the director the final say risks a possible deterioration in the relationship between the

WSI Claims adjusters and the OIR staff, however, the statistical evidence warrants that the Board consider such a change.

G6.f. WSI Controversy Over Hearing Officers

There has been significant external criticism of WSI relating to its November 2007 decision to change the source of its hearing officers. WSI has terminated its contract with the State Office of Administrative Hearings (“OAH”) for new cases, although that office continues to resolve pending cases initiated prior to the change. WSI has, in accord with its statutory powers, elected to contract with private attorneys to act as WSI hearing officers. See NDCC 65-02-22. WSI is empowered to designate as a hearing officer a person who is licensed to practice law within the state. From 1991 to 1995 OAH conducted a few of WSI’s hearings. In 1995 at WSI’s request, OAH began conducting all of WSI’s hearings.

In 2004 WSI gave notice to OAH that it was seeking to implement case management guidelines that would expedite the time that cases took to be resolved. In addition, by 2005 WSI was insisting upon OAH adherence to billing guidelines that had been established for WSI outside counsel. OAH agrees that the primary focus expressed by WSI was for case processing timelines. OAH believes that at every turn it has tried to work with WSI and meet half-way with respect to performance and cost guidelines, and that WSI has been less than cooperative or pro-active in improving the working relationship with OAH. OAH was taken by surprise in June of 2007 when WSI advised that it would be terminating its exclusive relationship and replacing OAH with private contractors.

We met with the Director of the State of North Dakota Office of Administrative Hearings and one of the administrative judges who is experienced with WSI cases, and

who was solicited to continue to be a WSI hearing officer. The Director is on record as having stated his opinion that WSI is more concerned about cost than quality and more concerned about streamlining case processing than providing quality results. The Director says that WSI has been dictatorial and that it has requested performance standards that are not reasonable. OAH also acknowledged that its performance was not always timely although its performance was improving. OAH has its opinion that regardless of the cost or timeliness of the process, that it maintains a body of impartial hearing officers who are removed from WSI's direct contact and who are independent impartial hearing officers.

WSI disputes the claims of OAH, that they have been responsive or open and reactive to needed improvements in the timeliness of decisions and the length of decisions. WSI asserts that its motivation is solely with respect to obtaining a timely result that will be beneficial to the appropriate disposition of claims and to the benefit of the workers who have disputed a Claims decision. WSI is clearly acting within its statutory authority and it has received the acknowledgement of OAH that improvement was needed in performance.

Thus, it falls to the Board to deal with the controversy and to determine whether the impact of the decision to contract to outside attorneys will, in fact, lead to non-impartial decisions or more likely to a public perception of the same.

In the present climate, where controversy surrounding the recent management of the WSI leads to a less than balanced public perception of WSI's impartiality, the Board should consider revisiting the decision to exclusively rely upon contracted hearing officers. Surely public perception of fairness and impartiality is important, if not as important as the fact of such impartiality. Although the Courts of North Dakota are still available to insure that such impartiality reigns, cost and timeliness warrant that most disputed claims should be resolved by OIR or the hearing process.

In the North Dakota system where the enormous costs and waste of needless litigation present in many other systems are absent, an impartial administrative law system must be afforded in perception as well as in fact. OAH has conceded that it was not as efficient as it could or should have been—but was improving. WSI has the attention of the OAH and the Board may be in a position to broker a promise relating to necessary performance and cost. OAH may be able to accept the standards that the WSI expects and to utilize and incorporate the contractors who are presently on the field.

We suggest that the Board review this issue with management and revisit the decision, to fully separate from hearing services provided by OAH, if appropriate and reasonable performance standards can be agreed upon with OAH.

H. IT System Replacement Concerns

An in depth review by CA of IT operations was specifically excluded from the scope of the assignment, but consistent with the our review of WSI management and the organization, and the critical importance of Information Technology and the systems that are the backbone for the delivery of WSI's services to employers and to claimants, we met with IT management and reviewed their structure and their high priority and large budgeted expense [\$14 million] for an enterprise wide system replacement project. The project is well meant but ambitious, and we feel it is important to highlight concerns that we have relative to the system replacement project.

H1. Background

WSI engaged Gartner Group in 2005 to conduct an assessment of its overall systems application environment and Gartner provided recommendations for replacement of its existing claims and policy management systems. Gartner recommended replacing the existing, proprietary systems with commercial off the shelf systems (COTS) that would provide a more technological up to date platform and that will also eliminate the reliability issues and maintenance burden of the existing systems.

As a result of the Gartner recommendations WSI went through an RFP process and selected Valley Oak Systems' iVos system. A project manager and deployment consulting firm, HCL, has been contracted to implement the system. The contract has been signed and work has commenced. Currently, the requirements for the systems are being developed using HCL's best practices deployment methodology. Our interview process among business users and IT staff has indicated uniform satisfaction with the process today and our observations indicate that the requirements process is effectively being driven based on business based needs. The process has been inclusive from a business standpoint.

After the requirements are defined and finalized, the vendor will do a gap analysis of requirements vs. what the base systems can provide off the shelf. From that analysis, we understand that the vendor will provide estimates in terms of time and cost for the modifications that will be required to match user requirements.

H2. Our Concerns

We believe that the process was well defined and thought out. There is a great deal of enthusiasm from the user community, but conversely, there is a corresponding morale issue in the IT area that results from their concern over potential job elimination and concern that the new system implementation may not be successful. Our cautions and concerns are:

- Mono-line, mono-state workers compensation carriers are unique organizations. By their nature, they are unique in terms of the way that they do business in their state. They are different from other State Funds who are also providing Workers Compensation in their jurisdictions. Because of this, it is always difficult to take a COTS system and have it fit precisely without some modification. We believe that it is possible that the amount of modification and enhancement required to match user expectation relative to the requirements review might be more extensive than expected due to:
 - The Valley Oak claim system has been used primarily in Risk Management organizations and functions. We reviewed the vendor website and note no instances where it has been licensed by a State Fund or Workers Compensation carrier. We would note that we did not see a customer list as such, but reviewed press releases etc.
 - iVOS is integrated with AON's RiskConsole risk management information system (RIMS). We note from the product description on AON's website

that the system tracks policies, monitors premiums and provides basic premium calculations with possibilities of more sophisticated calculations. We note no reference to essential policy management functionality that is available in existing systems (renewal management, payroll audit processing, etc.). Further, we note no mention of a billing feature.

- From our interviews we were advised by several individuals that they saw very little policy management functionality in the demos.
- Site visits with the vendor were limited to a risk management agency (CIRMA) and Marriott's self insured claim department. There are significant intrinsic differences in size scale and capability between risk management organizations and monopolistic state funds.
- We understand that the Policy Management portion is new and WSI will be helping the vendor build out components that will be brand new and therefore, WSI will be the test site as such.
- The contract with the vendor, we understand, has approximately \$1.5 million in over-run contingencies built in. This will be to fund the modifications and enhancements necessary to bridge the gap between what comes off the shelf and what is required. We point out that WSI may be responsible for funding that gap to a larger extent than \$1.5 million. WSI's Board should be aware, also, that the \$1.5 million contingency also applies to any increases in deployment services—and that modifications and deployment service increases will potentially exceed the same allocation.

While the system looks like it has performed well in risk management organizations, we must point out that there may be a significant variance between what will be required to run systems for WSI with the functionality that it now enjoys, and what the system can provide, given the fact that it is not an application that has been

designed for a workers compensation insurance carrier and is not functioning in the same mode that we are aware of.

There is a high expectation among the business community that the new systems will solve most, if not all of their existing issues with the integrity of the existing systems, particularly the policy management system. There are also potential gaps with respect to basic Claims functionality and services, such as the absence of a fee schedule and the lack of an auto medical bill adjudication process. As the process of identifying gaps progresses and funding requirements and delivery timeframes expand, there will be pressure to limit deliverables, and risk increase that the business will have to settle for less than what they have presently. If this occurs, the clash of high expectations with lowered deliverables creates great organizational tension and distress. With the project price tag in the \$11.5 to \$14 million range, that unhappiness will manifest itself in public ways.

We do not make the claim that the potential clash between expectation and delivered and functional system will happen, but we do make the point that we see risk, given the factors stated above, that there is a good chance that it can happen. We believe that WSI should manage this possibility. We offer the following recommendations for consideration:

- Requirements that are being developed right now should be completely cross-referenced to a detailed list of required functionality that exists now in policy and claim systems. We understand that this is the intent, but we recommend that WSI organizationally ensure that this is done. As an example, a requirement might be that the system provides payroll audit processing capabilities. WSI needs to make sure that the proposed solution not only provides that capability, in general, but the process flows of the new system either support the whole flow at a detail

level, or, will provide a flow that provides WSI with a desired process improvement. We believe that HCL is conducting this process now, but care needs to be taken to cross reference old to new capability.

