

PartnerSource Review ¹ of

Rejecting the Grand Bargain: What Happens When Large Companies Opt Out of Workers' Compensation? By Professor Alison D. Morantz ²

This 74-page study released on March 18, 2016 covers fifteen large, multistate employers that provided their Texas employees with customized occupational injury benefits in lieu of workers' compensation coverage between 1998 and 2010. This is Prof. Morantz' second research study of Texas "nonsubscription" (also known as the Texas "Option" to workers' compensation). ³ The new report is found at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2750134.

Major findings:

1. Option programs pay better wage replacement benefits.
2. Frequency of severe, traumatic employee injury claims is cut in half.
3. Percentage of employees disabled drops by a third.
4. Employer costs are cut in half.
5. Coverage exclusions have minimal impact on cost savings.
6. Negligence liability exposure incentivizes Option employers to invest in safety.
7. As large Texas employers elected the Option, workers' compensation costs dropped.

Better Wage Replacement Benefits. Prof. Morantz states that all of the study participants "offered employees private plans whose benefits roughly resembled (yet also differed from) those available through workers' compensation." She notes, "Some ubiquitous features of private plans – such as first-day coverage of lost earnings ⁴ and wage replacement rates that are not capped by the state's average weekly wage – are more favorable to injured workers than workers' compensation."

Impact of Moral Hazard? Prof. Morantz expressed concern because past studies have confirmed the existence of two moral hazard effects that negatively impact costs in workers' compensation systems when benefit levels are increased:

¹ Bill Minick, President, PartnerSource, March 31, 2016.

² Stanford University law professor and senior fellow at the Stanford Institute for Economic Policy Research.

³ The first study is "Opting Out of Workers' Compensation in Texas: A Survey of Large, Multistate Nonsubscribers" – 2010, Regulation vs. Litigation – Perspectives from Economics and Law, National Bureau of Economic Research, 2010. This research was supported by National Science Foundation Grant. Professor Morantz' report can be found at (<http://www.nber.org/chapters/c11965.pdf>). Key findings include (a) virtually all survey respondents said they deemed the program a success; and (b) a substantial majority of respondents cited higher-quality medical care for injured employees as an advantage.

⁴ Compared to eighth-day wage replacement coverage under workers' compensation.

1. “Risk-bearing” moral hazard predicts that employees will take more risks on the job as benefit levels increase; and
2. “Claims-reporting” moral hazard refers to the expectation that a worker will be more likely to file an injury claim (including for a feigned or off-the-job injury) as benefit levels increase.

“Consistent with the existence of both moral hazard, nearly all studies have found that increasing benefits or shortening waiting periods increases the frequency, cost, and duration of claims.”

Fewer Traumatic Claims and Lower Costs. In spite of this historic research on injury benefit improvements, Prof. Morantz found that:

1. Frequency of severe, traumatic injury claims⁵ declines by about 47% under the Texas Option;
2. Serious claims involving replacement of lost wages are about 33% less common in the Option environment;
3. Employer costs per claim fell by 49% under the Option;
4. Employer costs per worker hour fell by about 44%; and
5. Although the fall in wage-replacement costs is larger in percentage terms, the decline in medical costs was equally consequential.

Coverage Exclusions Have Minimal Impact. The Option injury benefit plans studied all contain:

1. Exclusions (non-coverage) for permanent partial disabilities,⁶
2. Exclusions for certain diseases (such as any caused by mold, fungi, pollen, or asbestos) and some non-traumatic injuries (such as non-inguinal hernias, cumulative trauma if the employee has worked less than 180 days, carpal tunnel syndrome, chronic fatigue syndrome and fibromyalgia),⁷
3. Caps on total benefits,⁸ and
4. An exclusion for chiropractic care.⁹

Prof. Morantz found that these exclusions from benefit coverage account for little of the estimated cost savings. “Even when all four factors are accounted for, [the Texas Option] is still predicted to lower total cost per worker hour by more than 35 percent....”

⁵ Those “least prone to moral hazard and reporting bias”.

⁶ Also known as “PPD” or impairment income benefits payable for permanent bodily damage that does not result in payment of the Option plan’s death or dismemberment benefits for an objective loss or loss of use of a member of the body. Prof. Morantz refers to PPD benefits as “one of the most complex and controversial areas of workers’ compensation reform”. Texas Option employers and insurance carriers have found that limitations on voluntary benefit coverage for certain impairments and caps on total benefits are appropriate in view of, and are better settled in exchange for a release of, the unlimited negligence liability exposure that accompanies the employer’s decision to elect the Texas Option.

⁷ Each of which are commonly excluded from Option injury benefit coverage due to related exclusions in Option insurance policies or are excluded due to medical questions regarding work-relatedness.

⁸ See footnote 5 regarding the balance of benefit commitments and liability exposures.

⁹ A well-known, common area of abuse in Texas workers’ compensation.

