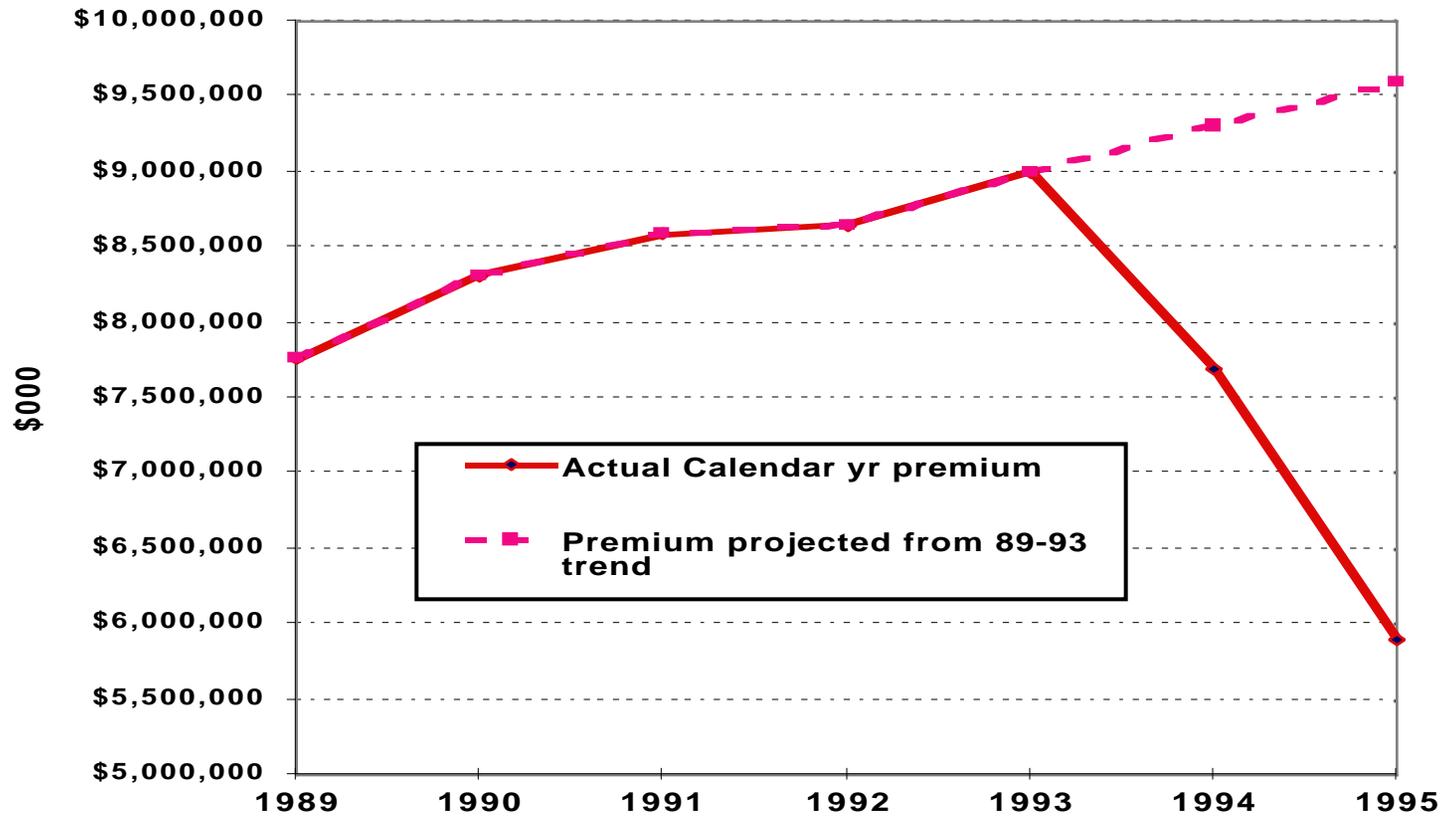


Workers' Compensation Reform Third Anniversary Update



DEPARTMENT OF INDUSTRIAL RELATIONS
JULY 1996

Workers' Compensation Reform

Third Anniversary Update

DEPARTMENT OF INDUSTRIAL RELATIONS

JULY 1996

“For years, California’s fraud-ridden workers’ compensation system has been the single greatest barrier to job creation in this state. But today, we’re starting the process of tearing down the barrier, freeing Californians to create tens of thousands of new jobs a year.”

Governor Pete Wilson, July 16, 1993

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Introduction

- Just three years ago California's workers' compensation premium costs had become among the nation's highest and the weekly benefits paid to injured workers were among the nation's lowest.
- Despite a number of quick fixes over the years the situation had worsened to crisis proportions. Upon entering office Governor Wilson stated that workers' compensation reform would be a top priority of his administration. He first championed legislation to battle fraud and limit stress claims which had increased virtually unchecked. He then embarked upon a complete overhaul to fix the systemic problems in a program that had grown out of control and was stifling business development and job growth in the Golden State.

- In December, 1991, Governor Wilson appointed the Council on California Competitiveness. This bipartisan panel, composed of business and labor representatives, was charged with finding ways to remove the barriers to creating jobs and thus increasing state revenues in California. In April, 1992, the Council issued its final report to the Governor, *California's Jobs and Future*. The Council found California's workers' compensation system to be an inefficient and fraud ridden "national embarrassment."
- After consulting with business leaders and experts in the workers' compensation community, Governor Wilson proposed a number of legislative measures to provide the most complete overhaul of workers' compensation laws in the history of California. The bills attacked the basic problems that continued to plague employers with ever increasing costs and failed to provide legitimately injured workers fair compensation.
- On July 16, 1993, Governor Wilson was able to sign into law the major components of his reform package. Since then we have seen workers' compensation premium costs plummet while mandated benefits for injured workers have increased. This publication provides a look at the impact which the Wilson Reforms have had on benefits and costs in California's workers' compensation system in the three years following enactment of the reforms.

“The workers’ compensation reforms have helped bring more medically sound treatment to injured or ill workers. I believe the reforms will be found to have improved outcomes in workers’ compensation cases by reducing costs and improving quality of care.”

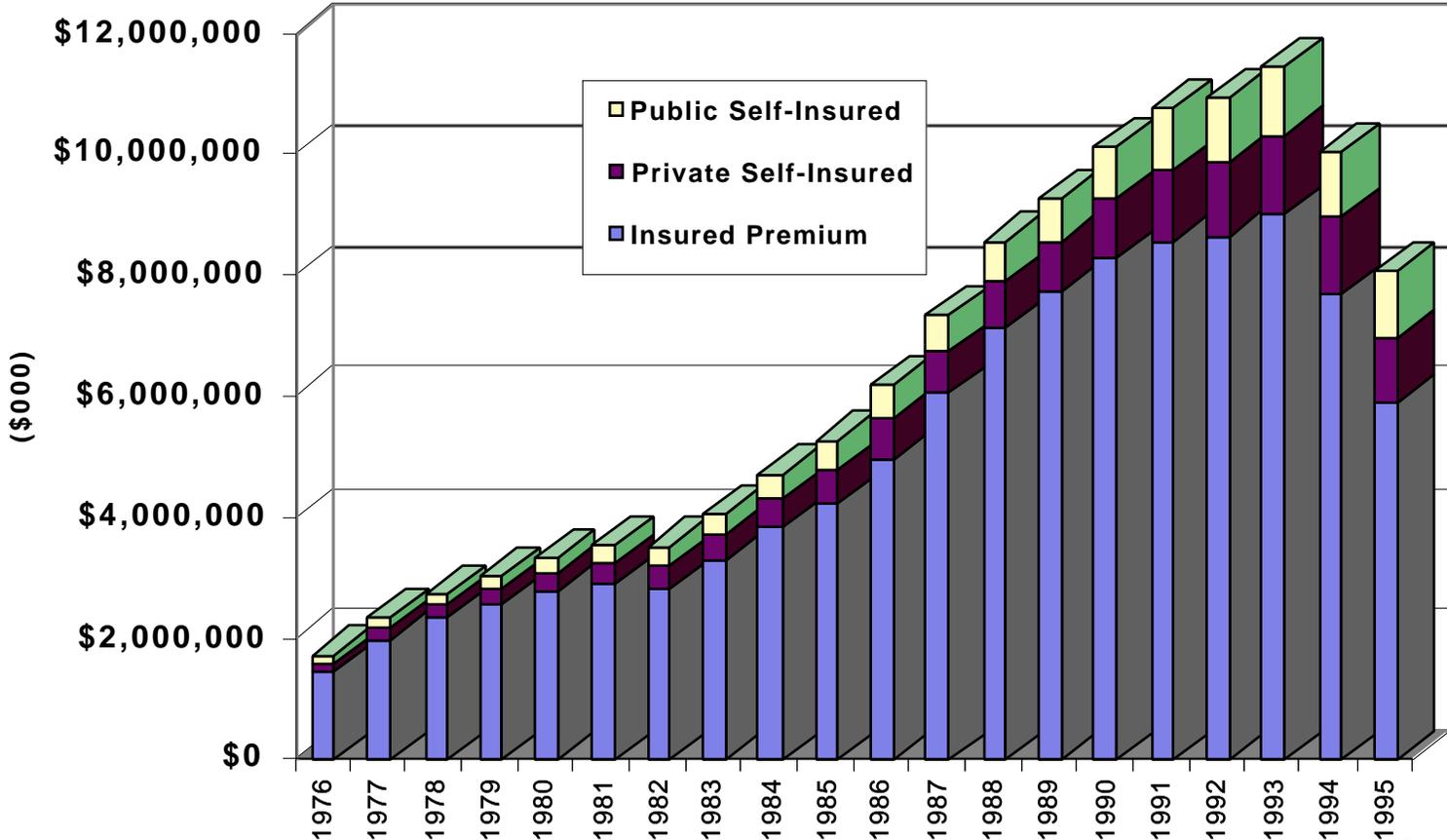
Laurence Miller, M.D., Medical Director: Workers’ Compensation, CCN