- WSI should try to match requirements to gaps at the earliest possible point. Our understanding is that this is not scheduled until Q2 or Q3 of 2008. We would suggest that as components of requirements are completed, that gap analyses be done as each component is completed. In this manner, WSI will not have to wait for the whole list before they begin to understand the magnitude and impact of any changes required.
- It is difficult to identify contingencies before the gaps are known. Some gaps will be critical and some will be more “nice-to-have”. In advance of this knowledge, we do recommend that WSI adopt a baseline expectation level that defines that the system must provide equal to or enhanced functionality vs. what the existing system has. It will be difficult to explain to any stakeholder or employee why this expenditure in time and money will return less than what is available at present.

We have seen some broad implementation delivery date estimates for Q4 2009.²¹ We believe that these estimates may be optimistic relative to the concerns listed above. We do suggest that these timeframe estimates be re-visited with the internal team, including IT staff to determine if they should be extended at this point. There is no sense creating an unrealistic expectation at the outset. Delivery date misses are almost inevitable as everybody has nothing but optimism at the beginning of the project. Our experiences with conversions of this type indicate that they can take 1.5 to 2 times longer than the original estimate.

²¹ Reference to AdvanTech, LLC ITTP-Strategic Information Technology Plan, 3/15/2006.

I. Board Governance

As has been well chronicled, in 1997, North Dakota's Legislature established a freestanding, independent board of directors ("Board") to oversee the policies, internal management and general operations of the WSI. The Board was charged, among other things, with "ensuring" that the WSI operated with "impartiality" and "freedom from political influence." (N.D.C.C. § 65-02-03.3.6). The effect of this action was to remove the Governor from having any direct oversight responsibility for the organization.

The Board consists of eleven members appointed by the Governor to four-year terms. Six members represent employers; three members represent employees; one member is from the North Dakota Medical Association; and one member is at large. Although the Governor makes each appointment, he generally does so by selecting from predetermined candidate lists prepared by committees or organizations associated with the represented constituencies. As such, the Governor presently has little to no influence over the qualifications of WSI Board members, nor the ability to require important Workers Compensation functions such as insurance, accounting, finance, law, investments or information technology, to be in the background of prospective Board members.

While the Governor has broad powers to remove public officials for such matters as misconduct, malfeasance and neglect of duty, the state's Attorney General recently opined that he "lacks authority under N.D.C.C. ch. 44-11 to remove members of the WSI board on any enumerated grounds" since "board members are not specifically mentioned in the removal statutes and are not custodians of public moneys." The Attorney General also affirmed that the Governor's power to appoint the WSI board members does not include the power to remove them because their "terms... are fixed for a term of years by statute" and "the majority of... members are required to be

selected from a list of candidates provided by outside entities or representatives.” Thus, the Governor’s only direct current legal authority and responsibility with respect to the Board is his initial appointment of its members

The Board, which meets quarterly and on an as needed basis, has adopted a governance model that is ostensibly designed to enable it to fulfill its obligation of accountability for the organization. The adopted model, the Carver Policy Governance Model, emphasizes the Board’s role as a policymaking body, distinguishing that role from the operationally focused, interactive role adopted by many traditional boards. In response to a recent query from the WSI’s internal auditor, the Board’s governance consultant articulated this distinction referencing the following principles:

“The board will govern lawfully...with an emphasis on (a) outward vision rather than an internal preoccupation, (b) encouragement of diversity in viewpoints, (c) strategic leadership more than administrative detail, (d) clear distinction of board and chief executive roles, (e) collective rather than individual decisions, (f) future rather than past or present, and (g) pro-activity rather than reactivity.

Accordingly:

The board will direct, control, and inspire the organization through the careful establishment of broad written policies reflecting the board’s values and perspectives. The board’s major policy focus will be on the intended long-term impacts outside the staff organization, not on the administrative or programmatic means of attaining those effects.”

In its introduction to its 2006 Revised Board Governance Policy, the Board states that it selected this particular model “to successfully provide continuity in leadership and to provide increased accountability as intended by the Legislative Assembly.” The Governance Policy does not address specifically how a more policy focused, outwardly visionary approach to governance will improve continuity of leadership, but suggests that providing management direction through a series of broad, outcome defined

policies and “executive limitations” and reducing the Board’s reach into day to day decision-making will bolster the effective authority of the Executive Director (or “CEO”) increasing his or her sense of support and willingness to stay on the job

It is not surprising that the Board has sought to reinforce the role of its CEO and to redefine its own role given its history of turnover. Since 1996, more than four different board Chairs and four CEOs (Executive Directors) have governed the WSI. It appears that much of this turnover is the result of counterproductive interactions between management and the Board over a number of years. Our recent interviews with senior management and board members discloses a history of certain key managers (below the level of CEO) accessing individual board members directly to question and influence operational decisions with which they disagree. This practice has been so pervasive and well known that a number of managers within the organization refer to these influencers as WSI’s “shadow management.”

The presence and empowerment of such a group is highly destructive to the trust and confidence necessary to a healthy organization. The Board rightly has sought to address this issue by clarifying its role and that of the CEO with respect Board/management interactions. The CEO, whoever he or she may be, must have the authority to run the WSI effectively without fear of self-interested interference from above or subversion from below. Yet, while the Carver model offers useful guidance in this area, it is not an end in and of itself. As the model recognizes, one of the Board’s primary tasks is to select a chief executive officer who will lead the organization effectively and achieve the outcomes the Board establishes.

Another equally important Board task is to oversee and monitor the CEO’s specific performance and that of the overall organization. To be effective, such oversight requires directors to actively engage management and to spend the time necessary to understand fully the basic operational issues that drive the organization. As the Board’s governance consultant observes:

“Boards require a broad wealth of information in order to craft wise policy and accurately monitor performance. That may mean calls to staff and other knowledgeable people for point of information questions related to the industry, legal questions, historical data, etc.”

When in the course of its oversight the Board uncovers material issues affecting the operation, it must act decisively, engaging and directing management as required. Such engagement will, of necessity, reduce the distance between the Board and management contemplated by the Carver model, but is critical if the Board is to satisfy its fiduciary obligations.

A case in point is the current crisis surrounding the Board’s termination of WSI’s most recent CEO. The Board must introduce new leadership into the organization quickly both to stabilize the environment and to preserve what has proven to be a most productive workforce below the executive ranks. At a minimum, the Board should hire an interim CEO [ICEO] possessed of the management and leadership skills requisite to reestablishing genuine trust and confidence throughout the organization.

We suggest that if at all possible, that the Board look first to someone who is familiar with the culture and the institutions of the state of North Dakota. The management and leadership skills and political sensitivity of the ICEO should have been demonstrated in either the public or private sector, but in an executive capacity. There is a need for someone who will immediately make the executive management choices and separations that will allow WSI to move forward and to restore trust of the management and staff within the organization, and who has political sensitivity and skill. The ICEO should be a person who can be relied upon to establish an orderly process for selection of a permanent CEO, to maintain momentum and to leave the recent crisis far in the rear view, while working with all the members of the Board.

The Board has suffered criticism for its apparent lack of knowledge regarding the operational issues that led up to the CEO termination. As just noted, WSI Board

members serve as fiduciaries over one of North Dakota's most significant financial/medical service organizations, a role that requires expertise and time. The governing statute and bylaws call for the appointment of eleven board members who must meet at least quarterly. The Board Chair, at his own discretion, may call additional meetings as can a majority of Board members. Given the significance of the Board's role, we recommend that the Board seek ways to increase the frequency and breadth of its member participation and support the acquisition of member expertise.

Specifically, we recommend that the Board consider as a goal (1) increasing the number of its mandatory meetings from four to six per year; (2) reaching consensus with its stakeholders, the Governor and the legislature to improve the professionalism of the Board to enable recruiting future Board members with backgrounds and experience relevant to WSI, and have their support in establishing substantial board member compensation; and, (3) require in depth continuous reporting from the CEO regarding key financial, human resource and claims management matters currently confronting the organization.

With respect to Board member compensation, we would note that the State Auditor in his October 26, 2006 Performance Audit Report observed that he intends to hold board members to "a higher level of expectation" and, as such, recommended that they be paid "adequate compensation for work performed." He identified compensation packages for similar board work that ranged from \$17,000 to 39,450 per year, but did not make a specific recommendation as to an amount for WSI. Finally, as a matter of information, two years ago the Utah state legislature established for the five compensated members on its mutual state fund a maximum annual compensation of \$75,000.

With respect to Board expertise, we recommend as a goal in the filling of future Board vacancies that at least one Board member have, through education and experience, (1) an understanding of generally accepted accounting principles, statutory accounting principles and financial statements; (2) the ability to assess the general

application of such principles in connection with the accounting for estimates, accruals and reserves; (3) an understanding of internal control over financial reporting; and (4) an understanding of audit committee functions. We also recommend as a goal that Board members have backgrounds and demonstrated experience, either by education or work history, in one of each of the professions of investment, law, insurance and information technology.

1.1. Internal Governance

The WSI has in recent years used four primary mechanisms to provide leadership and ensure accountability to its internal operations: an executive committee, a human resource department, an Office of Independent Review (“OIR”) and an internal audit function that reports directly to the Board.

