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Genesis of a Rate: Workmen's Compensation Insurance

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GENESIS OF A RATE: WORKMEN'S COMPENSATION INSURANCE

The problems presented to those learned in the law vary from reflection on sordid practicality¹ to contemplation on the infinity of time and space.² Somewhere between these, related to both, is the field of Workmen's Compensation insurance rate-making. A recent Minnesota decision³ on this intricate problem⁴ presents compelling questions of substance and procedure. The importance of the decision cannot be overemphasized. The field is one in which basic techniques can change considerably and in which the governing conditions are never static. Further, compensation insurance agencies work with varied statutes, procedures and formulas; judicial interference in this process has heretofore been at a minimum. With this as a background, a multiplicity of important considerations have avoided thorough investigation. The instant case is important not only because of the impetus it will give to such investigations but because of the encouragement it will provide to those who seek to contest rates.

In question in the instant case was the revision in the overall state rate level adopted by the Minnesota compensation insurance board⁵ for the year beginning January 1, 1951. The Minnesota compensation rating bureau⁶ had recommended a 10.6% increase;

1. See *People v. Tilley*, 104 N. E. 2d 499, 500 (Ill. 1952).

2. See *Shaw, Savill, Albion & Co. v. The Fredericksburg*, 189 F. 2d 952, 954 (2d Cir. 1951).

3. *State ex rel. Minnesota Employers' Ass'n v. Faricy*, 53 N. W. 2d 457 (1952).

4. For treatment of the general problem and for definitions and terminology, see Riesenfeld & Maxwell, *Modern Social Legislation* 372 (1950); Riesenfeld, *Basic Problems in the Administration of Workmen's Compensation*, 36 Minn. L. Rev. 119, 138 (1952). See also Michelbacher & Nial, *Workmen's Compensation Insurance* 282 (1925); Graham, *The Practice of Workmen's Compensation Ratemaking as Illustrated by the 1939 Revision of New York Rates*, 26 Proc. Casualty Actuarial Soc'y 47, 63 (1939); Johnson, *New York Compensation Rate Making*, 35 Proc. Casualty Actuarial Soc'y 6 (1948); Kulp, *The Rate-Making Process in Property and Casualty Insurance—Goals, Technics, and Limits*, 15 Law & Contemp. Prob. 493 (1950).

5. The board, provided for by Minn. Stat. § 79.02 (1949), has the obligation of approving a "minimum and adequate and reasonable rate for each classification." Minn. Stat. § 79.07 (1949).

6. The Minnesota compensation rating bureau, a quasi-public agency established at the same time as the board and comprising all the carriers of Workmen's Compensation insurance (the insurers) in Minnesota, assists the board in the rate-making process. See Minn. Stat. § 79.11 *et seq.* (1949). *Yoselowitz v. Peoples Bakery, Inc.*, 201 Minn. 600, 277 N. W. 221 (1938). The bureau was joined as a defendant in the instant case and appears to have conducted the active defense. The National Council on Compensation Insurance is the country-wide carrier organization which collects and tabulates information and develops overall rate-making policy. In connection with the efficacy of such arrangements, compare the argument over the

the board granted an 8.2% increase which included a 2.5% provision for profits and contingencies. The Minnesota Employers' Association opposed any increase, first at the hearings before the board, then by certiorari in district court, and finally by appeal to the Minnesota Supreme Court.

THE MECHANICS OF RATE-MAKING

The history and principles of compensation insurance rate-making have been well summarized in two recent works,⁷ and the general technique will therefore be set out here only in brief.

Employment activities are broken down into 660 individual classifications,⁸ each of which has its own *manual classification gross rate*, so that an employer can be assessed properly for the hazards he engages in. An employer does not, however, pay simple rates for his enterprises because of the existence of *merit rating plans*⁹ which make the *actual collectible premium* dependent upon actual experience and size of policy. What he does pay is based on payroll *units of exposure*¹⁰ of \$100. Since the compensation premiums should furnish the carrier sufficient income to cover both the actual benefit payments and underwriting expenses and profit, the rate for each classification is actually composed of two elements called *pure premium* and *expense loading*. Actually, in each rate revision the *classification relativity* for certain select classifications are revised on the basis of actual experience in that classification.

The fundamental theory of compensation insurance rate-making is that the experience of prior years will be duplicated in the year for which the rate determination is to be made. The two most recent policy years¹¹ for which experience is available are used as a base. Actual past experience, however, must be converted to figures which represent existing conditions. The effect of merit rating plans and changes in premium and benefit payment levels must therefore be compensated for in bringing payment figures up to date in usable function and usefulness of railroad rate bureaus set forth in Dumbauld, *Rate-Fixing Conspiracies in Regulated Industries*, 95 U. of Pa. L. Rev. 643, 655 (1947).