Benefit Enhancements and Liability Exposure Lead to Safety Improvements. Prof. Morantz mentions prior research finding that a rise in benefits can spur employers to invest more heavily in safety. Also, the significantly lower frequency of severe, traumatic accident claims “provides strong evidence for a real safety effect, which is precisely what economic theory would lead one to expect. [Texas Option employers] are, at least in theory, internalizing all of the costs associated with workplace accidents (including tort liability), which should induce them to invest more in safety-enhancing technologies.” The negligence liability exposure for employers that elect the Texas Option “may prove costly in exceptional cases”¹⁰ and “may strengthen their incentives to implement costly safety improvements” which, in turn, offsets the above moral hazard effects.^{11, 12}

Grounds for Denying or Terminating Benefits. Prof. Morantz found that the majority of private plans include more grounds for denying claims or terminating benefits in particular cases than are commonly found in workers’ compensation.¹³ These provisions focus on employee accountability just before or after the injury took place and/or the nature of the injury. (Those provisions are commonly subject to a “good cause” exception that must be administered by a fiduciary under ERISA in the best interests of the injured worker.)

Impact of Employment Status. Contrary to Option critic claims that all injury benefits cease upon any termination of employment, Prof. Morantz found that medical benefits continue unless the employee is fired for gross misconduct. She also found that Option plans commonly do not terminate wage-replacement benefits if an employee is laid off, but such benefits do cease if the employee voluntarily quits or is fired for other reasons. Only one study participant’s plan reserved the right to terminate wage-replacement benefits if the employee is fired for any reason at all.

Retaliatory Discharge Claims. Prof. Morantz notes that the Texas’ Workers’ Compensation Act protects employees who file workers’ compensation claims from retaliatory discharge, but that employees covered by Option programs enjoy no similar protection under state law. However,

¹⁰ Through January 2016, PartnerSource has identified 93 claim settlements and judgments in the Texas Option environment of \$1 million or more.

¹¹ In other words, workers receive the double advantage of safer workplaces as employers seek to prevent liability claims AND more generous wage replacement benefits. This represents a validation of what employers electing the Texas Option and their insurance companies have long-understood – that it makes good business and public policy sense to replace more of the wages lost by workers disabled from an occupational injury, and to incentivize safety through some measure of employer liability exposure (a reformulation of the “Grand Bargain”).

¹² Prof. Morantz further theorizes that, “the significant fall in severe and traumatic injury claims could also be explained by aggressive claim screening and/or termination of employees who report their injuries”. However, she also notes that traumatic injury claims are less subject to aggressive claim screening and that employees are protected from discrimination and retaliatory discharge under the Employee Retirement Income Security Act (ERISA). Anti-discrimination and anti-retaliation protections also apply to Option programs under the Americans With Disabilities Act (ADA), the Family and Medical Leave Act (FMLA), and the Occupational Health and Safety Act (OSHA).

¹³ For example, discouraging treatment by non-approved providers that may jeopardize achievement of the best medical outcome, or ceasing benefits for failure to keep scheduled medical appointments.

she also notes the anti-discrimination/anti-retaliation claim available to workers under Section 510 of ERISA.¹⁴

Drop in Texas Workers' Compensation Rates as Large Employers Moved to the Option.

Although very small firms (those with 1-4 employees) have always been disproportionately likely to forgo participation in Texas workers' compensation, Prof. Morantz notes that substantial numbers of very large employers (defined as those employing at least 500 workers) began doing so around the turn of the millennium. In 2001, Texas had among the highest reported cost per claim among the fourteen states included in the annual Workers' Compensation Research Institute (WCRI) cost benchmarking study. Since that time, both medical costs and indemnity payments per claim under Texas workers' compensation have plummeted.¹⁵

Need for More Study. Prof. Morantz concludes that there is an urgent need for further analysis of the economic and distributional effects of workers' compensation systems co-existing with privately-provided forms of occupational injury insurance. This includes the need to further (1) identify which specific characteristics of private plans are producing the lion's share of cost savings,¹⁶ (2) study potential cost-shifting to government programs or group health plans,¹⁷ and (3) consider differences between Option programs sponsored by small-, medium- and large-sized employers.¹⁸

¹⁴ Such claims can be brought in state or federal court, but do not provide an opportunity to seek punitive damages that may be available under workers' compensation laws.

¹⁵ See "Debunking Opt-Out Myths, Part 4" at <http://insurancethoughtleadership.com/debunking-opt-out-myths-part-4/> which reviews the contemporaneous drop in Texas and Oklahoma workers' compensation premium rates as employers elect the Option.

¹⁶ After developing and supporting Texas Option programs over the past 27 years, I recommend such research focus on the combined impact of these four "Core Principles" of effective Option programs: (A) better employee communication, (B) fiduciary decision making, (C) more employee and medical provider accountability, and (D) insurance competition.

¹⁷ Any study of cost-shifting must consider whether current workers' compensation systems or Option programs shift more costs to government programs. I submit that the program with the best medical outcomes shifts less cost to other programs.

¹⁸ This topic will require an understanding of voluntary versus mandatory Option benefit systems and current Option insurance market underwriting and service practices (for example, insurance carrier package programs and requirements for unbundling program components).