

Workers' Compensation Carve-outs Making Sense of The Numbers

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Background

Workers' Compensation Carve-out programs are Employer/Labor agreements that implement a custom claim handling, and/or dispute resolution process that circumvent many of the State mandated procedures which have tended to add more friction and cost to the process. The motivation and purpose for implementing a carve-out program is mutually beneficial for both the employer and Labor, as Labor is motivated by the potential for improved delivery of service and acceleration of return to work, while employers are motivated by the potential to reduce the overall cost of each claim. Alternative Dispute Resolution (ADR) programs are one of the most popular and commonly know types of Carve-outs. While ADR is often implemented as an organization's complete Carve-out program it does not represent the full scope of what can be Carved-out.

There has been much confusion around what a Workers' Compensation Carve-out is and considerable speculation about whether Carve-outs actually provide efficiency or cost savings. California grants wide latitude in creating a Carve-Out program so the scope can be wide or minimal. Carve-Outs are flexible and dynamic allowing alteration throughout their duration as the need arises. They are unique to the specific needs of Labor and management in each organization and can range from implementing Independent Medical Evaluator panels (replacing the State mandated QME panel), various vendors, medical networks, hospitals and surgery centers, or specific treating physicians. Ombudsman, mediators and arbitrators can be included to enhance the dispute resolution process.

Lack of information has led to the perception that Carve-out programs are ineffective. Even with the State of California publishing annual reports reflecting low mediation and arbitration usage rates, the absence of detailed information specifying ombudsman utilization and fees, as well as defense legal fees, have been detrimental towards statewide growth of Carve-outs in both private and public organizations.

Private insurance carriers have been largely responsible for the creation of construction industry carve-outs. Large carriers including Zurich and State Fund crafted general programs to combine several employers together as Alternative Dispute Resolution "signatories," allowing them to enter and exit the program at will. Since these general programs are not tailored to an employer's specific needs, many participating employers fall short in maximizing their potential cost savings. These companies may need individual support and education to keep their program dynamic and flexible. They may need to be measured more frequently for performance and compliance of the participants to capture the greatest savings potential.

A recent study of a large public entity carve-out program demonstrated how a "cookie cutter" application of an ADR Carve-out can leave costly gaps for an organization. In many municipal Carve-outs, legal ADR has not been included, leaving an Independent Medical Examiner (IME) as the only determination for dispute resolution.²

Although, in the case of this study, disputes moved through the Independent Medical Examiner or IME dispute resolution process within the expected 65 days, cases were not being settled timely and remained open several years beyond the dispute resolution date. This led to extending statutes of limitations for filing new and further injury claims therefore increasing other case related liabilities.

1 - Young, Scott/Elite Force Management - Co-author and editor

2 - DWC Non Construction Carve-out. (2015, February). Retrieved from <http://www.dir.ca.gov/dwc/Carveout/NonConstructionCarveOut.htm>

As in the afore-mentioned scenario, a legal ADR program would have proven effective in reducing litigation costs and bringing cases to conclusion sooner. Workers' Compensation litigation costs for public entities are not normally tracked, because these organizations use available in-house attorneys. Since this cost tracking was not included in the design of their carve-out, it made the argument for evolving their program to include legal ADR very difficult. It also excluded an important cost measurement to demonstrate the impact that their medical ADR program had on litigation costs.

Valuable input on legal ADR program performance comes from those involved with the ADR process. Ombudspersons have reported that, in organizations with carve-outs, employees are generally satisfied with the outcomes of their claims. This is largely due to the fact that carve-out programs often focus on improving service. Emphasis is placed on triage, quality care, expeditious diagnostics, early interventions, managing medical care, avoiding lost time, and aggressive return to work and safety programs. By placing more effort and administrative resources on the front end of the injury, long term costs are inherently reduced. This carries over to the expedient nature of resolving medical disputes in Carve-out programs. Private and government programs are experiencing dispute resolutions outcomes of under 65 days.³

We have polled many sources that collect data on Workers' Compensation programs in the State of California in order to assemble a picture of how these programs are performing. We have chosen to focus on the construction industry because they have the longest history with Carve-out programs.

3- C6-COUNTY OF LA FIRE DEPARTMENT CARVE OUT PROGRAM CASE STUDY. (204). Los Angeles, CA: InterCare. and Levine, D. I. (2002). Carve-outs in workers' compensation: An analysis of the experience in the California construction industry. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research. and Beigbeder/Deloitte, S. (2008). Deloitte Study for Long Beach. Long Beach, CA: Deloitte Tusch.

