

Testimony of  
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Before the  
The Consumer Operated and Oriented Plan (CO-OP) Advisory Board;  
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Health and Human Services

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I'm honored to speak before the Advisory Board to the Consumer Operated and Oriented Plan (CO-OP) Program and to provide my expertise in cooperative enterprise and I thank the board for this opportunity.

The National Cooperative Business Association is a membership association representing the interests of all types of the nation's more than 29,000 cooperative businesses, including agriculture, food distribution and retailing, childcare, credit unions, housing, health care, purchasing, energy and telecommunications. In addition, NCBA's CLUSA International Program has helped develop cooperatives and other sustainable businesses in over 50 countries since 1953. We were established in 1916 and our headquarters is in Washington, DC.

I'm here for my knowledge and expertise on cooperatives and the business model. Others here have expertise in health care and insurance.

Let me preface my comments by saying that, in 2009, NCBA entered the national debate on health care, advocating for the creation of health care cooperatives, which would be owned by their consumer members. NCBA actively worked with Senator Conrad (D-ND) and others to ensure that any use of the term cooperative or co-op meant that real cooperatives would need to be established. The Consumer Operated and Oriented Plan that is part of the current legislation does not contain that requirement. We continue to believe and advocate that these cooperatives can and should be incorporated under state cooperative statutes, not non-profit statutes, and, if a technical corrections bill does move forward, we will advocate that position strongly.

My comments offer guidance as to how the organizations that are likely to be created under the legislation can be structured so that they operate as cooperatives. I will discuss the differences between nonprofits and cooperatives and how the entities created through the Act could provide the value to consumers that cooperatives deliver through a cooperative governance structure. In addition, I will provide an outline for the rules and conditions needed that will enable these entities to create a consumer-centered program that meets real needs of consumers and will point out areas of the legislation that may hinder the success of these entities.

### **What is a "Cooperative"?**

Cooperatives operate in a wide variety of businesses, and there are many different applications of the business model, this flexibility in meeting so many different types of needs is one of the reasons that it is so attractive. It also creates some great challenges and uncertainty in the marketplace as to the true definition of a cooperative. With few exceptions, there are no rules governing the use of the term cooperative.

However, two factors distinguish cooperatives: governance and economics. In the strictest interpretation of a definition of a cooperative, there must be ownership by the member. There are businesses that are incorporated as cooperatives as well as businesses incorporated under other forms that apply the cooperative governance model to their operations through their by-

laws and articles of incorporation. Federal tax law recognizes that cooperatives provide patron benefits instead of profits to investors and that their residual earnings are passed through to patrons. In addition, the federal tax code grants tax exemptions to certain cooperatives in specific sectors, treating them as not-for-profit entities. It is this tax-exempt status that identifies these organizations as cooperatives.

### Highlights from the Legislation

Section 1322 of the Patient Protection and Affordable Care Act sets up the “Consumer Operated and Oriented Plan” and creates the acronym “CO-OP.” This plan is designed to develop at least one qualified nonprofit, consumer-run health insurance issuer for the individual and/or small group market in each state. This provision allots \$6 billion, to be spent by July 2013, for loans for assistance with start-up costs and grants to meet state solvency requirements. The entities established under the program would be given a new nonprofit tax exempt status. Cooperatives, that are nonprofit, member-run entities, are eligible for the program.

The program’s requirements include:

- Governance of the entities must be subject to majority vote of the members;
- Ethics and conflict of interest requirements to protect against insurance industry influence;
- Entities have a strong consumer focus, responsive to consumers’ needs;
- Any profits must be used to lower premiums, improve benefits or for other programs to improve quality of care for members; and
- The entity or related entity cannot have been a health insurance issuer on July 16, 2009 or sponsored by a state or local government.

To be successful, any cooperatives developed under this program should meet criteria and standards to ensure success and sustainability. Clear and strong governance, financial and structural requirements as well as protections against converting to for-profit status are needed. The program would benefit from clear guidance for how the co-op is incorporated and its relationship to state insurance law. With careful planning for the start of the program, the health insurance cooperatives created through this program could provide an affordable and responsive option for consumers.