The Cost of Workers' Compensation in California

Statewide Employer Cost for Workers' Compensation

- The total cost for California employers for workers' compensation coverage had been rising steadily until it reached a high of over \$11 billion in 1993, the year reforms were signed into law. Costs have come down significantly, and totaled approximately \$8 billion last year, a 30 percent reduction. (This reflects total statewide cost for all employers --including those who purchase workers' compensation insurance from commercial providers or the State Fund and those who are self-insured.)

Total Cost of Workers' Compensation 1976-1995



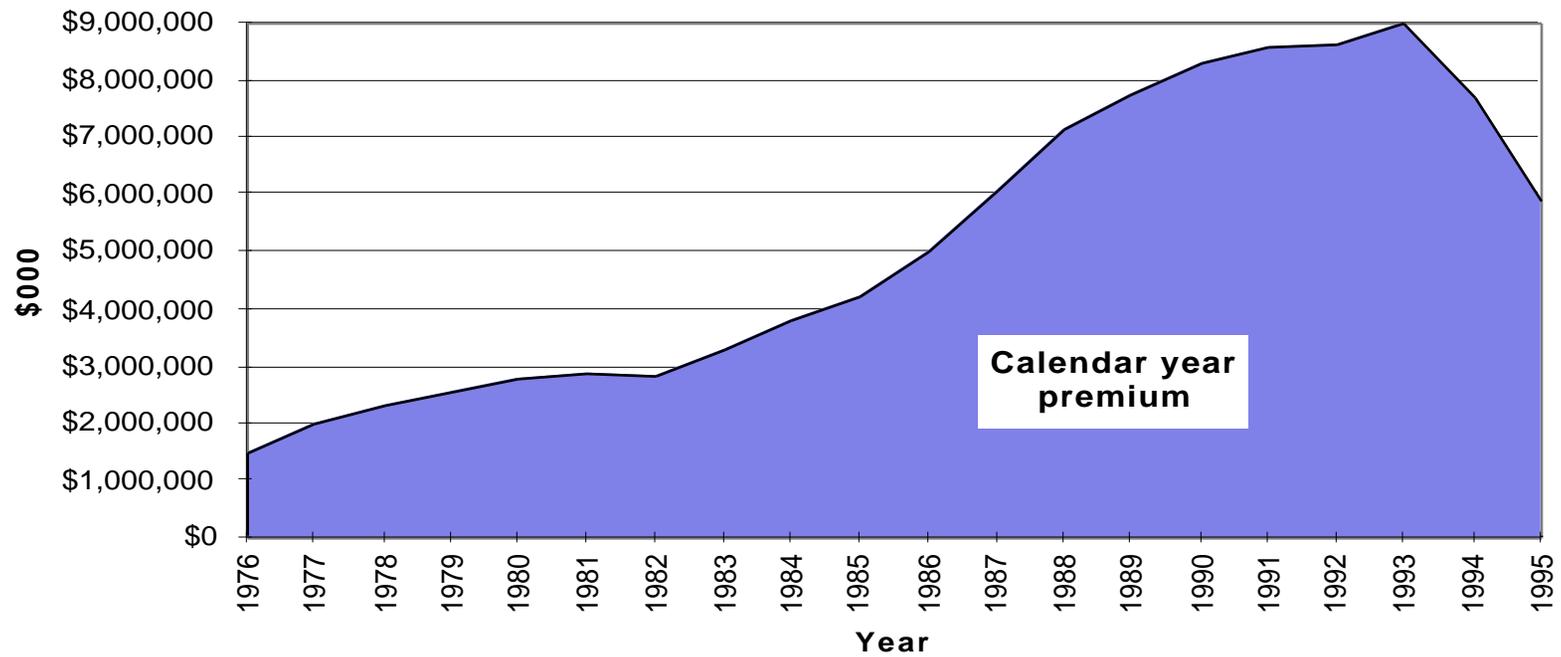
Self-insured benefits increased by 15% for expenses. Public SI calculated at 87% of private SI for 1976-1993

Total Statewide Costs for Employers Who Purchase Workers' Compensation Coverage

- Most California employers purchase workers' compensation insurance coverage from commercial providers or the State Compensation Insurance Fund. The total cost to these employers for insurance premiums grew from \$1.6 billion in 1976 to \$9 billion in 1993, the year reforms were enacted. Within two years the total premiums paid by California employers fell to under \$6 billion.

WC Premiums

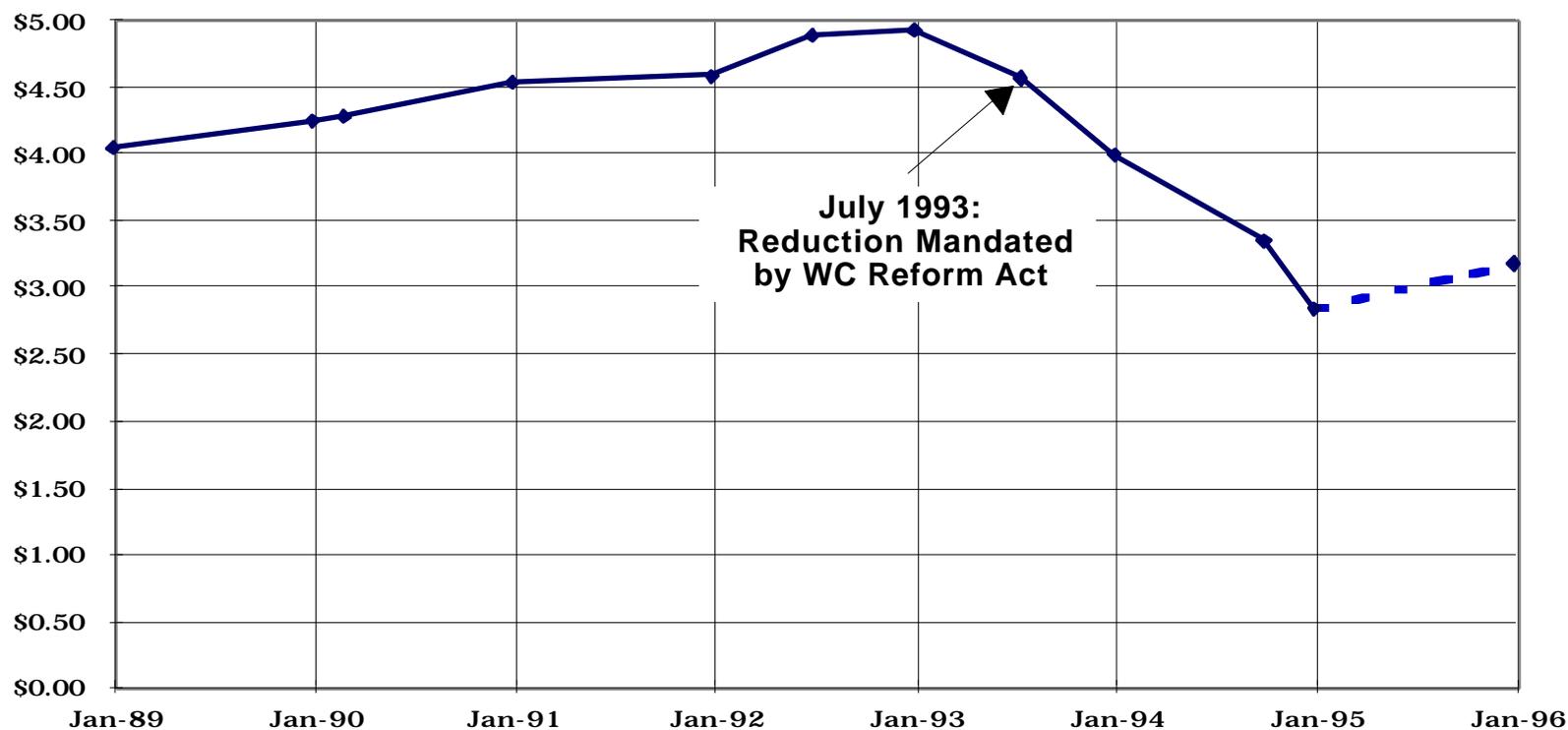
Calendar Year Premium, California WC insurers 1976-1995