Eight Years of Carve-out Programs

The Department of Industrial Relations, Division of Workers' Compensation and the Department of Insurance, gathers loss data electronically from claims administrators as a form of oversight.⁴ This data is digested by at least three well respected non-profit organizations dedicated to the research and analysis of insurance related trends: The Rand Institute, The Haas Institute at University of California Berkeley and The California Workers' Compensation Institute (CWCI).

The following tables are a collection of data presented in similar form by the Department of Industrial Relations (DIR) and the Commission on Health and Safety and Workers' Compensation (CHSCW).⁵ This data has not completely matured and is more of a snapshot of experience and financial data collected shortly after the end of each policy term. This is an important fact for organizations wishing to compare carve-out performance with their own programs.

Based on eight (8) years of Workers' Compensation Construction Industry carve-out program performance, the overall (2004 – 2011) average yearly paid cost per claim for medical, indemnity and med-legal expenses were \$13,940. These costs do not include legal expense costs or other allocated expenses. They are a combination of medical and indemnity paid costs for all claim types in the years itemized as shown below. Construction related injuries most commonly involve slip and fall and back injuries, which in 2009 ranged between \$57,814 and \$67,720 for medical and indemnity costs alone. The valuation of these totals were at 18 months from inception of each policy sampled, thus undeveloped and similar to the carve-out data listed below.⁶

Data Reported	2004	2005	2006	2007
Programs Reporting	13 (100%)	15 (100%)	18 (72%)	19 (90%)
Total Claims Reported	1,203	2,334	2,434	2,861
Med Only to Indemnity Ratio	60:40	52:48	47:53	48:52
Average Paid per Claim	\$12,218	\$10,105	\$14,120	\$11,885
Disputes: Medical & Legal Carve-out Performance				
Disputes	510 (42%)	934 (40%)	1,953 (80%)	2,488 (87%)
Ombudsman/Adj. Resolved	94%	96%	95%	95%
Litigation Rate	2.7%	1.8%	4.2%	6.5%
Mediator Resolved	2%	1%	3%	5%
Arbitrator Resolved	<1%	<1%	1%	<1%
WCAB Resolved	<1%	<1%	<1%	<1%
Court of Appeals Resolved	n/a	<1%	n/a	n/a

Table 1 - 2004-2007 Performance Data

4- DWC Construction Carve-out. (n.d.). Retrieved from <http://www.dir.ca.gov/dwc/Carveout/ConstructionCarveOut.htm>

5- Commission on Health and Safety and Workers' Compensation - Home Page. (n.d.). Retrieved from <http://www.dir.ca.gov/chswc/>

6- Workers' Compensation Insurance Rating Bureau of California. (2012). Report on 2011 California Workers' Compensation Losses and Expenses. Retrieved from Workers' Compensation Insurance Rating Bureau of California website: http://www.wcirb.com/sites/default/files/documents/2011_loss_and_expenses.pdf

Data Reported	2008	2009	2010	2011
Programs Reporting	19 (82%)	19 (91%)	20 (95%)	20 (95%)
Total Claims Reported	2,769	1,824	1,218	1,060
Med Only to Indem. Ratio	50:50	55:45	50:50	52:48
Average Paid Cost Combined	\$17,850	\$16,584	\$13,484	\$15,276*

Disputes: Medical & Legal Carve-out Performance

Disputes	2,301	1,503	962	764
Ombudsman/Adj. Resolved	83%	82%	80%	72%
Litigation Rate	4.2%	3.9%	2.0%	1.4%
Mediator Resolved	3%	3%	2%	1%
Arbitrator Resolved	1%	1%	<1%	<1%
WCAB Resolved	1%	<1%	<1%	<1%
Court of Appeals Resolved	<1%	0	0	0

* 2011 data not mature, paid costs doubled from original value of \$7,638 (Note: Allocated or Legal expenses are not included in this chart.)

Table 2 - 2008-2011 Performance Data

About the Data

In 2004, Senate Bill 899 mandated a formal method for collecting Carve-out data, although limited data was collected since 1993 in summary form.⁷ The purpose of this legislation was to expand the scope of data collected to include industry data (from the Department of Insurance) for a comparative analysis and to provide historical aggregate year-to-year data. Two commonly relied upon reports were published for years ranging from 2004-2009⁸ and 2004-2011.⁹ Many employers were found to have mis-reported data, mostly due to the absence of internal tracking mechanisms, rendering earlier reports unreliable. For this reason, the final report is considered to be the most viable.