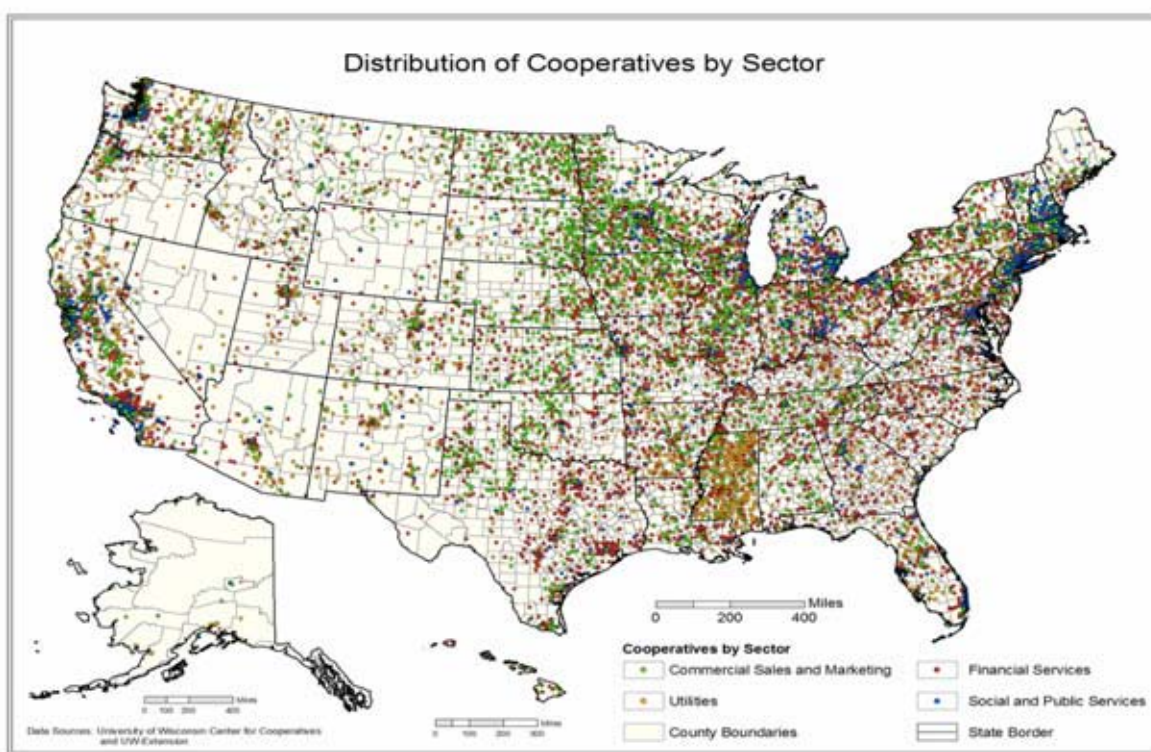
While the program has great potential, NCBA believes that issues threatening the effectiveness of the Act should be addressed before the program starts. In particular, the definition of and standards for cooperatives and their treatment under state insurance laws vary from state to state. Those interested in developing health insurance cooperatives may be making plans under a misconception about the type of eligible entity, the uses of the federal monies and the level of insurance industry involvement permitted. In addition, there is nothing to prevent entities from converting to for-profit status, as long as the loan and grant funds are paid back.

## What's the difference between Cooperatives and Nonprofits?

### Cooperatives

Cooperatives are member-owned and democratically controlled entities that provide services or products to their members. Cooperatives traditionally form because a need is not being met by the marketplace. People come together as members of a cooperative to receive services that are, not available, not affordable or for some other mutually beneficial reason.

Cooperatives operate in almost every sector of the economy, and according to a USDA and privately-funded study by the University of Wisconsin Center for Cooperatives on the economic impact of cooperatives, more than 29,000 cooperatives operate in the United States. These U.S. co-ops provide over 850 thousand jobs and create more than \$74 billion in annual wages with revenue of nearly \$500 billion.



Source: University of Wisconsin Center For Cooperatives

Cooperatives follow seven world-wide, generally acknowledged principles that guide the cooperative enterprise:

- Voluntary and Open Membership**  
 Cooperatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

- **Democratic Member Control**  
Cooperatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary cooperatives members have equal voting rights (one member, one vote) and cooperatives at other levels are also organized in a democratic manner.
- **Member Economic Participation**  
Members contribute equitably to, and democratically control, the capital of their cooperative. At least part of that capital is usually the common property of the cooperative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their cooperative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the cooperative; and supporting other activities approved by the membership.
- **Autonomy and Independence**  
Cooperatives are autonomous, self-help organizations controlled by their members. If they enter to agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.
- **Education, Training and Information**  
Cooperatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the public - particularly young people and opinion leaders - about the nature and benefits of co-operation.
- **Cooperation Among Cooperatives**  
Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures.
- **Concern for Community**  
Cooperatives work for the sustainable development of their communities through policies approved by their members.