Average Statewide Premium Costs Measured Against Payroll

- Premium costs for workers' compensation insurance can vary by industry. A common method of gauging the statewide average for all industries is to measure premium cost as a percentage of payroll. The average premium rate in January 1993 loomed at nearly \$5.00 for every \$100 of payroll. Introducing competition into the workers' compensation insurance field by eliminating the "minimum rate" law was a key element of the 1993 reform. As insurance providers competed for the premium dollar the average rate plunged to under \$3 for every \$100 of payroll by January 1995. By 1996 the rate reflected a market correction and for every \$100 of payroll the average premium cost was \$3.18 or 35 percent less than in 1993.

Average Premium Rate per \$100 payroll California, 1989-1996



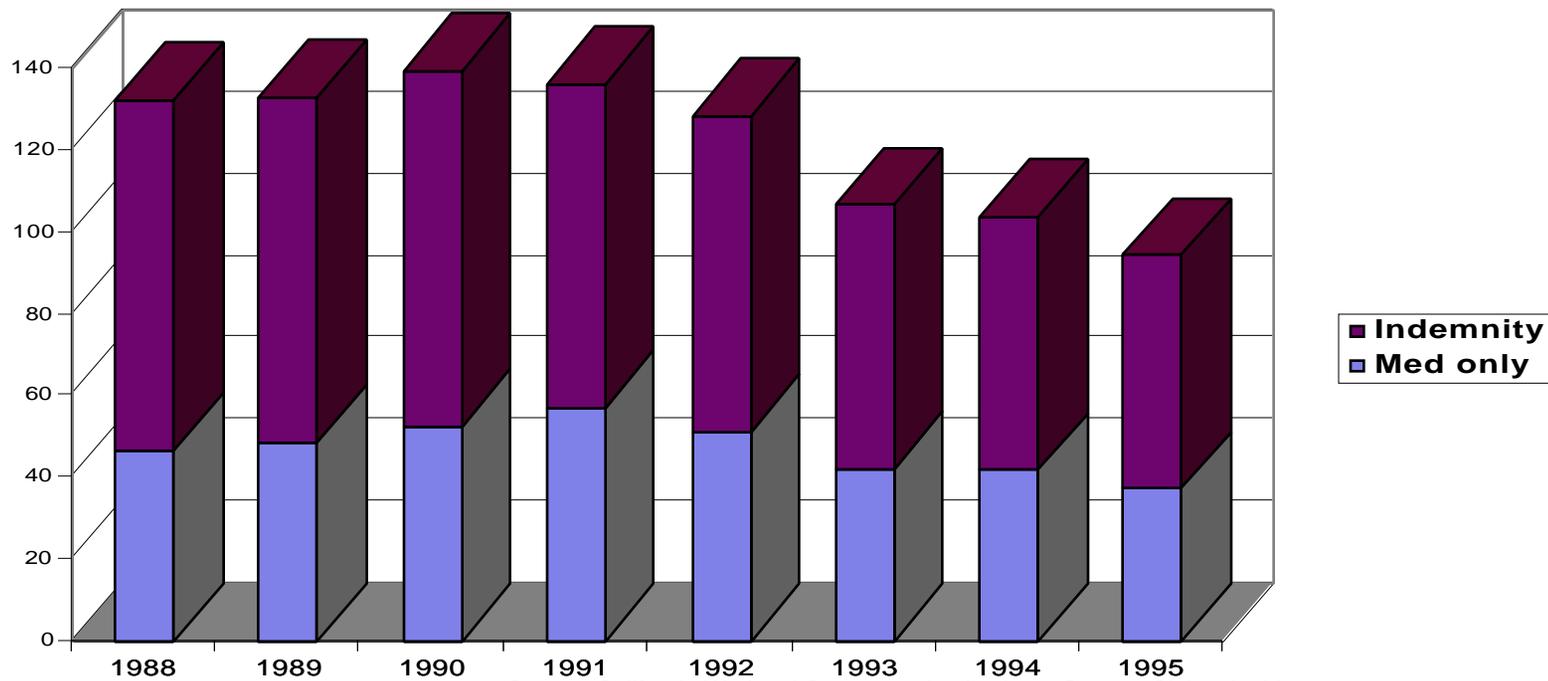
-----: Change in pure premium rate suggested
by Insurance Commissioner, effective 1/1/96

Claims Frequency Rates

- A survey of claims incidence of California workers' compensation insurers has shown a steady decline in claims frequency, from a high of 140 claims per \$1 million of adjusted earned premium in 1990 to approximately 93 per \$1 million in 1995.

Claims Frequency Rates

Claims per \$million Adjusted Earned Premium



Source: California Workers' Compensation Institute, Survey- Claims Incidence

“It is a triumph that means millions of dollars in new benefits for injured workers.”

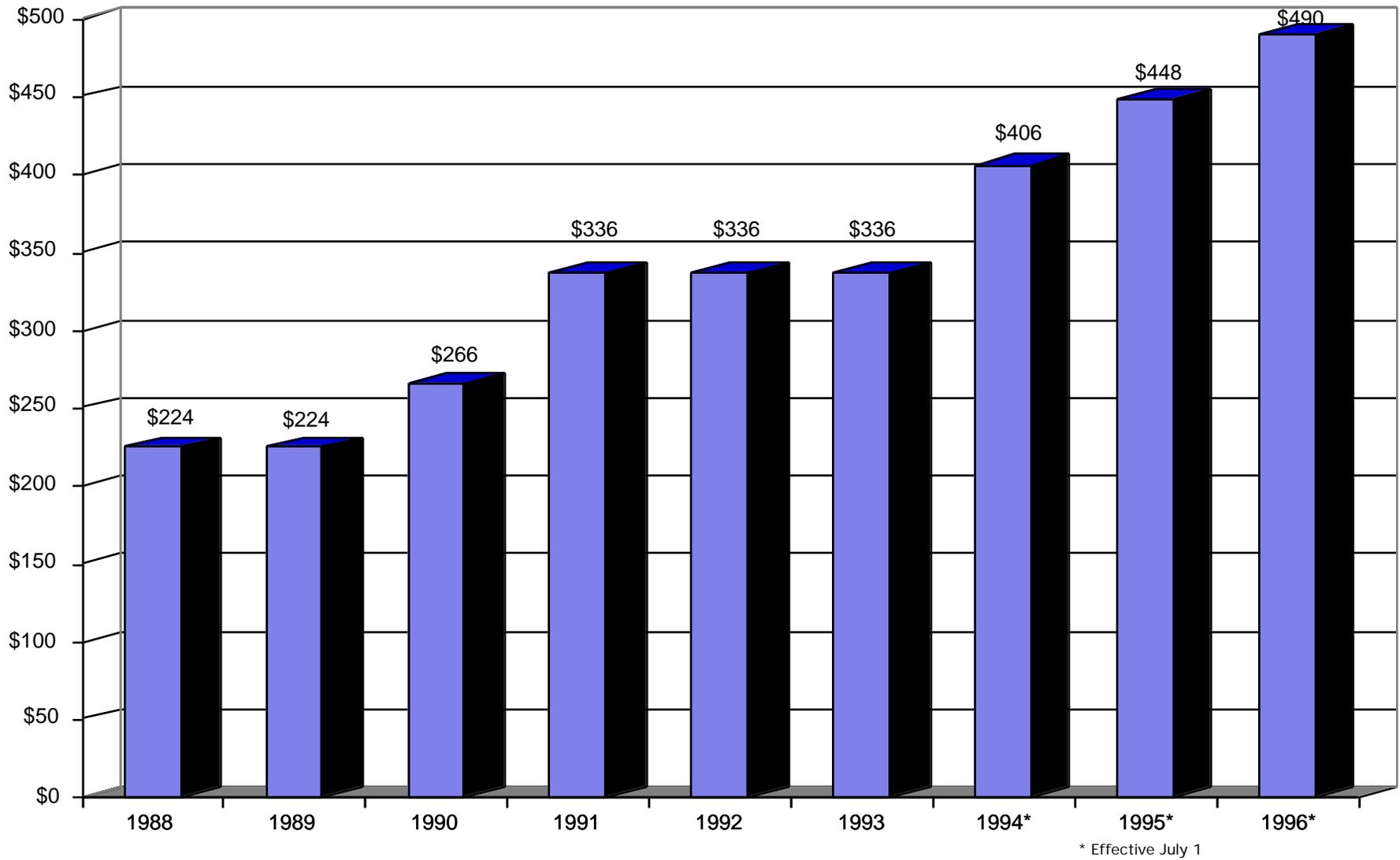
Jack Henning, Executive Secretary-Treasurer, California Labor Federation, AFL-CIO (July 16, 1993)