1.1.a - Executive Committee

Under N.D.C.C. § 65-02-03.3, the Board’s first, and arguably most important, task is to “appoint a director on a nonpartisan, merit basis.” The Executive Director (or CEO) heads the overall organization and is ultimately the person accountable to the Board for WSI’s success or failure. Given such responsibility, it is not surprising that new CEOs tend to establish early on a committee of key executives upon whom they can rely to run the business. Moreover, there is often a tendency for the CEO to seed such committees with persons he would consider his “own people”, managers in whom he has confidence and from whom he can expect loyalty.

Before April 2004, the executive group consisted of eight vice presidents. After that date, the recently terminated CEO (“former CEO”) restructured the executive committee over a two month period to include six members, three from the major operating departments---Injury Services, Employer Services and Support Services---and

three from staff functions presumably regarded as critical to the WSI's success---law, communication and strategic planning. Eventually the CEO added to the committee a seventh member who was in charge of leadership/organization. Each of these executive committee members reported directly to the CEO.

The most striking aspect of the 2004 executive committee reorganization is that the manner in which it was implemented commenced a level of distrust of current senior management that remains throughout the organization today. Of the executive committee members in place at the time of his arrival in 2004, the former CEO removed two thirds of them from their positions on the committee, placing them in lesser roles across the organization. He then established a new six-member committee, half of whom he drew from outside the organization. Of the three members he selected from within the organization, only two had served on the previous executive committee. According to one senior staff member, the decisions made at this very early stage with respect to the executive committee "created a divide" among the "old group" and the new committee that ultimately infected the entire workforce.

The new executive committee denominated itself "MADDOG" and met regularly on Monday mornings. Its meetings, perhaps in response to the history of "shadow management" or the former CEO's demand for loyalty, have been characterized by a high degree of secrecy that was compounded during the 2006 Performance Audit. Moreover, according to one member, the committee at the direction of the former CEO spent an inordinate amount of time on "mean spirited retribution activities" directed at individuals or departments not performing to the CEO's satisfaction. This focus on secrecy, unquestioned loyalty, and retribution has infused the entire organization with an abiding sense of fear and distrust. According to ICF International, an independent consultant WSI retained to analyze employee morale in June, 2007, senior management's credibility had ebbed to the point that:

"Employees report that senior leaders do not follow through with what they say and...do not take responsibility for actions that have failed....[P]olicies and

procedures are reported to be applied inconsistently and often without input from employees....[T]he organization starts management initiatives too frequently, without any planning and coordination, and then suddenly drops them.....[leaving employees] wondering what the overall plan and vision is for the organization."

Today, eight months after the ICF report, the executive committee's outright division, loss of respect and perception of dysfunction, and dismay continues with some executive committee members. That said, with the Board's termination of the former CEO two months ago, its temporary appointment of an Acting CEO, and the recent resignation of the head of Injury Services, a meaningful and positive opportunity for leadership change in the senior ranks has emerged. As noted earlier, to take advantage of this opportunity, the Board should immediately retain an interim CEO and direct him or her to develop an executive committee structure that relates more directly to WSI's day-to-day operations and workforce.

We do not believe that in an organization of the size of WSI with approximately 240 employees that there is a need for more than five members of the executive committee. We also believe that the CEO and the executive committee members are each individually responsible for showing leadership, strategic planning, and succession planning and that WSI will benefit from a truly flattened organization structure. Specifically, we recommend that the Interim consider truly reducing the executive committee from seven to five positions, retaining on the committee the Injury Services, Employer and Law positions and adding to it two new positions: a Chief Financial Officer and an Administrative Officer. We recommend that the current Strategic Planning position be absorbed within the CFO function and the current Communications organization be placed under the Administration Officer function; all at middle management levels. We recommend that the Leadership function be eliminated as a separate function and its fundamental charge be assumed by the HR and Communications functions under the Administration Officer. However, it should be the

prerogative of the ICEO and the CEO to utilize the talents and strengths of the people who are available to him or her, and that titles should reflect the best use of the talent available, but recognizing the importance of the basic functional activity at WSI. Because it is not within the purview of this report to recommend the appointment of specific personnel to any one position, we would simply urge the Board, and any Interim it may appoint, to be mindful of WSI's history of "shadow management" and, at the same time, of the benefits of promoting from within the middle management ranks of the organization.

1.1.b. WSI Human Resources

WSI is not subject to North Dakota state human resource management services, and WSI has the authority to establish its own system of personnel administration to be determined by the organization and governing position classification, pay administration, transfer of employees, discipline of employees and removal of employees. The Human Resources department ("HR") is responsible for overseeing and maintaining the integrity of WSI's personnel management systems. These systems govern the hiring, compensation, discipline, promotion, demotion and separation of employees in the organization and, by law, must comply with applicable state and federal fair treatment, equal opportunity and nondiscrimination requirements. The department's role in ensuring such compliance is particularly important given the Legislature's decision in 1995 to allow the WSI to establish its own personnel system.

WSI employees, while entitled to State benefits, serve in an "at will" employment relationship and, as in many private sector companies, can be terminated from their employment "at any time, for any reason, or for no reason at all, with or without notice." [WSI Employee Handbook, p. 3] In light of this circumstance, WSI has sought to promote a climate of fair treatment throughout the company, affirming in its Employee Handbook a commitment to maintain "a work environment where we treat each other with honesty, integrity, dignity, trust, and respect." Specifically, WSI has

introduced a number of programs designed to ensure objectivity, accountability and fairness with respect to its human resource management. Key among these programs is the conflicts resolution process and the recently installed compensation system.

The “conflicts resolution” process encourages employees and management to consult with HR at any time for “counsel, coaching, or clarification of ...any policies and procedures.” The process supports direct communication between employees and management, and offers non-binding mediation and a formal complaint procedure as a means of resolving disputes ranging from performance evaluations to treatment issues. While HR is central to managing this process, particularly with respect to matters involving involuntary terminations, the CEO is the final decision maker regarding all disputes. Accordingly, the effectiveness of the system is directly related to the credibility of the persons charged with managing it.

Two years ago, WSI installed a compensation program that included a detailed job evaluation and salary administration system. The program is designed to clarify organizational structures and job accountabilities, to enable comparisons that support internal pay equity based on measured job content and to facilitate pay comparisons to the external labor market. It is also intended to link pay to performance by establishing salary ranges based upon job content and paying for individual performance (based on the employee’s annual performance review) by placing the employee at a higher or lower level within the range. Under the guidelines, a competent performer, for example, is to be paid at the middle of the range while a superior performer is to be paid at the upper ends. The WSI is to review the salary ranges each year to reflect changes that may have occurred in the external market. Additionally, to ensure accurate performance evaluation, WSI introduced a sophisticated, web based performance evaluation system (Halogen eAppraisal) that attempts to tie individual performance targets to organizational goals and to promote “fairness and objectivity” by better defining objectives and conducting reviews at the same time. As with the conflict resolution process, HR is charged with managing the program and is accountable to the CEO for its “consistent application”. Indeed, it is the consistent administration of the compensation

program across and within all departments that will enable the program to reinforce WSI's operational and cultural objectives of fairness and accountability.

Despite the introduction of these and other reasonably well-structured systems, WSI's HR department has been singularly unsuccessful in establishing a climate of fairness and trust, or respect engendering the confidence of the organization. The department head and other mid-level managers have advised that the company has had a long history of ineffective HR management, due in part to the quality of the HR staff and in part to the respective attitudes of various CEOs toward the function.

In the current circumstance, our interviews disclose that few managerial and line employees have confidence in the HR department, regarding it as missing in action at critical times over the past five years. They cite as the most egregious example of HR's lack of influence its utter silence during the 2005 Policy Holder Services reorganization. Although the current HR Manager advises that she was aware of the reorganization and, in fact, informed the CEO that he was in for "lots of problems". HR's acquiescence and acceptance of the decision, has severely damaged HR's long term credibility, occasioned by a belief that it was not her role to "walk into the CEO's office and tell him how to do his job."

The 2006 Performance Audit Report cites a number of other HR actions that the workforce sees as undercutting any claim the Department may have to objectivity or fairness. These actions include apparent preferential treatment in the adjustment of salaries, failure to ensure that all annual performance appraisals are performed as required by the compensation system, and alleged conflicts of interest on the parts of persons conducting investigations of noncompliance with the company's policies. While the WSI explains each of these actions, generally disagreeing with the Auditor's conclusions, its explanations cannot repair the damage that has been done. Employees at all levels of the organization advised that with respect to problems in their work environment HR would be "the last place" they would go for redress or support.

We believe that WSI has installed workable human resource systems over the past several years. These systems, if operated effectively, will enable management to

achieve its operational goals and establish a sense of fairness and dignity in the workplace. Nevertheless, the former CEO's failure of judgment in senior management selections and the Department's lack of leadership have rendered HR irrelevant to WSI's operations in the eyes of the workforce. To remedy this situation, we recommend that the Interim select and improve leadership in the Department, increase its expertise and raise its profile within the organization. These actions will begin to reestablish HR's governance accountability and move it toward greater credibility within the organization.