7. Riesenfeld & Maxwell, *op. cit. supra* note 4, at 375; Riesenfeld, *supra* note 4, at 138.

8. Minn. Compensation Board, 14th Bienn. Rep. 9 (1951).

9. Experience Rating, Retrospective Rating, and Premium Discount plans are the types now in use. See Riesenfeld & Maxwell, *op. cit. supra* note 4, at 380.

10. Extra pay for overtime is omitted in computing units of exposure.

11. The policy year includes the experience of all policies *written* during a specified 12 month period, and therefore it extends for two years from the first day of a new rate. See Riesenfeld & Maxwell, *op. cit. supra* note 4, at 377.

form. Elimination of the "off-balance" due to merit rating plans gives *standard earned premium*,¹² use of present rates on actual payrolls gives the current *collectible* premium. *Incurred losses* are converted to *modified losses* by adjustment for statutory changes in the benefit payment level.

It is desirable that modified losses shall have a specified proportion, called the *permissible loss ratio*,¹³ to collectible premiums, and the indicated change in rate level is found by comparison of computed loss ratios to the permissible. However, because benefit payments lag behind wages and because the basic experience used is at least two years old, these adjusted figures are not reflective of current conditions. It has recently been deemed advisable, therefore, to introduce a new "trend" factor—the *rate level adjustment factor*,¹⁴ which is based on the variation between the latest calendar year actual loss ratio and the permissible loss ratio. The indicated change in rate level so revised is then further and finally adjusted by re-insertion of the "off-balance" factor.

The Minnesota compensation insurance board applied these accepted calculations, but went further in seeking to arrive at present day conditions. It applied wage factors to the adjusted premiums, on the assumption that wages would increase 3½ per cent in 1950 over 1949; and in doing so the board confused its factors and years.¹⁵ The board applied medical and indemnity cost adjustment factors which assumed that these elements of loss would vary as

12. The "off-balance" factor is recomputed by the National Council on Compensation Insurance every two years, and is applied during the statistical tabulation by that body. Actually, current collectible premium is obtained simply by using current manual rates with "off-balance" excluded. Riesenfeld & Maxwell, *op. cit. supra* note 4, at 377.

13. The permissible loss ratio was formerly 61% in Minnesota, Minn. Compensation Board, 14th Bienn. Rep. 13 (1951), although a more accepted figure is 60%, exclusive of a profit and contingency factor. Riesenfeld & Maxwell, *op. cit. supra* note 4, at 376.

14. See Riesenfeld, *supra* note 4, at 139; Minn. Compensation Board, 14th Bienn. Rep. 12 (1951); Minn. Compensation Board, 13th Bienn. Rep. 15 (1949).

15. Wage level figures (average weekly wage) were obtained from the Minnesota Employment and Security Division. Calendar years were converted to policy years by computation after separation into quarters. The 3½% increase was an estimate; modification of previous yearly experience was done in the following manner:

$$\text{For 1948 (1948 Adjusted Rate Level) times } \left(\frac{1950 \text{ Wages}}{1949 \text{ Wages}} \right)^*$$

$$\text{For 1947 (1947 Adjusted Rate Level) times } \left(\frac{1950 \text{ Wages}}{1948 \text{ Wages}} \right)^*$$

Note the impure multiplication.

did wages and that prior factors had been correct.¹⁶ It finally applied an accident frequency-severity factor which had little apparent justification.¹⁷

The court reviewed these adjustments and the assumptions on which they are based. Although it did not attack the basic formula and conceded that there was "no certainty that mathematically sound adjustments would produce results more accurate than those used by the board," it adopted the view that whether "the rate developed is reasonable can be ascertained by determining the reasonableness of the components." Those components are the pure premium and expense loading portions of the rate. In investigating these components, the court found that the board's order did not meet the test of adhering to "methods logically calculated to produce a reasonable rate."

The background in the instant case included a history of profitable rates for the insurance carriers,¹⁸ although the Minnesota

16. Stated as formulas, these factors were found as follows:

$$\begin{array}{rcl} \begin{array}{c} * \\ X_1 \\ \hline \frac{1949}{1946} \text{ MCAF} \end{array} & = & \begin{array}{c} \frac{1950}{1947} \text{ Wage Increase} \\ \hline \frac{1949}{1946} \text{ Wage Increase} \end{array} \\ \begin{array}{c} ** \\ X_2 \\ \hline \frac{1949}{1947} \text{ MCAF} \end{array} & = & \begin{array}{c} \frac{1950}{1948} \text{ Wage Increase} \\ \hline \frac{1949}{1947} \text{ Wage Increase} \end{array} \end{array}$$

* X_1 equals $\frac{1950}{1947}$ Medical Cost Adjustment Factor. ** X_2 equals $\frac{1950}{1948}$ MCAF.