In 2008, the Department of Industrial Relations started combining data from the construction industry (3201.5) and non-construction industry (3201.7) participants. Less detail was provided in the annual reports as a result, and the reader saw a steep decline in performance. This was largely due to the fact that several of the new non-construction carve-out participants were self-insured organizations without the benefit of infrastructure support and aggressive safety programs – all characteristics of construction carve-outs. Also, public entity programs were limited to medical ADR programs, which are much weaker than the combined medical and legal ADR program design adopted by the construction industry. Construction industry experience shows that including medical, legal and prevention in an ADR carve-out program significantly limits litigation exposure.

Nevertheless, decision makers are looking for a clear correlation between carve-out performance data and their organization or their industry by nature of business. This is a challenge for non-construction firms because of the mismatch in data collection between carve-out programs and insurance industry data collection. To remedy this disparity, we will take a two pronged approach. To this end, we have two worksheets (Table 4 and Table 5) that allow the reader to “fill in the blanks” with their organization’s data and compare it with the above carve-out results and those outlined in the frictional cost section of this report. (Table 3)

7- DWC Construction Carve-out. (n.d.). Retrieved from <http://www.dir.ca.gov/dwc/Carveout/ConstructionCarveOut.htm> (2004-2011)

8- Morgan/DWC, R. (n.d.). ALTERNATIVE DISPUTE RESOLUTION/CARVE-OUT PROGRAM Labor Code sections 3201.5, 3201.7 and 3201.9 REPORT ON ACTIVITIES 2004-2009. Retrieved from http://www.dir.ca.gov/dwc/Carveout/CarveOutReport2004_2009.pdf

9- Morgan/DWC, R. (n.d.). ALTERNATIVE DISPUTE RESOLUTION/CARVE-OUT PROGRAM Labor Code sections 3201.5, 3201.7 and 3201.9 REPORT ON ACTIVITIES 2004-2011. Retrieved from http://www.dir.ca.gov/dwc/Carveout/CarveOut_Report.pdf

Carve-outs, a mechanism for eliminating friction with an alternative remedy to California's State mandated system, give rise to a new set of data. Lead analysts in the industry are taking a different approach to understanding Workers' Compensation cost drivers as friction. These data are not as easy to measure as simple benefit delivery activity tracked by the State as friction, and which is present in many aspects of daily claims management. In fact, within the last year, several noted publications have focused on the underlying causes of friction. We use these reports in breaking down frictional cost drivers into several components. This data is the foundation of our rationale for cost savings created by a well-designed Carve-out programs and the second step in our data correlation worksheet.

And finally, there are several hidden factors not normally tracked and listed on the Workers' Compensation balance sheet for operational costs that should be considered when contemplating a Carve-out program. These factors are not routinely tracked by the State, or analyzed and published by industry experts or organizations to show the effective cost of injuries. The effective cost should encompass the full scope of the system's financial burden, including the individual departments impacted, medical management and other hidden costs.

Programs Reporting

Workers' Compensation carve-out programs have shown steady growth since 1993. A few programs were temporary in nature, existing only for the duration of a special project. All but a small number of programs involve pools of employers with most containing hundreds of entities. Each employer is identified as signatory to each contract or Memorandum of Understanding (MOU). For Example, in 2008, nineteen programs represented approximately 38,269 employees (calculated from payroll data provided for full time man-hour employees), which would involve several hundred employers.

Total Claims Reported

This number represents the actual claims for programs included in the report. Not all programs reported each year, but the majority complied with the reporting requirement, rendering this data reliable.

Medical Only to Indemnity Ratio

Medical only claims are injuries with no lost time. Indemnity claims are injuries that involve paid lost time and/or disability benefits. This could include permanent impairment, death, or supplemental job displacement vouchers. The ratio of these two types of injuries is reflected in this field.

Average Paid per Claim

Paid costs are actual amounts paid out on a claim at the time of reporting. This field includes medical, indemnity, and med-legal expenses for Independent Medical Exams (IME). This is an average of several employers: some included large losses and death claims, while others had very low losses. It is important to recognize that paid loss data sources were protected. The data was not linked or identified by employer, but treated as samples of data in an alphabetic list.

Med-Legal Expenses

This percentage represents actual paid med-legal expense (IME) compared to overall paid cost, including medical, indemnity and med-legal expenses.

$$\frac{ML}{(Medical + Indemnity + Medlegal)}$$

Disputes

Once a dispute is known, it is documented and routed to an IME or Ombudsman for medical, factual, or a combination of medical and factual dispute resolution.