Benefits for Injured Workers

Maximum Weekly Temporary Disability Benefits

- Although employer costs for workers' compensation coverage was spiraling out of control prior to the 1993 reforms, weekly temporary disability benefits paid to injured workers had not risen significantly and were still low by national standards. The reforms were designed to not only reduce employer costs but to provide for needed benefit increases for legitimately injured workers.
- In 1993 the maximum weekly temporary disability benefit stood at \$336. The reforms provided for incremental increases in the weekly maximum. As of July 1, 1996 the maximum weekly benefit is \$490.

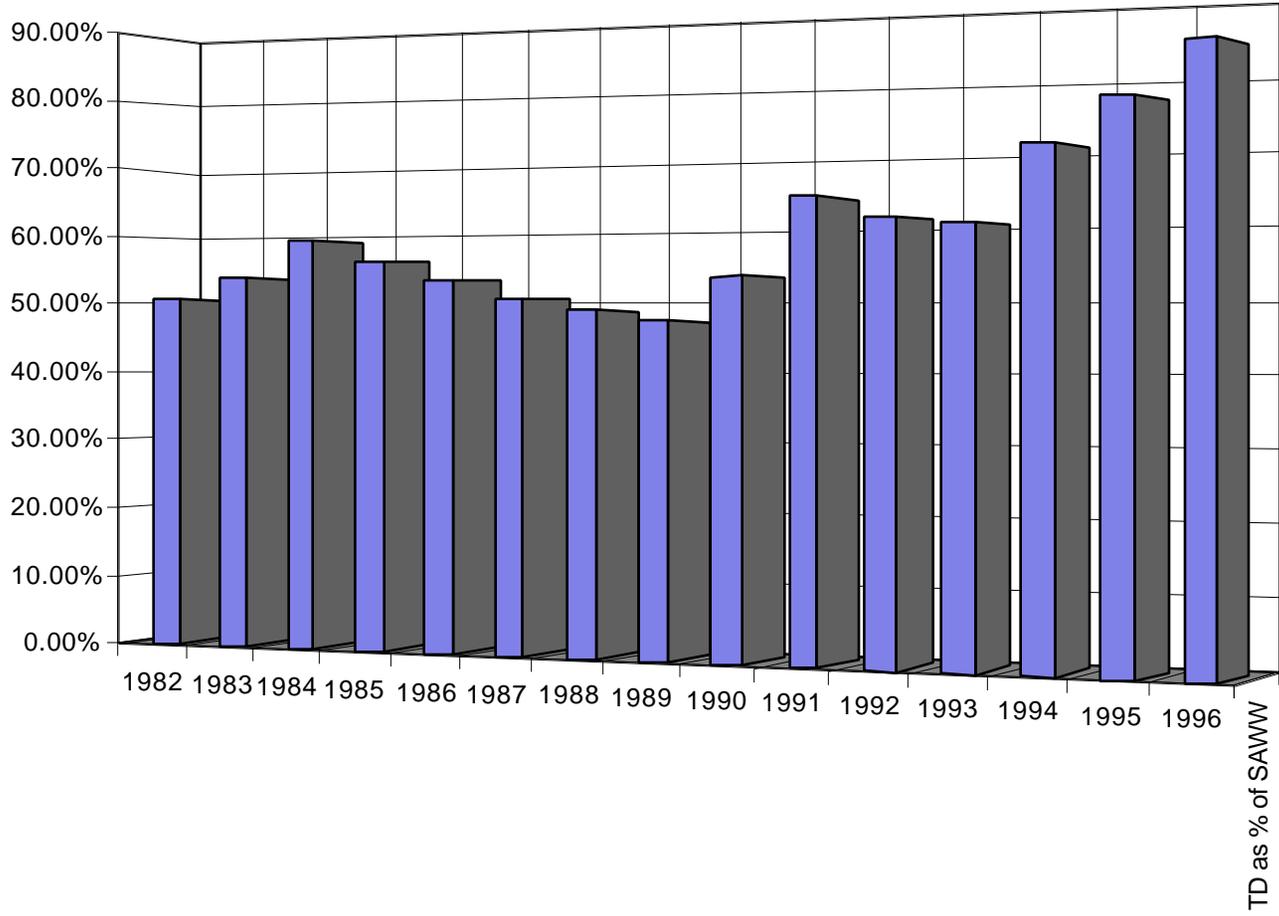
Maximum Weekly Temporary Disability Benefits



Maximum Weekly Temporary Disability Benefits Measured as a Percent of the State's Average Weekly Wage

- One method of assessing the adequacy of benefits is to measure the maximum against the average weekly wage earned in California. In 1993 the maximum weekly benefit was at only 63 percent of the average weekly wage. With the increases brought by reform, the weekly benefit currently stands at 85 percent of the state's average weekly wage.

Maximum Benefit as % of State Average Weekly Wage



“The 1993 workers’ compensation reform has finally allowed California businesses the impetus to overcome the tremendous competitive advantage that most businesses outside of our borders had previously enjoyed. It has proved to be the pivotal step to impede a massive exodus of California employers from the state.”

Dennis Altnow, Owner, Tiger Lines, Inc.

How California Ranks on Costs and Benefits

- Dramatic improvement in the health of California's workers' compensation system can be seen when measuring the system's costs to employers and benefits paid to injured workers against those of other states.

Workers' Compensation Costs

- Although current rankings will not be available until later this summer, two nationally recognized studies have shown dramatic improvement in California's ranking against other states after introduction of workers' compensation reform.
- The State of Oregon ranks states bi-annually by the cost of workers' compensation premiums. In 1990 and 1992 it ranked California (respectively) 9th and 8th highest in terms of premium costs paid by employers. Its 1994 study showed that California had dropped down to number 15. A report by Actuarial and Technical Solutions, Inc. showed continued improvement. It ranked California at number 16 in 1995.

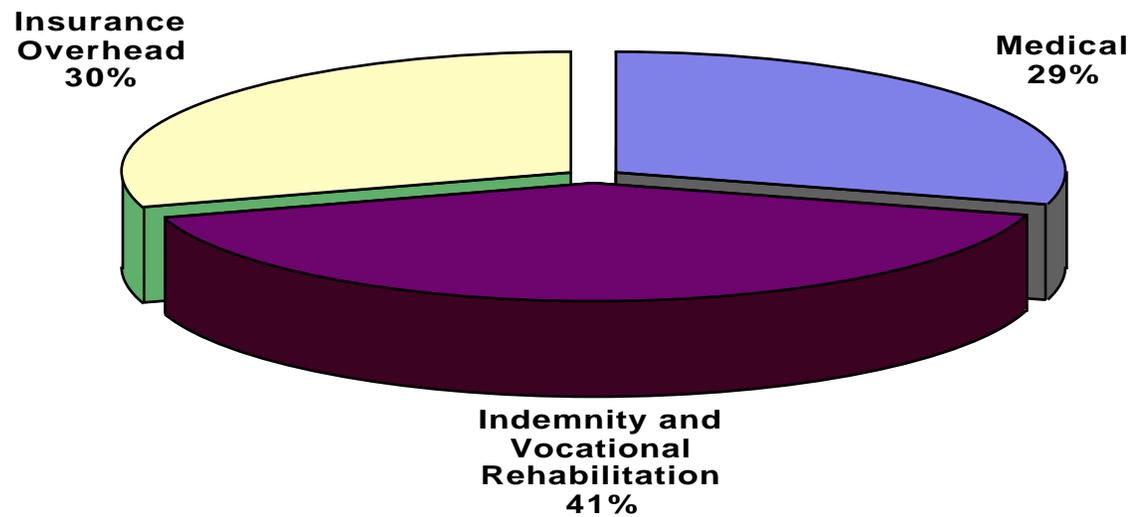
Workers' Compensation Benefits

- California's maximum weekly benefits paid to injured workers ranked 37th of 50 states and District of Columbia in 1993. In 1996, as a result of increased benefits brought about by reform, California ranked 27th on the list.
- Likewise, in terms of benefit levels as a percentage of average wage California had ranked 2nd to last in comparison to 50 states and D.C. in 1993. With reform this ranking showed improvement placing California at 42nd on the list in 1996.