Indemnity losses = Adjusted incurred losses—Incurred medical losses.

For the Indemnity calculation substitute ICAF for MCAF, e.g., $\frac{1949}{1946}$ ICAF for $\frac{1949}{1946}$ MCAF.

17. The factor and the method of arriving at it is presented for whatever logical value one can derive from it. The U. S. accident severity rate (in days per 1000 man-hours) was added to the U. S. accident frequency rate (in injuries per 1,000,000 man-hours) to give what is called the frequency-severity ratio. This was then subtracted from parity (100) and divided by 100 to give the frequency-severity correction factor, which was then multiplied by losses to give a loss figure corrected for the improved safety conditions. It should be observed that the higher the frequency and severity rates, the lower the adjusted losses, so that with sufficient accidents this formula would give the somewhat inconsistent result of no losses at all.

18. That history may be summarized as follows:

Policy Years	Actual Loss Ratio All Firms (%)	Difference between Actual and Expected Losses
1943	53.39	12.46
1944	50.08	17.88
1945	51.31	15.88
1946	47.70	21.79
1947	49.14	19.44
1948	55.82	8.48

board is perhaps more independent in its actions than the typical compensation insurance board.¹⁹ The court acknowledged the difficulties of prospective rate-making and the inability of anyone to state that a reasonable rate would certainly result, but it regarded the prior inaccuracies as making it "especially necessary that the methods adopted by the board be carefully scrutinized." The board's function in this situation is to "use all sources of information and experience in a reasonable manner to set a rate which will produce results as close as possible to what is desired."

The court was dissatisfied as well with the board's change of the permissible loss ratio from 61% to 58.5%.²⁰ It pointed out that only the principle, not the amount, had been approved by the National Association of Insurance Commissioners,²¹ and that there was no evidence in the record which would justify such a change. Mere approval by the board did not make it reasonable: "such a ratio can be established only after appropriate findings on expense requirements and what constitutes a reasonable profit."

Actually, a revision of the basic rate formula seems proper. This conclusion is reinforced by recent proposals for changes in several factors, including the newly adopted *rate level adjustment factor*.²²

19. Latest figures for overall increases show:			
<i>Requested</i>	<i>Approved as Such</i>	<i>Lesser Award</i>	<i>No Action</i>
52	33	17	2

These figures contain duplications in a number of states, including the three most recent requested increases in Minnesota, none of which were approved without reduction. The average discrepancy between request and grant in the 17 cases was 3.3%; in three cases increases were asked for but decreases were given. National Council on Compensation Insurance, Ann. Rep. 9-11 (1952).

20. The added cost of premiums is actually 4.3% because with expenses constant the total premium varies as: $\frac{61}{58.5} = 1.04273$.

21. National Council on Compensation Insurance, Ann. Rep. 15 (1952). A so-called emergency loading of 2.5% was used in the depression. Minn. Compensation Board, 5th Bienn. Rep. 5 (1933). A "contingency factor" was later included in the expense loading and a cumulative total of profits was kept, this contingency factor being manipulated to assure, in theory, protection against accumulated losses. See Minn. Compensation Board, 6th Bienn. Rep. 5 (1935); cf. Rober, Recent Developments in the Compensation Rate-Making Procedure, Proc. 1937 Convention IAIABC, U. S. Dep't of Labor, Div. Labor Stds. Bull., No. 17 at 45 (1938). This was attacked in district court in three cases which were not appealed. See Minn. Compensation Board, 9th Bienn. Rep. 18, 23 (1941); Minn. Compensation Board, 10th Bienn. Rep. 14, 16 (1943). After the 10th Biennial Report, however, this factor disappeared without comment or explanation.