1.1.c. Internal Audit

The American Institute of CPAs ("AICPA"), as a member of the Committee of Sponsoring Organizations of the National Commission on Fraudulent Financial Reporting, has observed that it is the internal auditor's role to provide the board of directors, management and other personnel with "reasonable assurance regarding the...(1) the effectiveness and efficiency of operations, (2) reliability of financial reporting, and (3) compliance with applicable laws and regulations." [*Internal Control: A Tool for the Audit Committee*] In fulfilling this role, the internal auditor must "evaluate the effectiveness of the internal control system and contribute to its ongoing" operation. AICPA recommends that the internal auditor report "directly to the audit committee of the board of directors and/or the most senior levels of management," stating that the "CEO has ultimate responsibility and 'ownership' of the internal control system" and the board, through its audit committee, serves as the "first line of defense with respect to the system of internal control over financial reporting."

The Institute of Internal Auditors, addressing the question "What is the appropriate relationship between the internal audit activity and the audit committee?" states on its website that the internal auditor must provide "objective opinions, information, support and education to the [board's] audit committee." It also observes

that the internal auditor must develop “a strong working relationship” with the audit committee if the auditor is to achieve the “requisite independence, objectivity, and organizational stature” necessary to fulfilling his or her responsibilities to “senior management, the greater board of directors...and other stakeholders.”²²

Similarly, these responsibilities require that the internal auditor develop an equally effective relationship with company management. As one writer has noted:

Communicating with senior management about risk is one of the most important activities performed by internal auditors....Because senior management holds the ultimate responsibility for managing risk, it is essential for auditors to be able to share their knowledge and effectively convey their concerns....[And, thus] it is important for internal auditors to communicate regularly with senior management....²³

Consistent with these principles, the WSI’s internal auditor, along with a subordinate, reports directly to the Chair of the Board’s audit committee and has a dotted line responsibility to the CEO. Under the terms of the Board’s internal audit charter, the auditor must adhere to a set of “Standards and Accountability” requiring the auditor, among other things, to “report significant issues related to WSI operations and programs including improvements...” and to “provide information on the status and results of the annual audit plan” to the Chief Executive Officer and the Board Audit Committee. To facilitate the auditor’s ability to meet these obligations, the Board has directed management to give internal audit “full and unrestricted access to all activities, functions, records (in both paper and electronic format), property and personnel” as necessary and to “provide...full support and cooperation at all levels of operations.” In

²² (<http://www.theiia/about-the-profession/internal-audit-faqs/?i=108>)

²³(Barry S. Leithhead, FCPA, CIA, *In Touch With the Top – internal auditing and effective communication with organizational leaders*,

http://findarticles.com/p/articles/mi_m4153/is_6_57/ai_69759750/print)

short, the WSI has established an internal audit function that reflects in structure and authority the best practices of the profession.

The incumbent head of WSI's internal audit department ("Internal Audit Manager" or "IAM") was hired in January, 2007 following the termination of her predecessor and an interview by the then Audit Committee Chair. The Audit Committee Chair advised her of her reporting relationships and of circumstances that could obligate her to report certain activities on the part of the CEO directly to the Board. Since her hiring, the IAM has engaged in two well-publicized actions that have alienated her from much of the WSI workforce and management. This alienation derives as much from the manner in which the IAM performed her work as from the actual substance of the work itself. Put simply, her actions have divested her of the kind of perceived trustworthiness, objectivity, and organizational stature necessary to perform effectively within the organization.

1.1.c.1. Uninvited Search

On or about October 16 or 17, 2007, without consulting the General Counsel, the Audit Committee Chair, or any member of the Board and prompted by an undocumented and alleged suspicion that a co-worker was in possession of "inappropriate" audit information from the Board, the IAM surreptitiously returned to the WSI offices after hours and entered the office of a co-worker. Once there she commenced to rifle through her co-worker's desk where she located a personal journal, which she read, photocopied and eventually shared with a senior manager who allegedly surprised her during the course of her search.

While in the office, the IAM attempted to locate writings that would confirm other undocumented suspicions she had received regarding the co-worker's alleged improper communication of personnel information. Through a series of events after the IAM's search, the journal copy was delivered to law enforcement officials who returned to the WSI within two days to seize the journal. Because of the delivery of the journal

copy to law enforcement, the subsequent seizure and a request by the affected co-worker for an investigation, details of the incident are widely known and have been discussed at all levels of the organization. To date, no action has been taken with respect to the journal or with respect to the alleged reasons for the IAM's uninvited entry into the office.

When queried as to why she failed to bring her concerns to senior management or the Board's Audit Committee prior to her search, thereby ignoring the standards and accountability that govern her work, the IAM responded that she did not "know whom she could trust." She also asserted "because internal audit is unique, it is not necessarily appropriate to take concerns to management." As will be examined further below, these responses demonstrate a profound misunderstanding of her role in the organization and a disturbing sense of self-importance and lack of judgment. Even if one assumes that the Board's directive to management to provide "full and unrestricted access...to all records" somehow authorizes her to engage in after hours desk rummaging, her inability to see the practical consequences of her actions with respect to the rest of the organization shows a narrowness of viewpoint that is anathema to objective analysis and good judgment.

Indeed, our interviews disclose that employees across the company, whether positive or negative toward current senior management, regard the IAM's actions as a shocking invasion of privacy and betrayal of trust.

I.1.c.2. November 5, 2007 Letter to the Board

On November 5, 2007, the IAM wrote a two-page letter to the general members of the Board of Directors, ostensibly to fulfill her duties as internal auditor, but also, in apparent contradiction of her professional obligations, to express her anxieties as "a concerned citizen of North Dakota." The letter states in its opening paragraphs that, in her opinion, the Board has discussed in "the past several months... no matters of real significance" and observes that the Board's "reluctance to speak up" in the context of

open meeting laws and immediate public scrutiny and media attention does not relieve it of “its responsibility and accountability.”

The IAM further opines that the Board is “not receiving critical information as a whole” and appears to be operating in a fragmented way, with perhaps only one or two members “in the know.” While acknowledging that the Board has taken steps to fully adopt Policy Governance, she expresses her personal belief that management could limit the Policy Governance efforts as could the Board’s commitment to integrity and transparency. Accordingly, she asserts: *“If our strategies are sound and our principles and actions honorable, transparency should be embraced.”*

As third party observers, we find this letter remarkable on several levels, even if written in good faith. First, given that the IAM reports directly to the Audit Committee and is professionally mandated to foster a “strong working relationship,” the letter’s lecturing tone, one bordering on insubordination, exhibits a profound confusion as to her proper role in relation to the Board. The WSI did not employ her to serve as a citizen representative of North Dakota to express whatever personal opinions she may have, whenever she has them, in a writing she knows will become public. Rather, the Board retained her to provide it with expert analysis (supported by fact, not personal opinion) to ensure its effective oversight of the efficiency of WSI’s operations, the reliability of its financial reporting, and its compliance with applicable laws and regulations.

Second, contrary to her professional duty to provide the Board with objective opinion, information and documentary support, the letter is full of innuendo and bereft of factual analysis. The IAM is expected to apply professional analytic skills to each assigned task, and to audit within the parameters established by the body to which she reports. Were the same not the case, mistrust and chaos would infect and ultimately destroy the Board’s current governance efforts, the very efforts the IAM appears to encourage in her third paragraph. In short, the Audit Committee did not assign the IAM to review the Board, or to offer a critique based solely upon her subjective opinions or personal beliefs as a citizen of North Dakota. The Board has retained her for the

important purpose of providing audit conclusions supported by research and fact.

Having subjected the Board to "ad hominum" criticism, the IAM goes on in the letter to address several documents related to her stated concern that WSI appears to have taken a new direction in the handling of claims of which the Board may not be aware. The prime document she presents is the detailed minutes of a Legal, Medical and Claims Meeting held on April 11, 2007, that lists all 19 attendees, including the CEO, the senior manager of Claims, subordinate supervisors, and all of WSI's attorneys. She attaches to the document a law intern's research paper concerning the legal definition of "objective medical evidence" and the intern's recommendation that WSI would benefit from adopting a statutory definition. She also attaches a WSI attorney paper discussing Occupational Disability Guidelines, references the fact that the WSI appears to be training prospective Administrative Law Judges in the use of "evidence-based medicine" and cites a personal conversation she had with a WSI physician along with legal research she conducted as a non-lawyer.

Referencing this material and a self-determined need to "independently" verify it "with [unnamed] sources," the IAM's letter suggests that she has uncovered a vague management conspiracy to keep information about allegedly untoward current claims practices from the Board. Specifically, she states: *"I can't help but wonder if WSI is taking a new direction and to what level this has been discussed after reading the meeting notes, the legal intern's research, and the ODC white paper."* Notably absent from her letter is any accurate analysis of what actually was said at the April 11 meeting; any documentation, review or presentation of objective facts supporting her suggestion that WSI had adopted an untoward strategy toward claimants; and any identification of facts demonstrating a WSI policy or practice to mistreat injured workers. Nevertheless, because of the seriousness of her allegations and her own stated inability to perform the necessary review (*"It is far too complicated for Internal Audit to review."*), we have conducted an independent examination of the April 11 meeting and the WSI's claims practices. See *infra*. Based on that review, we have reached the conclusion that the

Claims management and staff engaged in an entirely appropriate policy discussion regarding claims practices concerning degenerative disease on April 11, 2007—which was precisely what should have occurred to clarify WSI policy and confusion about that policy. When we queried IAM specifically as to whether she had any evidence to the inference that WSI was acting inappropriately, IAM provided not a single fact.