“Workers’ compensation reform has given employers the opportunity to have more input into the insurance and claims management process as whole. It has also helped businesses by streamlining the process and making it more efficient.”

Doug Magnan, Health Service Manager, Cargill Inc., Marysville

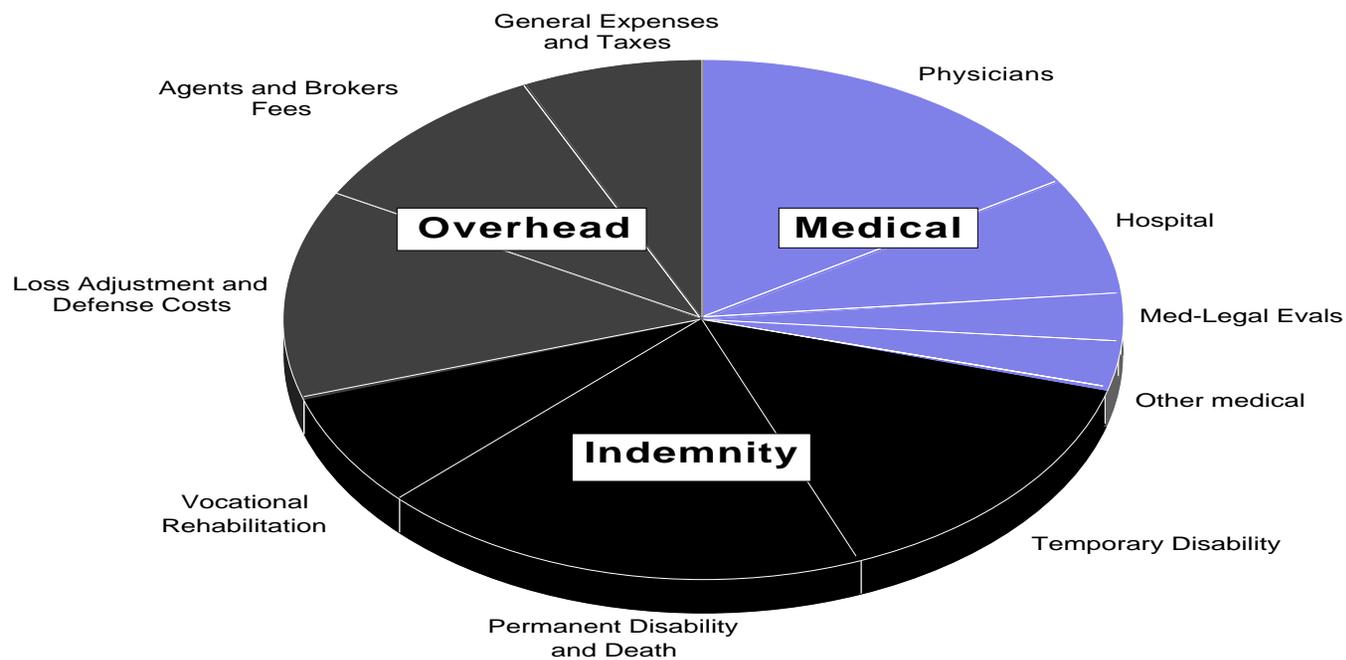
Money Spent on Premium Cost



How the Premium Dollar is Spent

- An analysis of 1995 total premium costs and distribution of costs shows that for every premium dollar:
 - 41 cents is spent on indemnity costs such as temporary disability payments, partial and total permanent disability claims, and pensions, and on vocational rehabilitation.
 - 30 cents goes to insurance overhead including general expenses, taxes and legal expenses.
 - 29 cents covers medical care including physician costs, hospital costs, medical-legal evaluations and pharmacy needs.

How the Workers' Comp Dollar is Spent California - 1995



Source: Workers' Compensation
Insurance Rating Bureau, 6/7/96

“At Safeway, we see savings in vocational rehabilitation expenses, where costs are down; bills for medical legal reports are down because of the new fee schedule; and, although we don’t have a lot of post termination claims, we have seen less of those in the past year. We are optimistic about the positive impact of these reforms.”

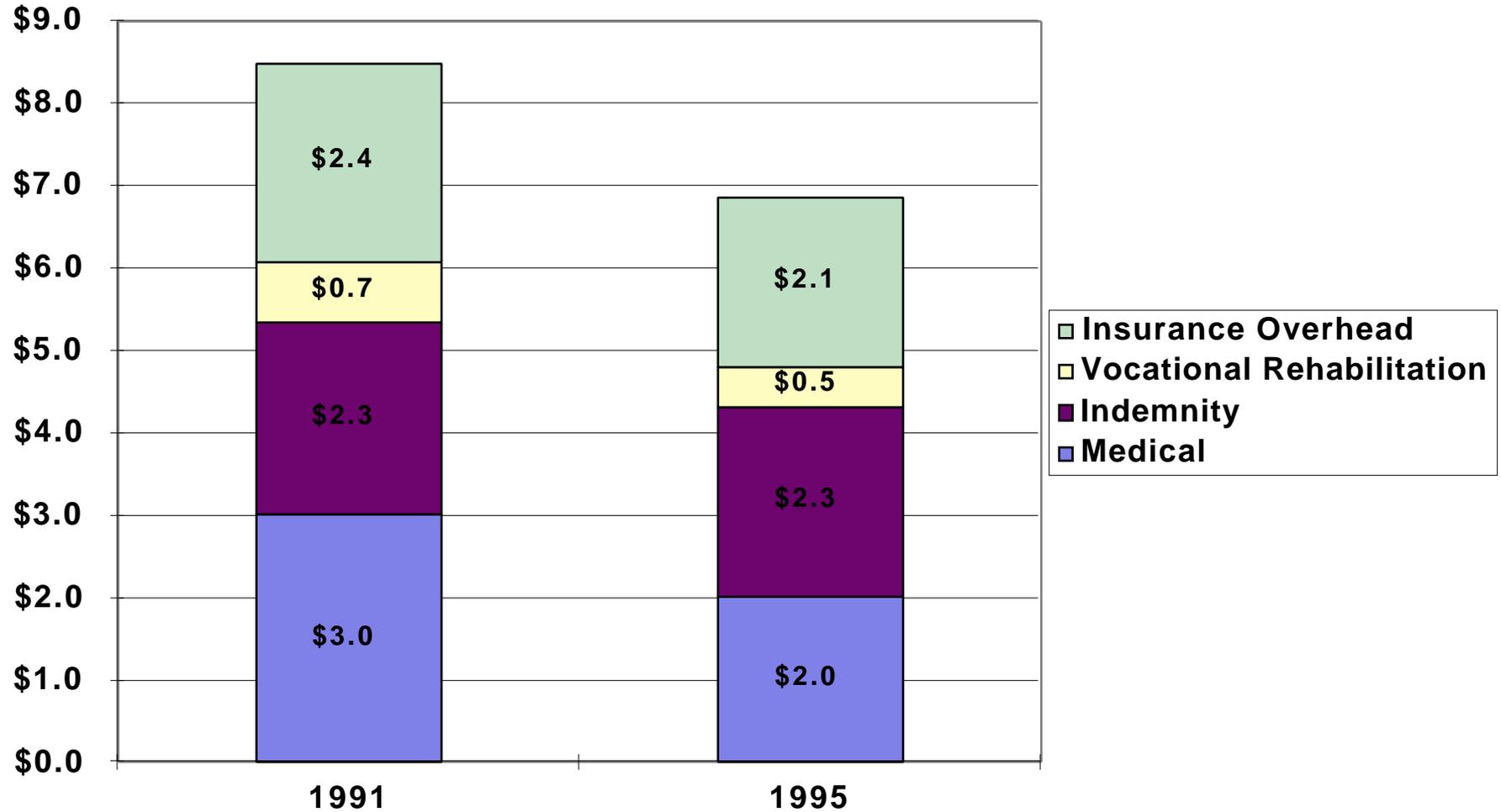
Michael Herberger, Corporate Workers’ Compensation Manager, Safeway