22. Proposed changes include: calculating the rate level adjustment factor by using the latest 12 months experience as a base with changes made in fact-gathering to afford use of more recent data; attempting to put claims adjustment expense under losses rather than expenses; correcting for off-balance with a uniform country-wide factor of 1.030. National Council on Compensation Insurance, Ann. Rep. 4 (1952). Note in this connection that despite a long period of favorable through inaccurate results, general revision

The corrections needed are suggested by the requirements of the problem. The board should utilize the latest information available at its hearings to establish a rate which will preserve its validity over its entire effective period. The data used need not be derived from insurance sources,²³ but the rate formula adopted should produce a fair proportion of accurate loss ratios when checked empirically using the conditions of previous years.²⁴

ADEQUATE RETURN AND REASONABLE RATES

The formulation of Workmen's Compensation insurance rates is not a common subject of judicial scrutiny.²⁵ The burden of opposing a rate order, considerable even before a commission, becomes discouraging under the usual judicial tolerance toward administrative discretion and expertise.²⁶ The significance of the instant case derives not from the easily variable mechanics of the process but from the role the court assumes in assuring that the administrative agency will attain its statutory goal of "minimum and adequate and reasonable" rates.

The most sophisticated judicial thinking on the question of rate-making was developed from a series of gas and oil cases culminat-

of the rate-making formula was not given serious consideration until the trend was reversed. Cf. Fondmiller, *Can State Figures on Average Cost Per Case be Used?* Proc. 1946 Convention IAIABC, U. S. Dep't Labor, Div. Labor Stds. Bull., No. 87 at 113 (1947).

23. Use of wage figures from the Division of Employment and Security is an example of the profitable use of outside figures.

24. For example, actual cost of specified medical services *might* be correlated to the accident frequency and severity rates and the benefit payment level to ascertain the statistical significance each has on overall losses. It would also seem to be more proper, until shown to be false, to use trends as to each factor. The argument contra is that predictions are useless because of the many variables and uncertainties; this, however, does not justify the static approach now used, particularly in the light of the lack of success it has produced.

25. Almost always the application of a rate to a particular employer, not the state rate level itself, is attacked. See, *e.g.*, *Rice v. Continental Cas. Co.*, 153 F. 2d 964 (5th Cir. 1946); *Gene Autry Productions, Inc. v. Industrial Comm'n*, 67 Ariz. 290, 195 P. 2d 143 (1948); *State v. Hughes Electric Co.*, 51 N. D. 45, 199 N. W. 128 (1924); *State v. Industrial Comm'n*, 125 Ohio St. 272, 181 N. E. 99 (1932). In some states the "state-fund" plan is used and private carriers are not involved in the rate-making process. See *Riesenfeld & Maxwell, op. cit. supra* note 4, at 391; *Riesenfeld, supra* note 4, at 137; *State Fund Round Table*, Proc. 1940 Convention IAIABC, U. S. Dep't Labor, Div. Labor Stds. Bull., No. 46 at 154 (1941). For a general listing of state organizations, see *Fletcher, Workmen's Compensation Insurance and Its Rate Administration*, 10 Ins. Counsel J. 32 (1943).

26. Cf. *Aurora v. Commissioner of Taxation*, 217 Minn. 64, 97-98, 14 N. W. 2d 292, 310 (1944); *State v. Tri-State Tel. and Tel. Co.*, 204 Minn. 516, 526, 284 N. W. 294, 302 (1939); *Steenerson v. Great Northern Ry.*, 69 Minn. 353, 376, 72 N. W. 713, 716 (1897); see *Roberts, Tax Valuation of Minnesota Iron Ore*, 34 Minn. L. Rev. 389, 435 (1950); 35 Minn. L. Rev. 661 (1951).

ing in the *Hope Natural Gas* case,²⁷ in which the Supreme Court held that in determining the reasonableness of a rate all that need be shown is a fair "impact" or "end result," considering the effect on the soundness and stability of the public utility involved. This doctrine was conceived to free determinative bodies from unrealistic concepts of due process,²⁸ and it serves such purpose adequately.²⁹ There must be some limitation, however, to the freedom given a commission, and it is generally found in the lack of evidence supporting the findings.³⁰ Thus the bare statement of a finding is not sufficient,³¹ and a formula if used must be correctly applied.³² To uphold a rate where there is nothing in support would be to assume, gratuitously, that the agency was acting properly on broader ques-

27. *FPC v. Hope Natural Gas Co.*, 320 U. S. 591 (1944). See also *FPC v. Natural Gas Pipeline Co.*, 315 U. S. 575 (1942) (predecessor to *Hope*); *Washington Gas Light Co. v. Baker*, 188 F. 2d 11 (D.C. Cir. 1950), *cert. denied*, 340 U. S. 952 (1951) (consequences analyzed). See generally Brown, *The Ghosts of the Hope Natural Gas Decision*, 32 Calif. L. Rev. 398 (1944); Hale, *Utility Regulation in the Light of the Hope Natural Gas Case*, 44 Col. L. Rev. 488 (1944); Welch, *Status of Regulatory Commissions under the Hope Natural Gas Decision*, 32 Geo. L. J. 136 (1944); Wheat, *Does Hope Case Mean Direct Approach to "Fair Return"?* 33 P. U. Fort. 531, 617 (1944); 32 Minn. L. Rev. 60 (1947). Cf. *State v. Tri-State Tel. and Tel. Co.*, 204 Minn. 516, 532, 284 N. W. 294, 305 (1939): "Confiscation proceeds from the result reached, not from incidental errors made in reaching it. Our review is in consequence restricted to a determination of the conclusions which the evidence put in by the state will reasonably sustain."