Our analysis and opinion of the April 11, 2007 meeting actually shows that there is no subjective evidence of a policy or practice at WSI to improperly adjust the claims of injured workers—much less a conspiracy. We note, parenthetically, that most conspiracies don't record the names of the participants, nor do they take meticulous notes of their proceedings. Ironically it appears that neither IAM or the media have taken the time to actually read the April 11, 2007 meeting minutes, or to analyze what was actually at issue much less said or determined at the meeting.

The consequences of the IAM's actions, to WSI and to the reputation and morale of all of its staff and particularly its claims personnel, have been devastating. Not only has the IAM managed to raise public suspicion of WSI and its management policies and practices toward claimants, she has done so without establishing a single fact or providing a scintilla of documented evidence. Moreover, in direct contravention of her professional obligations to the Board, she deliberately communicated her speculative suspicions (suspicions she characterized as a “dirty little secret”) to outside parties a week before bringing them to the Board's attention. When asked why she did not follow the usual and customary protocols associated with the internal audit function, she informed these interviewers that she had early on lost confidence in the Board's ability to treat her work with confidentiality. That rationale does not adequately explain why she then knowingly communicated her concerns to parties outside the Board in a manner that inevitably lead to their widespread publication.

Internal Audit is a critical and important function, however, the incumbent must recognize confidentiality and reporting lines, as well and the need to engender trust. An IAM who is not trusted within the organization, and who has no trust in her

direct report cannot be effective. The Board should immediately address the effectiveness of the incumbent of this critical function.

1.2. External Governance - WSI as An Insurance Carrier

The Legislature's decision to establish an independent Board of Directors in 1997 effectively removed the WSI from the Governor's direct control and subjected WSI to the operational oversight of three external bodies: the legislature, the State Auditor and the Treasurer. Under its governing statute, the WSI annually must submit a report of the organization's activities to the "legislative audit and fiscal review committee" (N.D.C.C. § 65-02—03.3.4) and must prepare a biennial budget for inclusion in the Governor's budget, subject to review and approval of the appropriations committees of the legislative assembly (N.D.C.C. § 65-02—03.3.5). Additionally, at the direction of the State Auditor, the WSI must undergo a biennial "performance evaluation of the functions and operations of the organization" by a firm expert in "workforce safety and insurance practices and standards" (N.D.C.C. § 65-02-30). The State Auditor presents the results of this evaluation to the Legislature.

Finally, the State Treasurer serves as custodian of the WSI fund and is responsible for making all payments from the fund other than for travel and administrative expenses. The WSI must submit to the office of management and budget a monthly financial statement showing the receipts, disbursements, investments and status of the fund based on information provided to the organization by the Treasurer's office (N.D.C.C. § 65-04-30). While the WSI's CEO is the official signatory on any check, document or other legal instrument relating to the investment of WSI funds, oversight of the fund investments is under the purview of the state investment board (N.D.C.C. § 65-04-31). This eleven-person board consists of, among others, the governor, the state treasurer, the WSI CEO, and the insurance commissioner (N.D.C.C. § 21-10-01.1). The board is charged with approving the securities in which the WSI invests consistent with policies and procedures it sets based on advice it receives from its advisory council, investment director and/or advisory service (N.D.C.C. § 21-10-02).

We believe that the dispersion of external oversight among these three entities has lead to more episodic and fragmented review than is in the best interests of the organization, its policyholders and injured workers. We do not suggest that the legislature forgo its appropriate public inquiry responsibilities, however, we do believe that the WSI's essential purpose is that of an operating insurance company. As such, it should be subject to more knowledge based and expert level of continuous regulatory oversight than it has heretofore received. Examination in the same fashion will allow for ready comparison and benchmarking of WSI to similar insurance organizations by qualified independent examiners.²⁴ We recommend, therefore, that the WSI seek to establish itself as a fully licensed insurer in the State of North Dakota subject to the regulatory authority of the North Dakota Department of Insurance ("DOI").

Under North Dakota law, the DOI has the authority to examine any licensed insurance company, along with its officers, employees and agents, the fairness of claims settlement practices, and its conduct in the market, whenever it deems necessary and is entitled to complete access to the company's books and records. The examination may be conducted by a NAIC qualified and certified property and casualty insurer examiner commissioned by the DOI. The Department can set minimum capital and surplus levels to transact business and apply Risk Based Capital standards to ensure solvency and proper reserving. It requires compliance with National Association of Insurance Commissioners ("NAIC") accounting procedures and practices, the filing of annual NAIC financial statements, an annual audit by independent certified public accountants and an opinion on company reserves by a qualified actuary. It also requires that each company maintain a diversified, appropriately liquid investment portfolio with securities valued in accordance with standards promulgated by the NAIC's Securities Valuation Office. Finally, the law authorizes the Department to direct a company to take necessary corrective action, or cease and desist certain practices, which, if not corrected, could place it in hazardous condition.

²⁴ Other state fund workers compensation agencies are so regulated and regularly examined by their state Insurance Departments, and are required to annually file their calendar year annual statements in the national NAIC format, for example California and New York.

Because of WSI's status as a state mandated monopoly, we recommend that the DOI's authority with respect to corrective action be modified in at least one area to accommodate the government's ultimate financial responsibility. Specifically, under Risk Based Capital standards, when the DOI determines that a private sector company's total adjusted capital is at a level sufficiently low ("authorized control level") that it poses a threat to policyholders and creditors of the insurer and the public, the DOI may take regulatory control of the company's operations.

With respect to the WSI, we recommend that instead of authorizing the taking of such control, the law require the DOI to issue a report to the Governor, the head of the Senate, and the head of the House setting forth the conditions that exist. The Governor, in consultation with the Legislature, may replace the CEO of WSI and appoint a recovery administrator. The recovery administrator would be responsible for developing a plan of recovery for WSI, and for implementing the plan. The recovery administrator should be a person who, through professional credentials or job experience, or both, has a demonstrated understanding of insurance law, insurer finances, experience in the rehabilitation of insurance companies, claims administration, and any other factors as are needed to create and execute a plan of recovery. The cost of the recovery administrator should be borne by WSI. The recovery administrator should remain in place until the DOI conveys to the Governor its opinion that WSI has improved its finances to the extent that it is no longer at the Authorized Control Level or above, at which point the Governor may dismiss the recovery administrator and direct the WSI Board to appoint a new CEO. During the time that the recovery administrator is acting, the WSI Board shall act in an advisory capacity to the recovery administrator and the Governor.

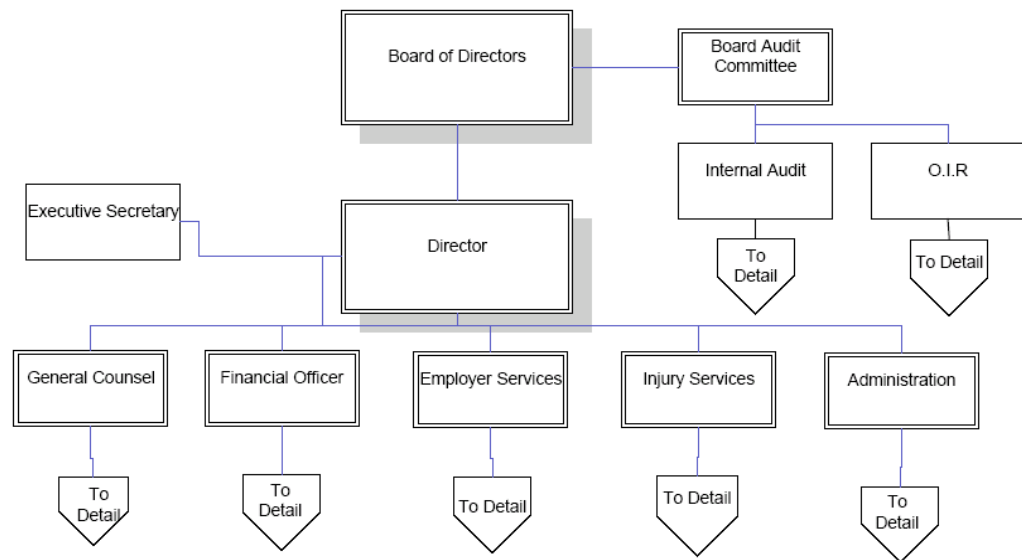
Finally, if WSI is placed under the DOI's regulatory oversight, we recommend that the current oversight activities of the State Auditor and Treasurer be modified and scaled to avoid any conflicts of policy and duplication of effort with the Department of Insurance, thereby enabling useful financial comparisons and performance benchmarking.