Key among these principles for today's discussion is that cooperatives are owned and governed by their members. Homeowners provide greater care to their homes than do renters. Cooperative ownership provides the same level of value to the member owners. In addition, that risk is spread among the members of the cooperative ensures long-term stability. By contrast, a nonprofit is a corporation that is organized for scientific, educational or charitable purposes in which there are no individual stockholders and no part of the corporation's income is distributed to its members.

The cooperative members have a double function. The member of a cooperative is a capital owner **and** customer, consumer or producer of the goods and services provided by the cooperative.

Cooperative businesses deliver value to their consumer members and communities because they are responsive to their members needs and through their commitment to the cooperative principles.

The cooperative model is extremely flexible and is one of the reasons it is applied to so many different types of industries. Every state has at least one cooperative statute and many have several. Whether you are the farmer in rural Wisconsin or member of a credit union in Los Angeles, CA, you can both proudly be members of your local co-op. As privately owned businesses that are established for the public good of serving their members it is not surprising that co-ops are seen as a “third road” between those that advocate for a government-led system and those for a for-profit market solution.

Cooperatives play a vital role in our economy and provide an advantage to their member owners. By operating at cost and recycling savings back to members, cooperatives are an effective corporate structure to address the economic and social needs of their members.

#### *When do co-ops work best? (market conditions)*

Cooperatives have greatest success and develop when certain market conditions arise, such as:

- The market is failing to meet the need either based on cost or access
- There will be a benefit from economies of scale
- There is a need to assure an adequate supply of the good or service
- The intrinsic value of ownership will help to ensure the success of the business
- Social conditions such as needs of the community warrant the creation of a community owned business

#### *Today's conditions in health care are conducive to co-op development*

According to a study by Kaiser Permanente, the number of non-elderly uninsured Americans rose to 50.0 million in 2009—an increase of 4.3 million people—amidst rising unemployment rates and an economic recession. Almost one in five (19%) of the nonelderly was uninsured in 2009.

By aggregating their numbers through a cooperative organization, the members benefit from economies of scale. Larger groups have a larger population to spread risk, ensure adequate supply of the good or service and have greater leverage in negotiating fixed costs, such as administration. By pooling resources and coming together, the cooperative members can have access to services and negotiations that they would not otherwise have.

Surely, that so many of our people lack health insurance indicates a failure in the market that cooperative enterprise can help to rectify—and represents a need that warrants the creation of a community-owned and focused business.



The introduction of cooperatives into the health care debate as a mechanism to help provide more consumers with affordable health insurance coverage is a positive development if implemented correctly. But the health care system in this country is very complicated, involving many factors that affect cost and coverage. To ensure the success of the entities created through the Act, the Secretary and the Advisory Board should follow NCBA's recommendations.

### **Nonprofits**

As stated earlier, a nonprofit is an agency, institution, or organization owned or operated by one or more corporations or associations having no part of the net earnings or benefit of any private shareholder or individual. Many cooperatives are incorporated or operate as not-for-profit organizations. This designation encompasses two different subsets. Incorporation statutes that are specific to cooperatives, but that classify them as not-for-profit entities, also make provisions for member ownership rights including member voting rights for board of directors, distributions and rights to residual returns.

In contrast, organizations incorporated under general nonprofit statutes are not statutorily bound to follow organizational and operational criteria specific to cooperatives, making the cooperative character for such organizations more difficult to identify. General nonprofit statutes permit member organizations, but may not guarantee the right of members to vote. General nonprofit statutes also prohibit distributing residual earnings to those who control the organization, including members. The distribution of benefits to patron members based on use is a central concept to the cooperative operation. This prohibition on distributions would seem to disqualify all nonprofit membership organizations as cooperatives.

However, nonprofit cooperative typically operates in sectors commonly designated as not-for-profit and where residual earnings are uncommon. Member benefits in these cooperatives are the services provided

### **Principles and practices matter: Ensuring that the nonprofits created through the Act operate like cooperatives**

That cooperatives incorporated under general nonprofit statutes are not bound to follow organizational criteria specific to cooperatives, such as democratic governance and member ownership, causes NCBA concern as regards the CO-OP program.

However, certain provisions in the Act suggest that the public can receive benefit. In particular, the section stating that "Profits Inure to the Benefit of Members" provides a means by which the public can receive a value similar to that provided by cooperatives, as described above. In addition, if the entities created through the Act provide a governance structure that enables democratic control akin to member ownership, these entities will be more responsive to the needs of their members.

Group Health Cooperative, while much more than a health insurance cooperative, stands out as an example of this type of entity. Although organized as a nonprofit, Group Health Cooperative includes in its bylaws provisions that allow policyholders to apply to become members and

grants those members voting rights on certain governance issues, including the election of directors. However, because it is a nonprofit, policyholders do not have ownership rights.