28. "Whatever the remaining right of judicial review may be, or the criteria of confiscation, the court has firmly established the presumption that rates fixed by a regulatory body are in fact just and reasonable. It no longer leaves the federal court open, almost eagerly ready, to undertake review on any claim or pretense of confiscation or due-process violation, to retry and redetermine the facts, and really to take over the rate-making function." Bauer, *Transforming Public Utility Regulation* 151 (1950).

29. See, e.g., *Panhandle Eastern Pipe Line Co. v. FPC*, 324 U. S. 635 (1945); *Colorado Interstate Gas Co. v. FPC*, 324 U. S. 581 (1945); *Potomac Electric Power Co. v. Public Utilities Comm'n*, 158 F. 2d 521 (D.C. Cir. 1946), *cert. denied*, 331 U. S. 816 (1947). Some disfavor has been shown at the application of the *Hope* doctrine to situations where statutory requirements are explicit. See *id.* at 533 (dissenting opinion).

30. But note the comment that "... when the Supreme Court sets aside administrative actions for supposed lack of adequate findings, one is often left in doubt as to whether the real reasons relate to clarity of findings or to judicial disagreement with administrative policy." Davis, *Administrative Law* § 158 (1951).

31. *Washington Gas Light Co. v. Baker*, 188 F. 2d 11, 16 (D.C. Cir. 1950), *cert. denied*, 340 U. S. 952 (1951): "The only reference to rate of return in the Commission's opinion is that 'a return of less than 4% is obviously inadequate to maintain the Company in a sound financial position.' Commission expertise alone cannot support so pivotal an assumption. . . . Without any evidence on this essential issue, there is no basis for application of any standard and the judicial review authorized by the statute becomes a formal but futile gesture."

32. *Mississippi River Fuel Corp. v. FPC*, 163 F. 2d 433, 449 (D.C. Cir. 1947): "When the Commission announces principles or formulae as applicable, the validity of its order can be determined only by measuring what it does against the principles it announces."

tions.³³ Thus "end result" is not an abstraction which precludes judicial scrutiny of the components of the rate.³⁴

State courts have not regarded the rule of the *Hope* case as the true and given word.³⁵ This can be explained largely on the basis that state court interpretations in rate cases have been statutory or in line with state precedent and have not reached the Fourteenth Amendment due process issue. There are fundamental differences as well in the status of the parties and the nature of the suit which might preclude consideration of the doctrine. Thus, in the instant case the board is allied with the carriers and does not need the support of the "impact" doctrine; the employers cannot invoke the rule since the court would then be a rate-making body. Further, there are a considerable number of carriers of varying structure: they may be of national or local scope, organized on a stock or mutual basis—the mutuals, and some of the stock carriers, writing participating policies which pay dividends to the buyer. And these carriers must be regulated as to only the compensation insurance segment of their insurance business. Nor are all the employers likely to complain of high rates.³⁶ Of course, since compensation insurance rates exist separately, profits must be computed separately, and, therefore, if the carriers ever assume a position antagonistic to the board some concept like "end result" must ultimately be considered. The *ratio essendi* is the same in insurance as in utilities—the carriers can seek no more than a wholesome financial integrity in a regulated industry.

The "impact" rule has been applied to insurance rate-making in a case parallel, in some respects, to the instant case—*Jordan v. American Eagle Fire Ins. Co.*³⁷ The case involved regulation of the rates of some 200 companies, and in dictum the court showed re-

33. For example, one question is whether the rate is proper in comparison to rates for other services, and another is whether it is correct in view of cyclic economic trends. For some hidden considerations in the making of rates see Fisher, *What Says the Court? Criteria for Utility Regulation*, 44 P. U. Fort. 856 (1949).

34. See *Mississippi River Fuel Corp. v. FPC*, 163 F. 2d 433, 451 (D.C. Cir. 1947).

35. Nemmers, *The Hope Case—Pandora's Box*, 45 Ill. L. Rev. 460, 469 (1950); Rose, *The Bell Telephone System Rate Cases*, 37 Va. L. Rev. 699 (1951); Note, 33 Geo. L. J. 70 (1944); 30 B. U. L. Rev. 120 (1950).