Conclusion

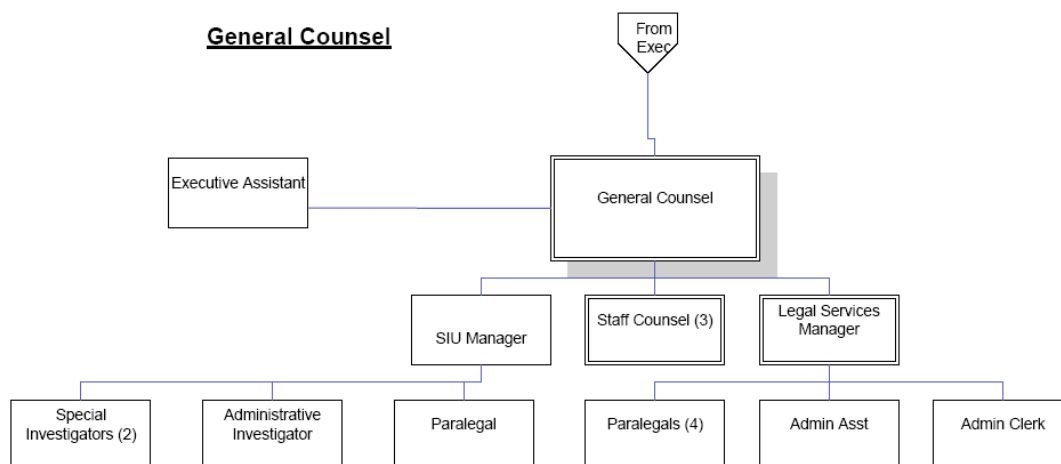
We believe that WSI is a strong institution that does a good work for the People of the State. WSI is possessed of well trained and well meaning staff and managers who, in the vast majority of cases, serve well the work force of North Dakota. The Board's choice of leadership, particularly of the CEO, has enormous consequences for the future of WSI. The Board should urgently but carefully take the necessary steps to find quality leadership for WSI, who can and hopefully will restore the trust and confidence of the staff who continue to be WSI's greatest asset. We hope that our recommendations will meet with positive discussion and enable consensus by the Board as to its future action. WSI is well on the way to mending, and we hope that this review will aid the Board in that process.