Comparison of Benefits and Expenses Before and After Reform

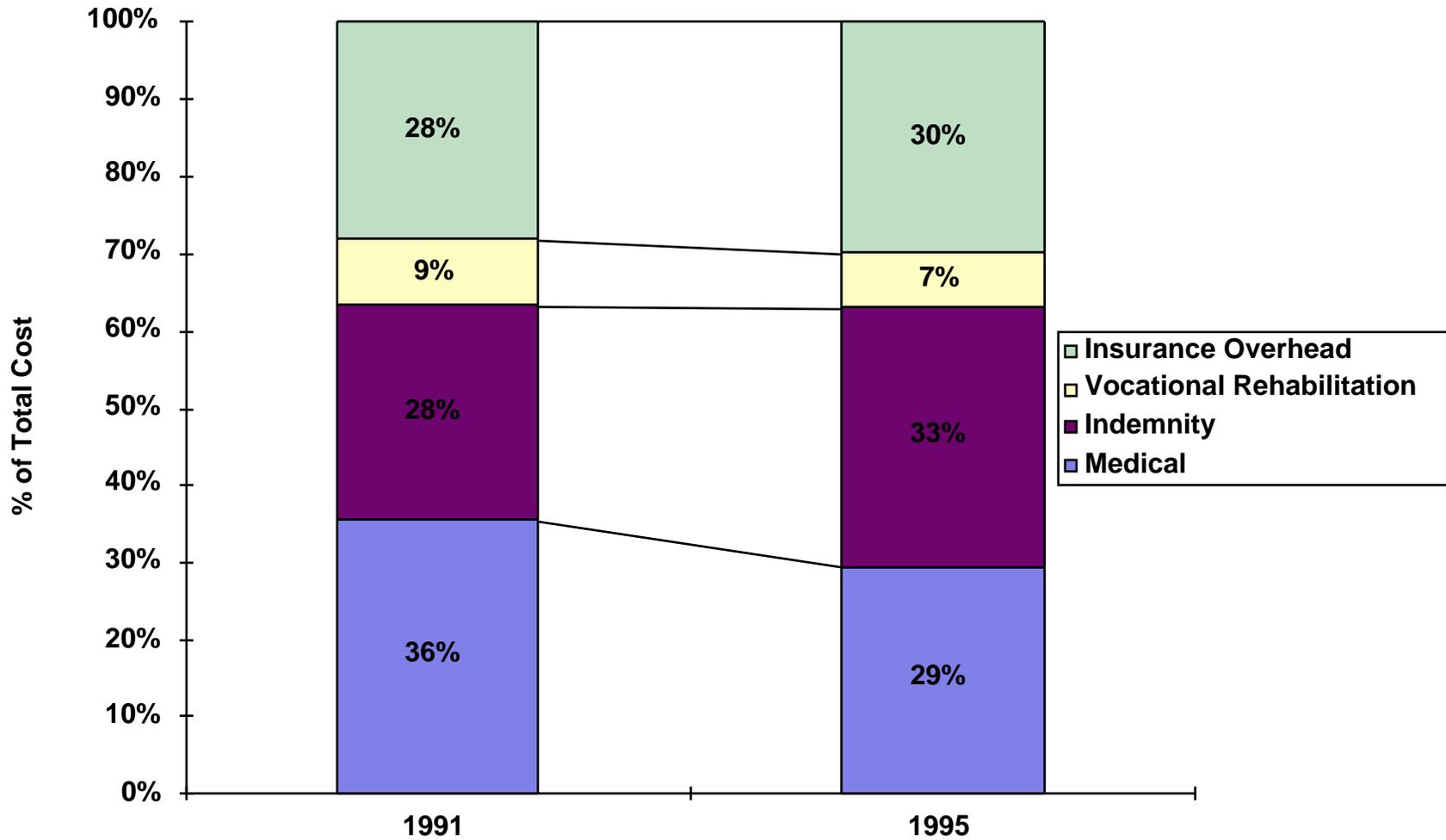
- Remembering that overall premium costs have been reduced dramatically since reform it is interesting to note the change in various areas of expenditures. Medical costs which were spiralling out of control before reform have diminished as a percentage of the total as have vocational rehabilitation expenses. The percentage of indemnity costs and overhead expenses have increased as a portion of the total, albeit lowered costs.

Distribution of Benefits and Expenses Insured Employers, 1991 & 1995

\$Billions



Distribution of Benefits and Expenses Insured Employers, 1991 and 1995



“The fraud program is working very well. Although arrests have leveled off now, convictions are going up. We’re very pleased about the way the fraud legislation is working.”

Willie Washington, Director of Workers’ Compensation, California Manufacturers’ Association

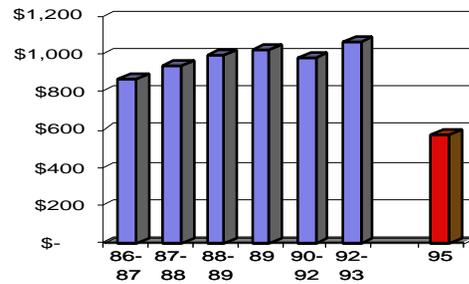
Success of Various Reform Components

Medical Legal Evaluation Costs

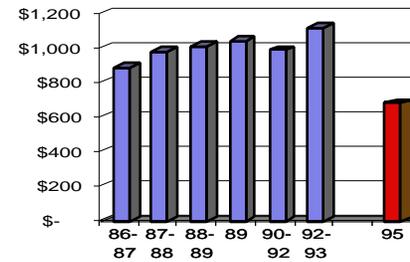
- Prior to workers' compensation reforms the cost of medical-legal evaluations required to prove or disprove a claim were growing steadily and adding millions in unnecessary costs to the program. The reforms replaced an inflationary formula for determining medical legal fees with an administrative fee schedule. Fees for virtually every type of evaluation have dropped since the reforms.

Cost of Medical-Legal Evaluations, 1986-1995

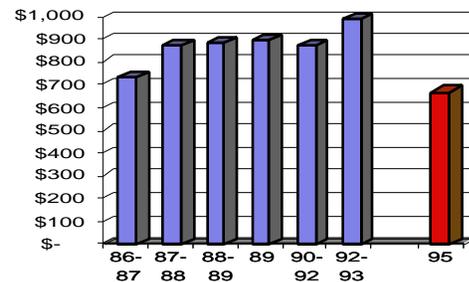
Orthopedics



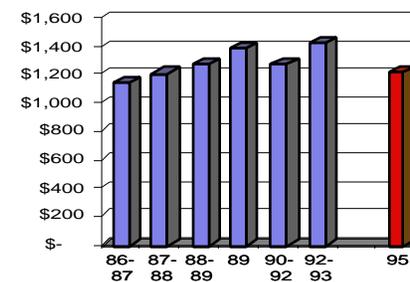
Cardiovascular /Internal Med



Neurology



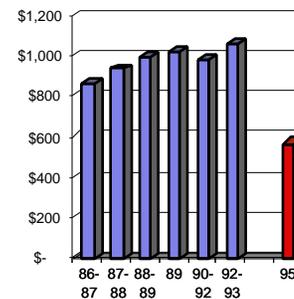
Psychiatric



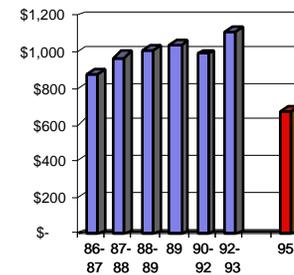
Medical Legal Fees

- Fees for medical-legal evaluations dropped with introduction of new law and regulations in 1993.
- The fee for an orthopedic evaluation, which was “presumed reasonable” at \$1070 in 1992-93, dropped to an average of \$575 in 1995.
- Fees for Cardiovascular or Internal Medicine evaluations, presumed reasonable at \$1121 in 1992-93, dropped to an average of \$683 in 1995.