36. Employers who get non-participating policies suffer directly from high rates which enable stock carriers to remain in business while non-stock carriers return high dividends. But these employers, though members of the employers' association, are generally small and unorganized. Employees and the public are affected only indirectly.

37. 169 F. 2d 281 (D.C. Cir. 1948), 33 Minn. L. Rev. 771 (1949).

luctance³⁸ to follow previous holdings³⁹ which would require the rate to be satisfactory to the highest cost company. It looked askance as well at the use of a system of graduated rates, because that would have the practical result of tending to monopoly by squeezing out those unable to compete at the lowest rate. The most appropriate result, therefore, would be a consideration of all interests, including that of the public.⁴⁰

A distinction has been drawn, as to review of rate-making, between the substantive requirement of fairness in the result and the procedural requirement of fairness in reaching that result.⁴¹ Under normal practice, however, the result cannot be ascertained, so the method of computation alone is decisive. Thus the court in the instant case based its determination solely on the inadequate and improper method of reaching the result.

One unsolved problem is that of giving proper credit to the investment income of the carriers in the computation of a reasonable profit. This was early considered by the Minnesota compensation insurance board but was dropped as impractical.⁴² In view of the number of carriers, their numerous modes of doing business and the complexities of the computation itself, it may well be that not even an employers' association would seriously seek to pursue the subject. But if an appreciable amount is involved it goes to the crux of determining a fair profit; even without information supplied to it the expert board still might be obliged to develop the necessary data itself.⁴³

38. *Id.* at 293: "If constitutional validity is to be determined by consideration of the several companies separately, the only valid uniform rate would be that fixed by the experience of the company with the highest expenses. Such surely is not the requirement of due process."

39. *Aetna Ins. Co. v. Hyde*, 275 U. S. 440 (1928); *Missouri Rate Cases*, 230 U. S. 474 (1913); *Minnesota Rate Cases*, 230 U. S. 352 (1913).

40. *Jordan v. American Eagle Fire Ins. Co.*, 169 F. 2d 281, 293 (D.C. Cir. 1948), 33 *Minn. L. Rev.* 771 (1949): "On the other hand, if constitutional validity can be tested by a reasonable figure fixed by the general experience of all, the public interest against monopoly, the companies' interest in reasonable return, and the incentive toward good management by the companies would all be well-served." See also Bauer, *Transforming Public Utility Regulation 7* (1950).

41. See Nemmers, *The Hope Case—Pandora's Box*, 45 *Ill. L. Rev.* 460, 469 (1950); *cf.* *Jordan v. American Eagle Fire Ins. Co.*, 169 F. 2d 281, 287 (D.C. Cir. 1948), 33 *Minn. L. Rev.* 771 (1949).

42. See *Minn. Compensation Board*, 2d *Bienn. Rep.* 13 (1927), which said there was "... no practical way of considering this source of revenue when making compensation rates." *Cf.* Johnson, *New York Compensation Rate Making*, 35 *Proc. Casualty Actuarial Soc'y* 6 (1948), where an attempt was made to consider the extent of such earnings and the conclusion was that they were not important.

43. *Minn. Stat.* § 79.07 (1949): "The board shall, in approving these rates, make use of the experience which from time to time may be available

The true amount of return to the carrier is also worth some scrutiny by the board.⁴⁴ In compensation insurance, profit is normally considered on the basis of premium volume. The use of this basis, however, may mean a high rate of return on investment—or a considerably higher amount than that needed to preserve the carrier as a going concern under the “impact” rule.⁴⁵

The basic division of carriers of compensation insurance into stock and mutual companies would of itself be unobjectionable were it not for the fact that the stock companies have basic expenses about 14% (of the total premium) greater than the non-stock.⁴⁶ After initial perturbation the board announced that all companies should enjoy rates sufficient to provide a profit to the stock companies because (1) to do otherwise would discriminate, (2) buyers of participating dividends get dividends, and (3) stock companies take smaller risks with higher costs.⁴⁷ Use of this rationale means that the participating insurance buyer pays effective premiums dependent not only on the state rate level and his own merit rating but on the experience of his carrier as well, which controls the dividend amounts. Some argument can be made that profits are reduced by the amount of dividend payments, but against this is the fact that rates paid are then indisputably higher than actually required. The court in the instant case avoided examination of this question by saying simply that the “formula is devised on the basis of standard earned premium, and it is on that basis that the accuracy of the rate set must be determined.” Preservation of the carrier dichotomy is of questionable necessity, but in the end the only clear-cut solution is legislative.⁴⁸

and of such other helpful information as may be obtainable.” See Rep. Comm. Statistics, Proc. 36th Convention IAIABC, U. S. Dep’t Labor, Bureau Labor Stds. Bull., No. 142 at 203 (1950), indicating a general inadequacy of administrative data.