NCBA strongly advocates that the nonprofits created through this Act operate as cooperatives, because to do so will ensure a great and sustainable benefit to the American public. Although the legislation does not allow these entities to organize as cooperatives in the legal sense, they can—and should—function as cooperatives and should possess a governance according to the cooperative principles and have bylaws and articles of incorporation that enable members to govern. Principles and practices matter and will ensure that the American people receive ongoing value from these entities.

### **Co-ops offer competitive answer**

To thrive in the world of business, cooperatives must always be as good as—or better than—their competition. Cooperatives operate in almost every sector of the U.S. economy and compete effectively against investor-owned companies—even in highly regulated areas. For example, credit unions, which are cooperatives, operate in a regulated environment and currently have six percent of the market. Food cooperatives are another sector that competes effectively in the market against investor-owned grocery stores.

These cooperative enterprises have a positive impact for consumers by creating competition in the marketplace that leads to improved services and/or a reduction of costs. Many years of data support the fact that credit unions and investor owned banks compete for consumers in deposits, that credit unions influence bank certificate of deposit rates and that credit unions have an influence on reducing loan rates offered by banks.

### **Health co-ops around the world**

Health co-ops are well established in Europe, the United States, Canada, Japan and Brazil, with applications ranging from local community operations to national health systems.

While the United States currently spends more on health care than other countries do, it doesn't get better results.

In Germany, medics and health networks organized themselves as cooperatives. They are buying and marketing jointly within the cooperatives to achieve advantages or to work together with further suppliers to create new health care units.

Italy has created a healthy social enterprise sector, through which cooperatives perform a central role in the country's economy. Italy has a national health system funded through central taxation (part hypothecated or pledged and part from general tax), responsibility for which currently lies with central government. It is in the process of decentralizing the management of the service.

In July of 2010, the International Health Co-operative Organisation (sic) gathered key health care cooperators from America and around the world to discuss how to implement a cooperative solution to America's health care and health insurance issues. NCBA participated in the "Cooperative Opportunities for Health Care" seminar where both Global Health Cooperative and



Health Partners shared the stories of their success, Commonwealth Fund President Karen Davis provided a vision for the conditions under which cooperative health care entities could thrive and cooperators from other countries shared best practices. The meeting engendered a productive dialogue; presentations from that meeting are included in the resource section of this document.

### **Health and insurance co-ops in the United States**

The cooperative concept exists in the insurance sector through "mutual" insurance companies. Mutual insurance companies are owned by their policyholders, and closely related to cooperatives. Policyholders are entitled to vote for members of the company's board of directors, and may receive special dividends in the form of capital distributions or reductions of policy premiums. Unlike stock companies, mutual companies exist solely to serve the insurance needs of their policyholders, and not to provide investment profits to shareholders. They may not technically be cooperatives, but they work for members' benefit, and return profits through lower rates and even refund checks.

As consumer-owned and governed enterprises, co-ops put patients first rather than the interests of shareholders or providers. This should be the guiding principle of any reforms implemented that the patient's needs are paramount. Co-ops can adapt quickly to the needs of the consumer members and maintain the focus on the consumers and do this through aggressive wellness programs, a member-peer claims dispute process that treats all parties fairly and electronic medical record systems.

Over the last twenty years, health care related cooperatives have emerged as a key strategy for:

- Keeping health care costs and insurance premiums affordable for consumers and small businesses;
- Controlling the high cost of prescription drugs;
- Helping community-owned, nonprofit hospitals remain independent;
- Improving the quality of home-based health care and assisted living;
- Helping small independent pharmacists compete with big box stores, allowing them to offer locally available prescription drugs.

Group Health Cooperative of Washington and HealthPartners in Minnesota are the two largest health care consumer co-ops, serving 1.3 million people.

[HealthPartners, Inc.](#), based in Minneapolis, the nation's largest consumer-owned HMO was founded in 1957 and serves more than one million medical and dental health plan members nationwide. Health Partners provides care, coverage, research and education to improve the health of members, patients and the community. HealthPartners is rated one of the best plans in the nation by U.S. News and World Report in association with The National Committee for Quality Assurance.

Group Health Cooperative is a consumer-governed, nonprofit health care system that coordinates care and coverage. Founded in 1947 and based in Seattle, Wash., Group Health and its subsidiary health carriers serve more than 600,000 residents of Washington State and Idaho.