Appendix 1 – Recommended Organizational Charts

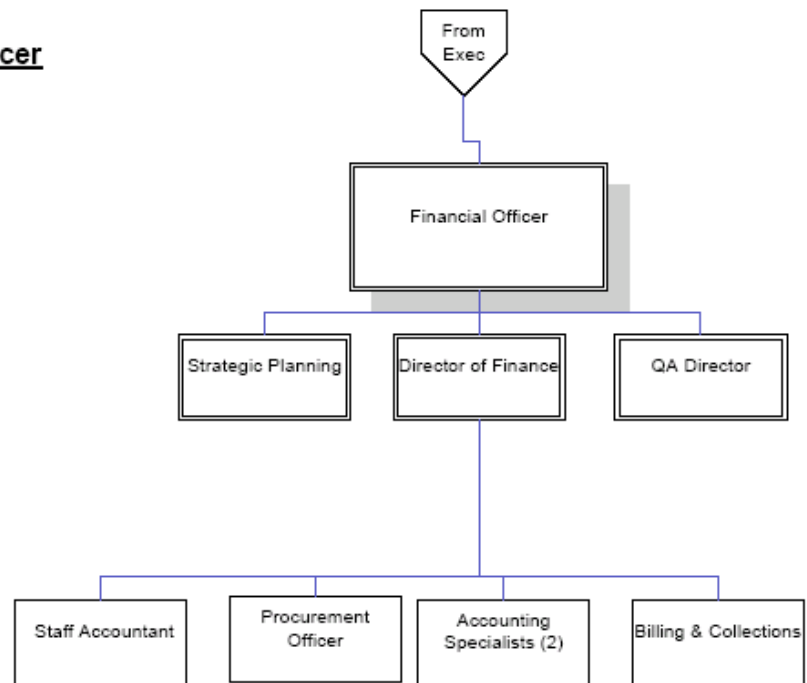
Board and Executive Organization



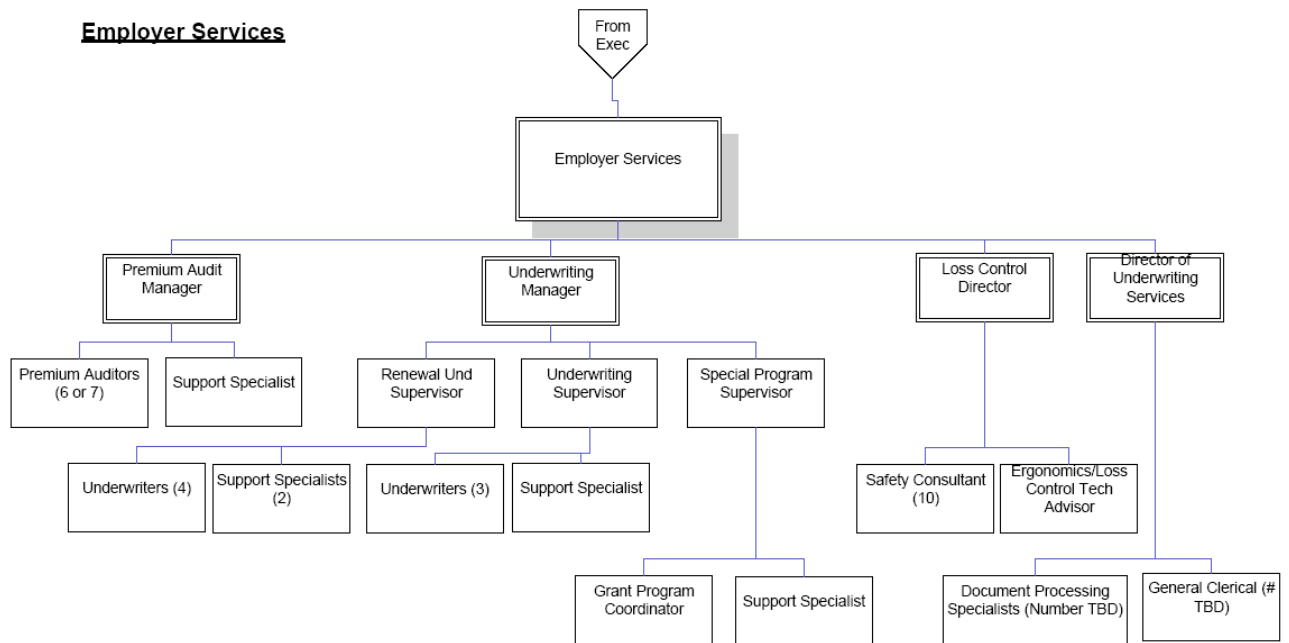
General Counsel



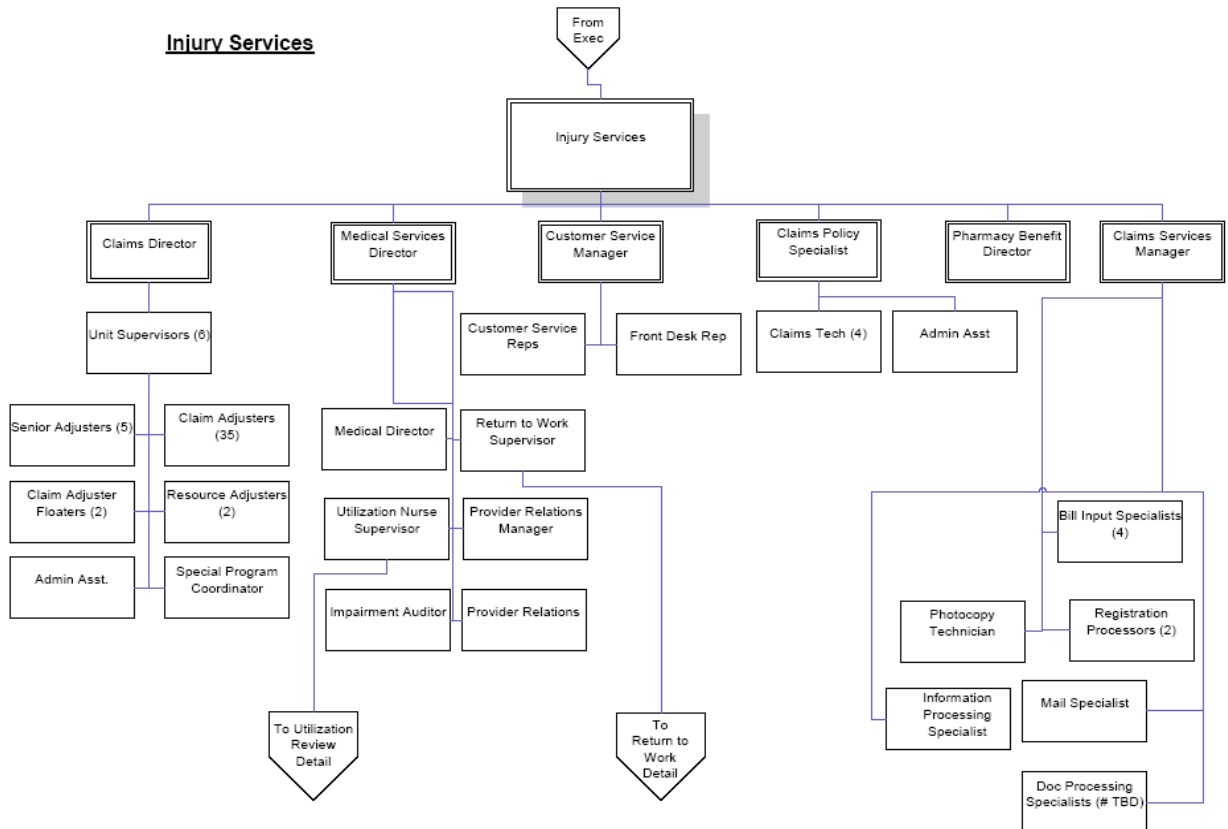
Financial Officer



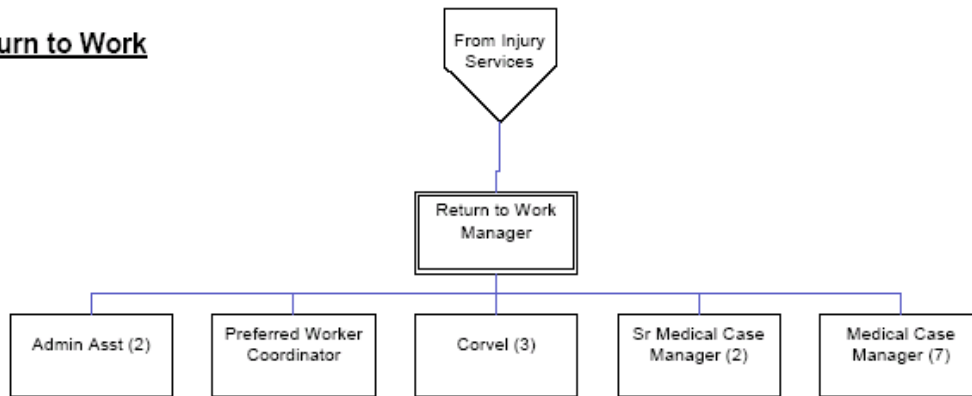
Employer Services



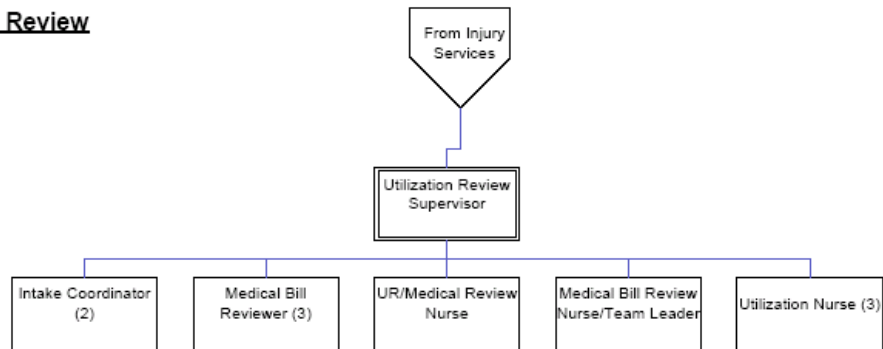
Injury Services



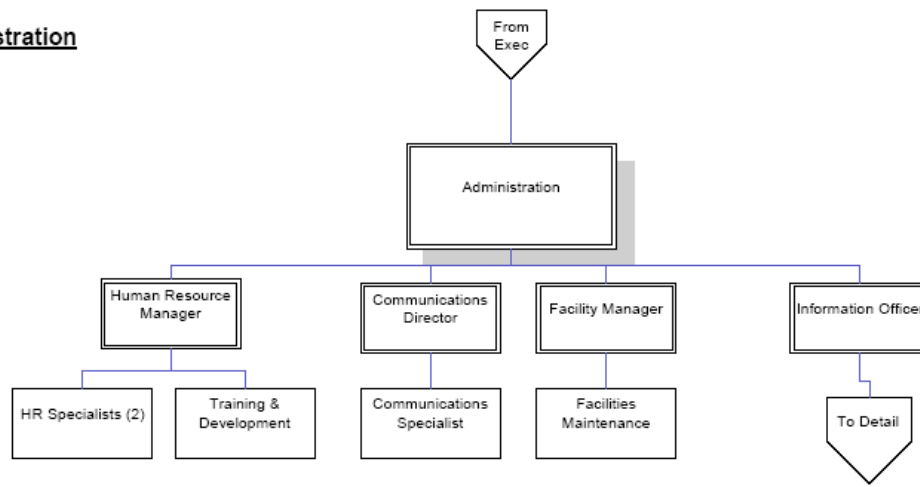
Return to Work



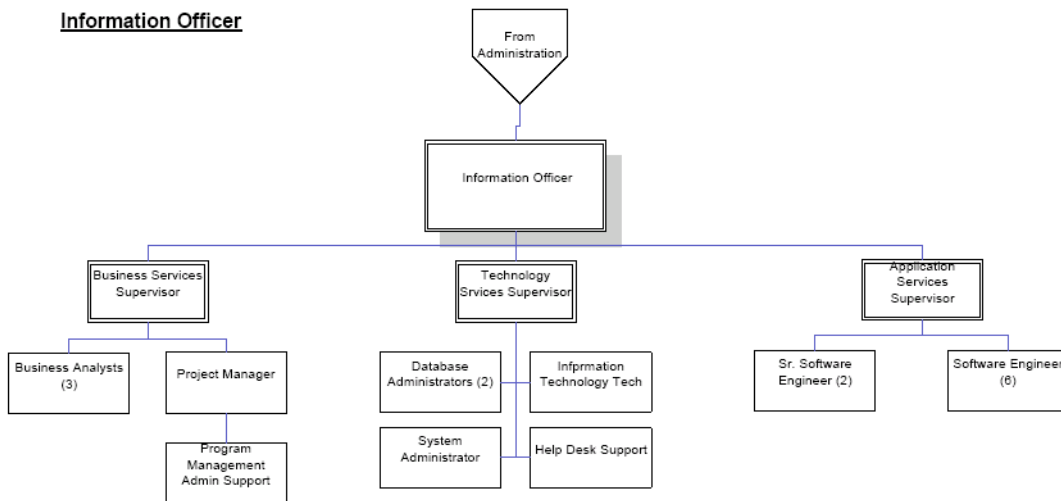
Utilization Review



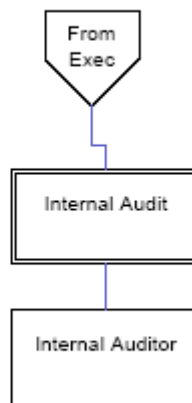
Administration



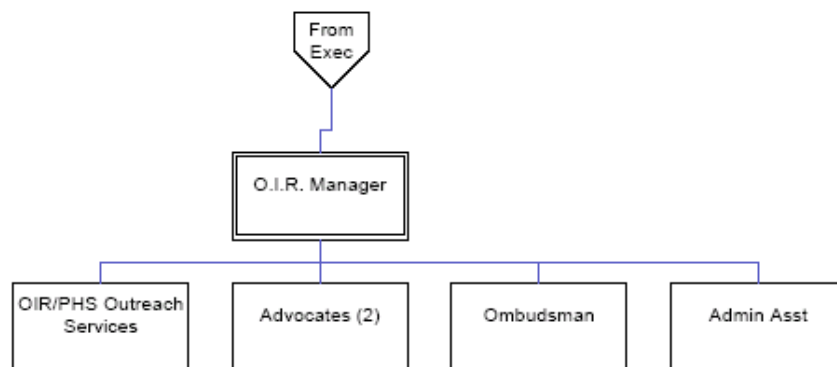
Information Officer



Internal Audit



O.I.R



Appendix 2 – Consultant Bios

Henry Neal Conolly
Bio (update 10/2007)

Neal Conolly is a consultant to the insurance industry.

In January 2002 Mr. Conolly was retained by the Superintendent of Insurance of the State of New York as the consulting administrator for Frontier Insurance Company in Rehabilitation, with fiduciary responsibility to the Superintendent in Frontier's court supervised rehabilitation. Frontier, which ceased writing in the spring of 2001, was licensed in 50 states and had a national medical malpractice, workers compensation and surety program.

Mr. Conolly acts as the claims committee chair for Frontier's medical malpractice, general liability, workers' compensation, and surety claims committees. He has principal responsibility for the direction of counsel upon significant reinsurance and recovery litigation throughout the US, direction of claims management, and the initiation and conduct of litigation with regard to the disposal and collection of Frontier assets, and resolution or defense of corporate claims. Since entering rehabilitation Frontier has resolved more than 21,000 claims, paying more than \$550 million to claimants, while collecting more than \$475 million of reinsurance. Frontier has not drawn upon any security fund during the course of its rehabilitation. Frontier's insolvency has been reduced by more than \$75 million during the rehabilitation.