44. However, this would require an analysis of the capital investment involved in underwriting compensation insurance, entailing a complex correlation of compensation insurance to the entire casualty insurance field.

45. It should be remembered that when rates are too high, agents’ commissions and taxes are higher than they would be with a proper rate, making realized profit less, but not diminishing the error. See Bauer, Transforming Public Utility Regulation 112-114 (1950). On the theory of rate of return generally, see Tatham, *A New Look at Rate of Return*, 46 P. U. Fort. 867 (1950).

46. This arises largely because of their higher acquisition costs: nationwide, for the year ending December 31, 1949, commissions and brokerage expenses were 13.39% for stock companies and 2.54% for non-stock. Minn. Compensation Board, 14th Bienn. Rep. 21 (1951); see Riesenfeld, *supra* note 4, at 140. The difference is due to the fact that mutuals write policies directly while stock companies employ commissioned insurance agents.

47. Minn. Compensation Board, 2d Bienn. Rep. 10 (1927).

48. See Riesenfeld, *supra* note 4, at 140-141. It might be desirable to

EFFECTIVE JUDICIAL REVIEW

Exponents of practicality in jurisprudence can find numerous delights in rate-making cases. There are still virgin questions of the appellate function in general⁴⁹ and of realistic review in particular.

In the instant case the court determined that the agency action was unsustainable because where it purported to apply mathematical logic that logic was erroneous, and where it approved a new factor it stated no basis for its conclusion. In any view which concedes that judicial corrective action may sometimes be necessary, the result was sound and the approach salutary, for the immediate powers of the board were not circumscribed and no arbitrary general requirements were imposed; the court was not compelled to use novel legal concepts due to application of old dogma to a new practical situation. Essentially its holding was on insufficiency and inaccuracy of findings.⁵⁰ In this it took an orthodox viewpoint.⁵¹

It requires no theorizing, however, to raise questions which the court might have answered. The time consumed in judicial review placed the question of 1951 rates before the Minnesota Supreme Court in 1952. Because of the importance of the case the court might have thought to (if it did not actually do so) substantiate

use an escrow fund system for a given portion of the rates, permitting refunds to all buyers if rates were found to be excessive in fact. Re-establishment of the old contingency factor, if used to equalize profit, would also act as a partial stabilizer. While this makes subsequent buyers in a sense the beneficiaries of previous gains and the sufferers from previous losses it is still a conformity to the prior practice and the statutory mandate.

49. See Dickinson, *Judicial Review of Administrative Determinations, a Summary and Evaluation*, 25 Minn. L. Rev. 588 (1941); Hoshour, *Proposed Legislation Pending in the Congress and in the Minnesota Legislature Concerning the Scope of Judicial Review of Administrative Decisions*, 29 Minn. L. Rev. 157 (1945); Riesenfeld, Bauman & Maxwell, *Judicial Control of Administrative Action by Means of the Extraordinary Remedies in Minnesota*, 33 Minn. L. Rev. 569, 685 (1949).

50. Comparison of the 13th Biennial Report of Minnesota compensation board with the 14th reveals them to be nearly identical in many sections as well as in format, while in its earlier reports the board displayed wide comprehension and initiative. This may not be significant, but it does not aid the claim of careful independent scrutiny by the board. The court also might draw its own conclusions as to the skill of the board from its review of the record in the case. Samples taken from it include (these are admittedly hand picked):

Board member: "What I am trying to get at, Mr. King, is this—I am probably just as confused as you are or anybody else around this room over these figures." Record, p. 169.

Board member: "Mr. Chairman, I suggest these two actuaries get together for a couple of minutes and work out their minds between them. . . . I am very frank to say I don't understand what you are talking about and I would like to have it in English." Record, p. 222.