### **Act creates opportunity for cooperatives via private purchasing council**

While the Act promotes the establishment of member-run health insurance issuers, there are other avenues for cooperatives to operate in providing health insurance coverage. Both the group that "organizes" coverage provided by insurers and the company that provides insurance could also be structured as cooperatives—and both could be present in the same market.

The Act calls for the "Establishment of Private Purchasing Council[s]," which "enter into collective purchasing arrangements for items and services that increase administrative and other cost efficiencies, including claims administration, administrative services, health information technology, and actuarial services." These councils could be organized as cooperative businesses. Two such entities operate as purchasing cooperatives for health insurance and point the way for these councils.

Thanexus, Inc., a funeral practice management cooperative created by the New Jersey State Funeral Directors Association, Inc., assists independently-owned funeral homes with critical business management services. Thanexus has aggregated the small independent funeral directors for the purchase of health insurance and other services. Current law prohibits the use of these successful models to cross state lines in an economically efficient manner.

The Farmers' Health Cooperative of Wisconsin brings together independent farmers to form a pool to purchase insurance. Farmers' Health Cooperative plans offer coverage for work-related injuries; multiple plan, provider and network options and choices; predictable, stabilized rates; prescription drug coverage and a 24-hour nurse hotline. The premium increases have been below market and they are close to expanding by forming another cooperative that will be operating in Minnesota.

## **How the Advisory Board can Support the Success of the CO-OP program**

### **Create conditions that enable cooperatives to thrive**

Among the challenges to the success of cooperative businesses is access to equity. This lack of access can constrain growth as well as threaten the ability of start-up enterprises. Developing cooperatives, in particular, must be adequately capitalized or they will fail.

Two ways by which the Advisory Board can create such conditions include, authorizing government support (precedents in REA and Farm Credit System) and enabling access to equity.

## Restrictions to success in the current legislation

### Is \$6 billion enough?

The Maryland Nonprofit Health Insurance Co-op, which is currently conducting a study to determine the feasibility of forming a nonprofit insurance carrier estimates that it would need \$100 million to \$150 million in reserves to start and to enroll 50,000 to 100,000 people to be economically viable. If every state required the same funds to start its own exchange, we'd need over \$7 billion.

Although the Act encourages qualified issuers to seek funding from private sources, the potential for such funding would be inadequate, according to one member of the MNHIC steering committee, "no foundation has that kind of money."

### Restriction on marketing will hinder economic viability

The Act states that any entity receiving funds via the CO-OP program may not use those funds for "marketing." Although not defined in the Act, the term generally refers to the promotion, distribution and selling of a product or service, including market research and advertising. It is difficult to comprehend why the federal government would place such restrictions on these entities. How, for example, will the Maryland Nonprofit Health Insurance Co-op enroll the 50,000 people it requires to be a viable business unless it is able to market its services?

NCBA suggests that the Advisory Board clarify this restriction and create a very narrow definition of this provision that would allow CO-OP participants to compete effectively and gain economic viability.

## Conclusion

NCBA believes that, implemented properly, the CO-OP program could ensure successful, sustainable organizations that will act in a manner consistent with cooperative principles. To achieve this outcome, NCBA suggests that the Secretary and Advisory Board provide the following:

- Clear guidance as to the type of co-op entity that is eligible for the program, including requirements for governance and its relationship to state insurance laws. The Secretary could develop a model health insurance issuer cooperative standard for the program or for adoption by the states, e.g., through the National Association of Insurance Commissioners (NAIC) process. This can also be coordinated with Treasury Department to ensure the tax-exempt status requirements are consistent.
- Technical expertise and outreach for those interested in developing a cooperative. This assistance could be coordinated with the states, which will want successful co-ops, can help identify potential members, and protect against conflict with state law issues.
- Coordinate with the CO-OP Advisory Board to ensure the program has access to expertise needed and to provide guidance to HHS/states on the legislative requirements.
- Rules to protect against conversion to for-profit status.

NCBA offers expertise in the cooperative business model and cooperative development and looks forward to working with this group and others as this part of the law becomes implemented.

#### **ABOUT NCBA**

Headquartered in Washington, DC, the National Cooperative Business Association creates cooperative connections across all sectors of the nation's more than 29,000 cooperative businesses, including agriculture, food distribution and retailing, childcare, credit unions, housing, healthcare, purchasing, worker, energy, and telecommunications cooperatives. In addition, NCBA's CLUSA International Program has helped develop cooperatives and other sustainable businesses in over 50 countries since 1953. CLUSA currently runs 23 projects in 11 countries. To learn more about NCBA, please visit [www.ncba.coop](http://www.ncba.coop) or email [info@ncba.coop](mailto:info@ncba.coop)

## Resources

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