Mr. Conolly was retained in 2005, at the direction of Governor Arnold Schwarzenegger, by the Board of Directors of the State Compensation Insurance Fund of California. Mr. Conolly, with his associates, prepared an organization wide evaluation of the SCIF. The SCIF is one of the largest workers' compensation carriers in the US currently [2007] writing \$3.5 billion in premium, with more than \$23 billion of invested assets employing 7,500. In July 2007 Mr. Conolly was re-engaged by the SCIF to advise the SCIF interim President and to review SCIF senior management issues and the status and completion of CP Associates recommended initiatives in SCIF business process.

Previously, from 1997 through 2001, Mr. Conolly served as the chief executive officer of NYSIF, a New York state sponsored competitive workers' compensation insurance carrier writing more than \$1 billion of premium. During a four year tenure at NYSIF he presided over an organization-wide re-engineering focused on underwriting, policyholder services, claims process, customer service initiatives, paperless processing and the integration of technology into every business corner of NYSIF. Surplus doubled to more than \$1 billion during Mr. Conolly's tenure, while downsizing in locations and the number of employees by almost 600 to a staff of 2,600.

Mr. Conolly has more than 28 years experience as an attorney. Mr. Conolly achieved from peers Martindale Hubble's "Av" rating in New York as a trial lawyer, with a defense focus for general liability and medical malpractice carrier assureds and commercial clients including surety litigation. He is a reinsurance and commercial arbitrator. He is a member of the bar by examination in New York, Maryland and Florida.

Mr. Conolly was the 2005 honoree of the New York Claims Association for his service to the insurance industry. Mr. Conolly is designated as a "WCP" and is a 2007 honoree by the AmComp, the national society of Workers' Compensation professionals.

Mr. Conolly is a graduate of Colby College and holds a Bachelor of Arts degree in American Studies, and he is a graduate of Albany Law School of Union University and holds a degree of Juris Doctor.

KEVIN M RYAN

Currently

Bickerstaff, Whatley, Ryan & Burkhalter
Partner

Effective July 1, 2001, Kevin Ryan joined the firm of Bickerstaff and Whatley, an actuarial consulting firm providing a full spectrum of independent casualty actuarial consulting services to insurance, business, and governmental organizations. The firm enjoys a reputation for the highest professional standards and is known for creating innovative solutions to challenging insurance, reinsurance and actuarial problems.

1997 to 2001

American ReInsurance
Vice President

A key strategist in the workers compensation reinsurance area, developing programs involving alternative and emerging markets, he advised on various domestic and foreign programs and designed creative reinsurance programs involving loss portfolio transfers, various innovative products and traditional reinsurance mechanisms.

1994 to 1997

Wexford Actuarial (An AON subsidiary)
President

Developed a general actuarial consulting practice focusing on Workers Compensation and Medical Malpractice reinsurance. During this period, he developed alternative workers compensation ratemaking and classification systems, formed a rating bureau that is licensed in twelve states, and implemented a streamlined experience modification program that is currently used in several jurisdictions. He served as a key member of the Aon due diligence team in the Alexander and Alexander purchase.

1990 to 1993

Milliman & Robertson
Consulting Actuary

Rejoined Milliman & Robertson after a ten year term with NCCI. He continued to develop his reputation as a highly qualified expert in general actuarial matters in the medical malpractice and the workers compensation areas. He served as consultant to Coopers & Lybrand, Peat Marwick, State Farm, and Allstate, among others. He has appeared before Delaware, Texas, New York, Florida and California legislative bodies, the Labor Subcommittee of the U.S. Senate, the Federal Trade Commission and in

various administrative court proceedings. He has performed a broad range of actuarial assignments, from reserving to ratemaking to evaluations.

1980 to 1989

National Council on Compensation Insurance

President

Revitalized and modernized the Council that had become complacent with the positive pre-1980 underwriting results. In addition to developing a professional staff, he moved and consolidated headquarters' operations in Florida, its largest jurisdiction. He implemented goal oriented business practices and implemented meaningful budgetary and fiscal controls. In 1989 he organized the Workers Compensation Congress under Co-Chairmen, Hank Greenberg, Chairman of AIG, and Gary Countryman, Chairman of Liberty Mutual. The resulting legislative initiatives are considered to be the force behind the improved results in the 1990's.

1976 to 1980

Milliman

Partner

Developed M&R's East Coast Casualty Actuarial practice, building a strong professional presence in the Pennsylvania office and assisted in developing programs in other offices. Due to the size and profitability of his practice, he was made a partner early in his tenure. His clients in this period included the Pennsylvania Medical Malpractice JUA, the Florida Medical Malpractice JUA and the Patients Compensation Fund. Milliman currently enjoys a strong presence in the East.

1972 to 1975

Insurance Services Office

Vice President – Commercial Lines

Merged of six independent fire rating bureaus into the newly formed ISO, creating the Middle Atlantic Region. Reduced the combined work force from 1,400 to 700 and installed operational and management programs that replaced antiquated bureau procedures. He also served as Vice President - Commercial Lines where he oversaw ISO commercial underwriting and actuarial operations.

1968 to 1971

Illinois Insurance Department
Deputy Director – Property & Casualty Division

Directed all Property and Casualty regulatory functions including: rating, policy forms, financial examiners, financial analysts and market conduct units. He drafted and implemented the historic Illinois open rating law and developed the first solvency-testing program in conjunction with the Michigan and New York Insurance Departments. Many of the programs instituted under his guidance continue in place today.

Prior to the Illinois Insurance Department Mr. Ryan held actuarial positions with the Aetna Casualty & Surety Co and Industrial Indemnity.

PROFESSIONAL CREDENTIALS

Mr. Ryan is a member of the Casualty Actuarial Society and a former President of that organization (1989-90). He has served two terms as a member of the board and has been active on various committees.

He is a member of the American Academy of Actuaries, where he served as Treasurer and Board member.

PERSONAL

Mr. Ryan graduated with a degree in Mathematics from Fairfield University, is married, and has three children.

John F. Plunkett
PO Box 1302
Greenville, Maine 04441
207-695-0946 (Office)
610-417-0916 (Cell)

Mr. Plunkett has 33 years of experience in all aspects of insurance operations and insurance information technology. Mr. Plunkett's specific area of expertise is the identification, development and implementation of new business systems that create enhanced value throughout the entire insurance customer chain.

Mr. Plunkett's experience and accomplishments include the following:

- **Co-Founder and President of Millbrook Incorporated.** Millbrook is a recognized leader in providing information solutions to the property and casualty insurance industry. Their unique industry competence and focus create solutions that let insurance companies direct and improve their business performance. Millbrook's solutions enable complete information management, including planning, measuring performance, and providing targeted, industry specific analytics and reporting.

The Millbrook suite of products and services allow insurance companies to employ one, several, or all components, to address their needs in using information to drive lower claim costs, increased revenues, and increased profitability. With its industry specific models and success in deployment, Millbrook has helped its insurance company customers to successfully use the power of information.

Mr. Plunkett is jointly responsible for management and operations of Millbrook.

- **Strategic Consulting** - Designed and implemented enhanced operating processes and automated processing environments for multiple insurers while retained on a strategic consulting basis. This includes shared project leadership for the operational and structural reengineering of the New York State Insurance Fund. This four year effort resulted in:
 - Conversion of all internal computer and embedded chip systems for Y2K compliance.
 - Redesign of organizational and functional platforms for all operating units within the agency.
 - Introduction of advanced technologies that allowed NYSIF to reduce staff from 3,500 to 2,600 employees while eliminating operating backlogs, increasing surplus and creating underwriting profit.

Worked for the State Compensation Insurance Fund Board of Directors in California to review all State Fund operations and provide recommendations for organizational, functional and technology change.

Restructured IT and operational environments for multiple insolvent insurers as agent for New York and Georgia Departments of Insurance.

- **Insurance Company Background** – Served several insurance companies as an employee in technical, functional and management capacities.
 - Vice President of Operations and Chief Information Officer for the Rutgers Casualty Insurance Company - Implemented new mission critical systems and enhanced operating processes
 - Vice President of Operations and Chief Operations Officer for Warwick Insurance Company - Served during a period where company revenues grew by 500%. Designed and developed all corporate automated systems and innovative internal operating environments. Additionally, responsible for creating and managing Premium Audit, Statistical and Loss Control functions.
 - Royal Insurance - Design, programming and insurance operations management experience at Royal Insurance where he designed and implemented multiple countrywide policywriting, claims and accounting systems. Additionally, as a regional officer, planned and managed three major territorial office reorganizations. Experience covered all personal and commercial lines of insurance, totaling over \$1.5 billion in annual premiums.

Mr. Plunkett is a graduate of Blair Academy and a graduate of Lehigh University, Bethlehem, Pa. He holds a Bachelor of Science degree in Finance.

Richard D. Baum**Consultant**

Richard D. Baum, appointed by Insurance Commissioner John Garamendi, served as Chief Deputy Insurance Commissioner at the California Department of Insurance from 2003-2007 and 1992-1996. Between 1996 and 2003, Mr. Baum was the President and CEO of Care West Insurance Company, a worker's compensation company, and prior to that was Senior Vice President of Amfac, Inc., a diversified operating company engaged in various businesses, including real estate development and property management. Mr. Baum holds a B.A. from Stanford University, an M.A. from the State University of New York, and a J.D. from George Washington University, National Law Center, Washington, D.C.