51. See *SEC v. Chenery Corp.*, 332 U. S. 194, 196 (1947); *Morgan v. United States*, 298 U. S. 468, 480 (1936); cf. *Colorado-Wyoming Gas Co. v. FPC*, 324 U. S. 626, 634 (1945); see Davis, *Administrative Law* § 158 *et seq.* (1951).

the result it reached by later data.⁵² Some of this information would be of such a nature as to almost compel its use,⁵³ while other facts would be of doubtful certainty although of great persuasive effect.⁵⁴ The court in sum could decide between (1) assuming the perspective of the board at the time it made the rates and (2) adopting a position of enlightened post-vision. The first is unrealistic wherever it reaches a result contrary to, and by the exclusion of, already ascertainable facts. The second raises a problem of the extent of judicial notice within the broader limits of official notice,⁵⁵ but it should certainly govern where the later facts are readily available, indisputable, and decisive of the issue. Where of lesser value they should not preclude general considerations of fact or policy. One such consideration here is the prior history of rate-making by the board. Previous aberrations from the norm could not be decisive because the court did not attack the basic formula,⁵⁶ but they are one reason for not accepting the findings when they were improperly supported.⁵⁷

The court evidently left the board free, on remand, to make its own interpretation of what data to use to correct the previous rate determination. The board can either use all the information available presently or only that available at the prior hearings. There seems little doubt but that the first is proper, and more desirable, where a lengthy delay is involved—here it was one and

52. If, as in *Steenerson v. Great Northern Ry.*, 69 Minn. 353, 377, 72 N. W. 713, 716 (1897), “. . . on appeal from the commission the court should, to the best of their ability, take judicial notice of all such technical learning, knowledge, and information of a general character as should be known and understood by the commission,” then it should not close its eyes to later and more valuable information of the same nature which was not available to the commission.

53. For instance, the board was requested to grant an 8.3% increase due to a law amendment change in benefit levels in 1951, but only allowed 3.5%, and it disallowed a requested 7.8% increase for 1952. National Council on Compensation Insurance, Ann. Rep. 11 (1952).

54. The National Council on Compensation Insurance has recently indicated that loss ratio experience is becoming unfavorable. National Council on Compensation Insurance, Ann. Rep. 1 (1952). This is very strongly borne out by Minnesota experience figures which became available after the decision in the instant case was filed. These show an actual loss ratio for the calendar year 1951 of 72.4%, something which might have given the court real trouble. Minnesota Workmen's Compensation Expense Exhibit for Calendar Year 1951, compiled by compensation insurance board for Legislative Interim Committee.

55. On notice generally, see Davis, *Administrative Law* § 150 *et seq.* (1951).

56. It is questionable, however, whether consistently high rates should be permitted. Compare *Potomac Electric Power Co. v. Public Utilities Comm'n*, 158 F. 2d 521, 523 (D.C. Cir. 1946), *cert. denied*, 331 U. S. 816 (1947) with *United States v. Public Utilities Comm'n*, 158 F. 2d 533, 535 (D.C. Cir. 1946), *cert. denied*, 331 U. S. 516 (1947).

57. *Market Street Ry. v. Railroad Comm'n*, 324 U. S. 548 (1945).

one-half years. With a lesser time interval, however, the court might see considerable value in limiting the board to prior data only, since this would compel correction of method and eliminate the natural tendency of the board to justify its first determination by selected later data.

The court was undoubtedly aware that the board, after remand and reinvestigation, might return the same or a higher rate. Yet the standards imposed on the board may compel it to abandon its casual approach to rate-making, and might ultimately result in establishment of a sound rate-making system,⁵⁸ so that reversal was not a useless act.⁵⁹ Many of the problems presented here could be minimized by statutory provision for prompt judicial review of such important questions.

CONCLUSION

Workmen's Compensation insurance rate-making problems cannot be solved from the hazy security of the ivory tower.⁶⁰ Sound administration demands close examination of questions which vary from the mathematical to the constitutional; the instant case is a careful entry into this complex field. Even more, however, it is an effective judicial correction of administrative defection.

58. The court cannot, and should not, consider the nature of the administrative investigation, or whether more hearings are necessary. *United States v. Morgan*, 313 U. S. 409, 422 (1941); see *Davis*, *Administrative Law* § 101 (1951).

59. *Cf. FPC v. Interstate Natural Gas Co.*, 336 U. S. 577, 583 (1949), 34 *Minn. L. Rev.* 66, stating that funds might be impounded and then distributed by the lower court after determination of the parties who would have benefitted. See Note, 63 *Harv. L. Rev.* 1023 (1950); 65 *Harv. L. Rev.* 521 (1952). The court might have regarded an added profit factor as wholly unjustified, since although it might be desirable to have profit provided for explicitly, it need not necessarily be taken from the pure premium portion of the rate. If the permissible loss ratio is incorrect it should be changed; insertion of a profit figure merely makes the formula less flexible and sets an arbitrary profit minimum.

60. *Rodell, Woe Unto You, Lawyers!* 258 (1939).