Orthopedics

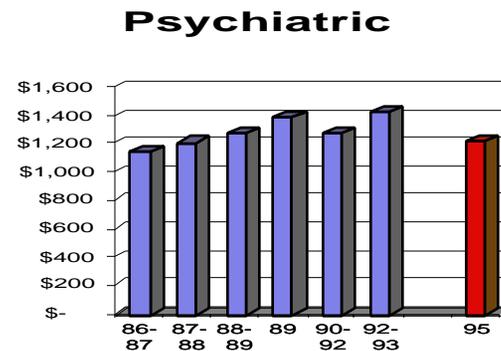
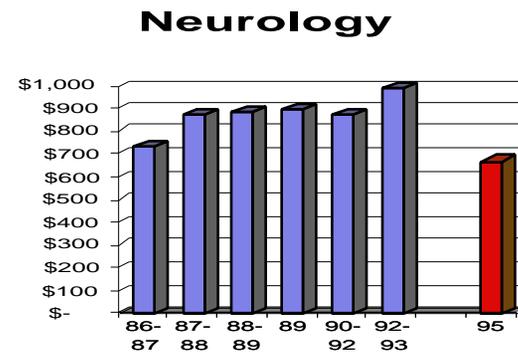


**Cardiovascular
/Internal Med**



Medical Legal: Neurology and Psychiatric Evaluations

- Fees for Neurological and Psychiatric Evaluations also dropped significantly.



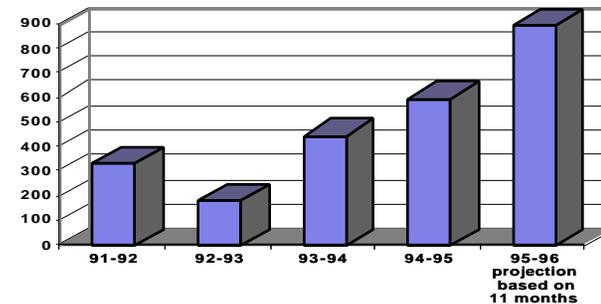
Workers' Compensation Fraud

- Although it was a growing problem, workers' compensation fraud received little public attention prior to Governor Wilson signing legislation in 1991 to combat it. The legislation established a specific felony for workers' compensation fraud, provided harsher penalties and dedicated funding for investigation and prosecution. Suspected cases are reported to the Department of Insurance for assignment to district attorneys for prosecution.

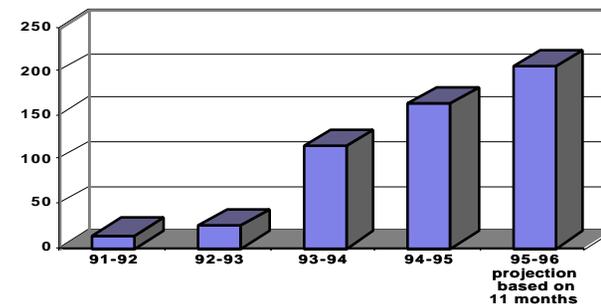
Workers' Compensation Fraud

- The number of cases of suspected workers' compensation fraud assigned to District Attorneys and cases resulting in arrests after investigation have grown steadily in recent years.

Suspected Fraudulent Cases Assigned to District Attorneys



Cases Resulting in Arrests After Investigation

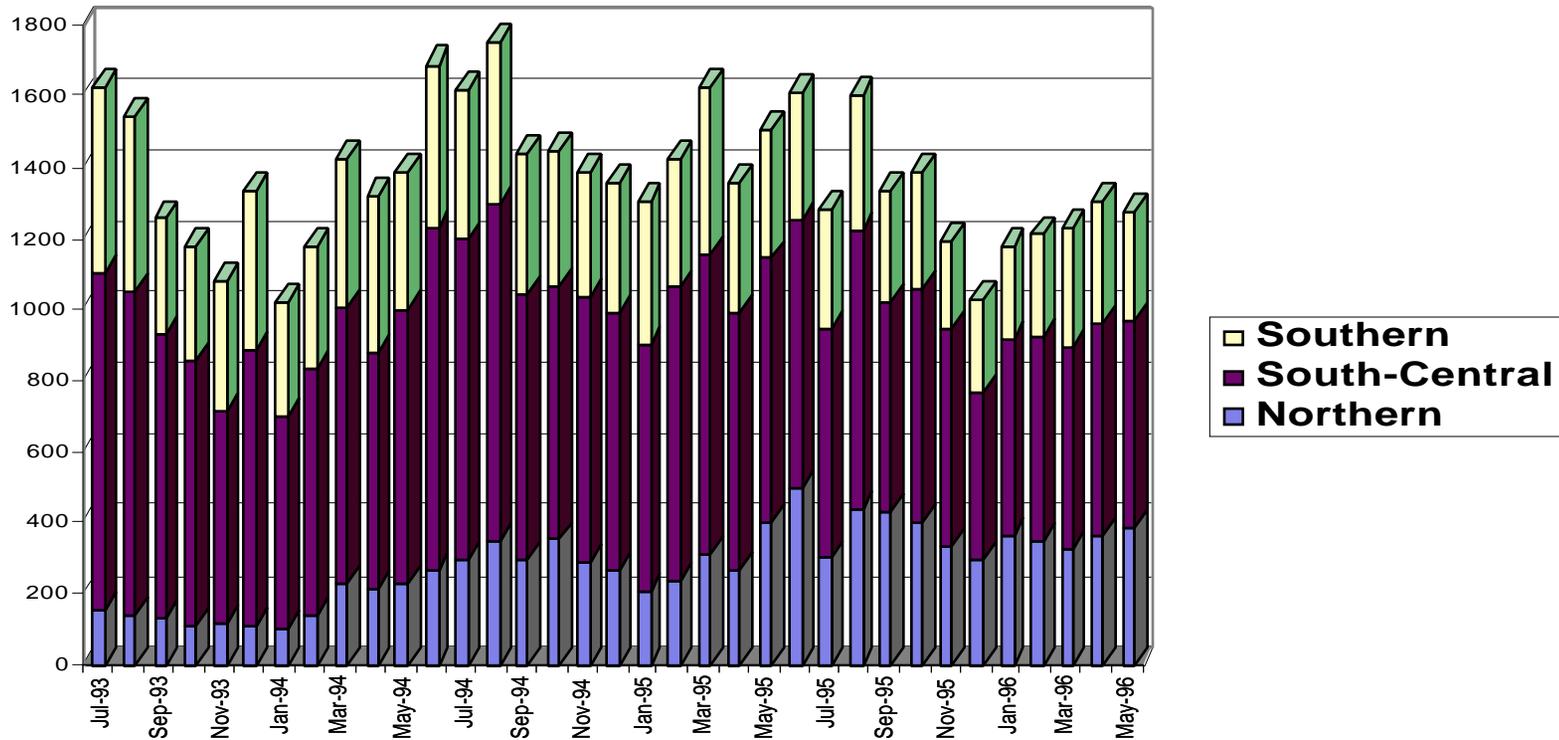


Psychiatric Stress Claims

- Psychiatric claims, commonly known as “stress claims” had become the symbol of abuse of the workers’ compensation system by 1993, with their incidence increasing in one year by almost 50 percent. Reform legislation provided limits on these types of claims. Employment must now be the predominate cause of of a psychiatric injury before it can be compensable; a claim is not compensable if it arose from a good faith personnel action; post-termination claims in most cases are not considered compensable. Although the number of filings of psychiatric claims appears to fluctuate, the number of claims have fallen since 1993.

Psychiatric Stress Claims

WCAB Case Openings Involving Psychiatric Stress



Note: Psychiatric claims are now subject to limitations as a result of reforms. The number of filings does not necessarily result in a comparable number of valid claims.

“Over the past three years we have observed a definite and beneficial change in focus by employers and providers with regards to medical care...away from an adversarial attitude and back to where the emphasis should be, on prevention and providing quality care to return injured employees to productive employment.”

Zelda Sunderman, Clinical Services Coordinator for Occupational Health, Kaiser Permanente Northern California

New Initiatives and Looking Ahead

Construction Industry “Carve-Out” Programs

- One of the innovative programs contained in the 1993 reforms allowed parties to a collective bargaining agreement in the construction industry to agree to an exclusive panel of medical treatment providers, an exclusive panel of medical evaluators, an exclusive panel of vocational rehabilitation providers, and an alternative dispute resolution process. The Division of Workers’ Compensation has the responsibility to ensure those who enter these arrangements are qualified to do so under the law, and to evaluate these new arrangements.
- 1995 was the first full calendar year of the program. Seven agreements were found to be eligible and were in operation during the year. Participating in the seven programs were 241 employers, who reported over 6 million personhours of labor and nearly \$150 million in wages to employees.

Construction Industry Carve-outs

- 1. An agreement between the California Building & Construction Trades Council, AFL-CIO, and the Metropolitan Water District of Southern California. This is a project labor agreement covering all contractors and sub-contractors on a \$2 billion, 5-year construction project called the Domenigoni Reservoir.
- 2. An agreement between the District Council of the International Brotherhood of Electrical Workers and its 20 local unions and a multi-employer group called the National Electrical Contractors Association, consisting of about 300 contractors. Each individual employer must sign up.
- 3. An agreement between the Southern California District of Carpenters and its 19 local unions and six different multi-employer groups consisting of about 1000 contractors. Each individual contractor decides whether or not to sign the master carve-out agreement.
- 4. An agreement between the Southern California Pipe Trades District Council No. 16 and a multi-employer group called the Plumbing & Piping Industry Council, Inc.
- 5. Two agreements between the Cherne Contracting Corporation and Steamfitters Local 250 covering two projects at different oil refineries.
- 6. An agreement between TIMEC Co., Inc., and TIMEC Southern California, Inc., and the International Union of Petroleum and Industrial Workers.
- 7. An agreement between the Contra Costa Building & Construction Trades Council, AFL-CIO, and the Contra Costa Water District. This is a series of three project labor agreements covering all contractors and sub-contractors on a \$200,000,000, 2.5 year dam project called the Los Vaqueros Project.

Workers' Compensation Information System

- The lack of a comprehensive data information system has made it difficult to gain an overview of how the workers' compensation system is working, where the problem areas are, and what the solutions to those problems could be. As a result of legislative mandates contained in the reform, DWC is currently developing a proposal for a workers' compensation information system which would provide data needed to monitor the performance of the entire system and evaluate the effects of policy changes when they are made. The new system, which is being developed with the full participation of the state's workers' compensation community, is coordinated with ongoing national efforts to create standards for electronic data interchange.

Medical Cost Containment and Quality Control

- Prior to reform, medical costs accounted for nearly half the cost of workers' compensation benefits and were growing out of control. Major goals of the reform legislation were to provide mechanisms which could help bring these costs under control, improve the quality of medical care for injured workers, and facilitate early return-to-work.

Health Care Organizations

- The Health Care Organization (HCO) program is an effort to expand the use of managed care techniques in the workers' compensation system. Under this program employers gain up to one year of control when employees enroll in a managed care program that is certified by the Division of Workers' Compensation. By participating in an HCO program, employers can control costs better and also ensure the quality of care that is provided to injured workers. Early comments from the medical community indicate that the HCO program's emphasis on the quality of patient care has increased the focus on quality of care throughout the entire workers' compensation medical community.
- To date, DWC has certified eight HCOs, and other applications are pending. The division is also working on proposed legislative and regulatory changes which would make it easier and more attractive for employers and providers to participate in these programs.

24 Hour Health Care Pilot Programs

- To test the concept of providing for all of an employee's medical needs, both industrial and non-industrial, through one medical provider, the legislature has authorized DWC to conduct "24-hour coverage" pilot projects in four California counties. Under this concept, employers should realize cost savings through a combination of the two types of coverage, while employees realize the added convenience of having one doctor or health care provider for all of their medical needs. The first pilot to be approved is operated by Kaiser Permanente in San Diego County and includes 12 employers, including Kaiser, the County of San Diego and the San Diego Community College District. It began on June 1, 1994. Since then, three other pilots have been approved and are operating in San Diego, Los Angeles, Santa Clara and Sacramento Counties.
- California is now one of just two states operating a pilot project to determine the potential for this type of coverage. At the national level, it is considered important enough that the Robert Wood Johnson Foundation is funding the evaluation through a grant to UCLA and the Rand Corporation. The three year program is scheduled to conclude at the end of 1997.

Utilization Review and Medical Fee Schedule

Utilization Review Oversight

- Utilization review is a way to manage costs and improve patient care by establishing standards for the frequency, duration, level and appropriateness of medical care and services on a case by case basis. The purpose is to help claims administrators determine, using medically based standards, whether treatment provided is or was reasonably required to cure or relieve the effects of the injury. New regulations were adopted on July 29, 1995 which implemented legislation giving DWC oversight authority over utilization review systems used by claims administrators.

Medical Fee Schedule

- Historically, the only way the Division of Workers' Compensation had to control medical treatment costs was through its Official Medical Fee Schedule, which was contained in regulations that set forth fees for medical procedures generally payable in workers' compensation cases. Effective April 1, 1994, this outdated schedule, which did not include fees for many common procedures and did not apply to hospitals or pharmaceuticals, was thoroughly revised. It is now based on the American Medical Association's Current Procedural Terminology coding structure and contains thousands of additional procedures and pharmaceutical charges.
- This schedule covers outpatient hospital charges, but not inpatient bills. In 1996, new regulations covering inpatient services are expected to be adopted.

“To some, California was once infamous for being about as inviting to business as communist Bulgaria. We still have to work on this, but at least we have put a stake in the heart of the most obnoxious impediment--the notorious workers’ compensation system that was piling unnecessary costs on all business and crushing small ones. Now such costs have been reduced 40 percent.”

“The California Bear Awakens,” by columnist Tom Plate, Los Angeles Times

Workers' Compensation Reform Legislation During The Wilson Administration

1991

AB 971 (Peace), Chapter 115, Statutes of 1991 -- Eliminated "stress claims" for employees employed for less than 6 months.

SB 1218 (Presley), Chapter 116, Statutes of 1991 -- Increased the penalties for workers' compensation fraud and provided a dedicated source of funding to investigate and prosecute workers' compensation fraud cases.

1992

AB 3757 (Bronzan), Chapter 1131, Statutes of 1992 -- Created a "24-hour pilot program" to determine the benefits of providing both occupational and non-occupational care through one exclusive provider of care.

AB 2329 (Peace), Chapter 904, Statutes of 1992 -- Required any advertising soliciting workers' compensation claims to disclose that filing a false or fraudulent claim is a felony.

1993

AB 110 (Peace), Chapter 121, Statutes of 1993 -- The omnibus workers' compensation reform legislation. Among other provisions, AB 110 established the Employee Rights, capped vocational rehabilitation benefits, emphasized the role of the treating physician in the evaluation process, incrementally increased temporary and permanent disability benefits, and extended injury prevention efforts.

AB 119 (Brulte), Chapter 118, Statutes of 1993 -- Placed severe limits on psychiatric injury and post-termination claims.

AB 1300 (Brown), Chapter 120, Statutes of 1993 -- Enhanced the tools for combating workers' compensation fraud.

SB 30 (Johnston), Chapter 228, Statutes of 1993 -- Repealed the "minimum rate which precluded insurers from charging less for workers' compensation insurance than the rates established by the Department of Insurance.

SB 31 (Johnston), Chapter 4, Statutes of 1993 -- Limited medical-legal evaluation and the circumstances under which these fees can be charged.

SB 983 (Greene), Chapter 117, Statutes of 1993 -- Authorized alternative arrangements for the delivery of workers' compensation benefits and dispute resolution in the construction industry.

References and Endnotes

- **1** Workers' Compensation Insurance Rating Bureau; DIR Estimates
- **9** Workers' Compensation Insurance Rating Bureau; DIR Office of Self-Insurance Plans
- **11** Workers' Compensation Insurance Rating Bureau
- **13** Workers' Compensation Insurance Rating Bureau; DIR Calculations
- **15** California Workers' Compensation Institute, Claims Incidence Survey, various years
- **17** California Labor Code
- **21** California Labor Code; U.S. Department of Labor; AFL-CIO
- **24** State of Oregon, Department of Consumer and Business Services, Research and Analysis Section; Actuarial and Technical Solutions, Inc.
- **25** U.S. Chamber of Commerce; AFL-CIO
- **27** Workers' Compensation Insurance Rating Bureau, June 7, 1996
- **29** Workers' Compensation Insurance Rating Bureau, June 7, 1996
- **32** Workers' Compensation Insurance Rating Bureau; DIR Calculations
- **37-39** 1986-1993: California Labor Code §4624(a) lists fees "presumed reasonable." For 1995, average costs calculated for cases submitted by insurers to Workers' Compensation Insurance Rating Bureau, June 7, 1996.
- **41** California Department of Insurance, Fraud Bureau
- **43** DIR/DWC WCAB Online system. Cases in which initial filing at district office of Workers' Compensation Appeals Board alleges Psychiatric or Stress injury. Does not necessarily represent the number of cases filed with insurers and self-insured employers.