Ombudspersons/Adjuster Resolved

This number represents cases that were resolved prior to mediation; with a claims examiner resolving most, with a small percentage utilizing an Ombudsperson. Data quantifying this statistic will be featured in a future report by EFM, however, it is important for the reader of this report to understand that this data is a key element in understanding the effectiveness of a Carve-out program, since the number of files that proceed to mediation or beyond, is a reflection of the number of cases in which an application for adjudication was filed. In most years, this is a very small percentage of the overall claims, suggesting that including an ombudsperson and the strength of the Carve-out program were effective enough to consistently maintain a very low litigation rate in order to manage systemic friction.

Litigation Rate

This statistics was calculated by dividing the number of litigated cases (applications filed, notices of representations received) by the total number of cases. In a recent CWCI report, it was noted that 80% of the files were litigated with a finding of impairment or Permanent Disability in the construction industry.¹⁰

Mediation Resolved

Data reported on the usage of mediators is tabulated in this field. This assumes that either the claims administrator or ombudsperson did not resolve disputes. Litigated cases reported matched the total number of cases that were resolved by mediation, arbitration, Workers' Compensation Appeals Board (WCAB) and at the appellate level that follow.

Arbitration Resolved

This represents the percentage of cases resolved by arbitration. Arbitrators replace the Judge in the statutory system, and his or her decision is final, however, the injured worker has the right to appeal that decision. The Workers' Compensation Appeals Board Judge does not challenge the final opinion of the arbitrator and signs off on his or her finding as well as settlement agreements prepared by the claims administrator, ombudsperson or mediator.

WCAB Resolved

Some Carve-out programs by design may allow for a WCAB decision. Although this is rare, the Workers' Compensation Appeals Board Judges decided a small percentage of claims. If there is a procedural issue that is in conflict with the laws governing the Carve-out agreement (a statutory benefit due is excluded), the Judge may over-ride the settlement agreement or decision of the arbitrator.

Appellate Court Resolved

The right to appeal is not impacted by carve-outs. Once the Judge signs off on the agreed upon settlement documents, the injured worker and the employer maintain their right to appeal by filing a request for reconsideration.

10- Young/CWCI, B. (2014, February). Attorney Involvement in AY 2005-2010 California Workers' Compensation Claims. Retrieved from http://www.cwci.org/press_release.html?id=374

The Missing Data

Loss experience in the construction industry shows highly litigated claims with protracted medical issues and lost time. Implementing a Carve-out program with shorter lifespans should equate to lower costs, however, the data is not being reported. Why is this? One indication points to the valuation date, or when the data is collected. The Department of Worker's Compensation (DWC) collects a snapshot of data as of a specific date, usually months after the end of a policy period. The Workers' Compensation Insurance Rating Bureau (WCIRB) collects their data each year for prior policy years as it develops or increases in value over time as paid costs increase. For this reason, the WCIRB data is a moving target and difficult to compare with Carve-out data.

Another reason comparison data is not being reported is because the DWC and WCIRB are not tracking the same data that is being tracked for the Carve-out program. This seems like an obvious action to take on their behalf, but these two organizations serve different functions: The DWC is a State agency and the WCIRB a non-profit organization. Add the Office of Self-Insurance Plans (OSIP) into the picture, and you have yet another State organization collecting a different set of data that does not normally interface with the WCIRB. However, they both collect data for employers participating in Carve-out programs.

There are several other non-profit research organizations involved with mining data from private and government entities. They include Public Entity Risk Institute (PERI), Public Risk and Insurance management Association (PRIMA), and the Haas institute/UC Berkeley. Unfortunately they have not been collecting detailed legal expense data, nor have they been reporting lost time for sworn employees. Since 2011 these organizations have not even considered these cost points, which may be due to the fact that the State of California's annual reports ended in 2011, with government officials citing the last reform (Senate Bill 863) as the reason, although labor code 3201.9 regulating the reporting for carve-outs still remains untouched. Furthermore, the OSIP data reported in their annual reports has been inconsistent from one year to the next, leaving the most current year as the most reliable.

Injury loss (claims) data comes from two separate sources:

- **Insurance Companies:** Report policyholder loss data to the Workers' Compensation Insurance Rating Bureau (WCIRB). The WCIRB, a non-profit research organization, publishes loss experience data (experience modifications) and loss trend analysis for policyholder and public use. The Department of Workers' Compensation (DWC) publishes policyholder data on their web site.¹¹ Included in the WCIRB and DWC policyholder loss data are financial reserves for medical and disability benefits. Legal paid or reserve financial data has not been made public because it is not gathered by the WCIRB.
- **Self-Insured Organizations and Government Entities:** The Office of Self-Insurance Plan (OSIP) division of the Department of Industrial Relations (DIR) publishes data each year on their website, but only in the last few months started collecting data on wage loss for sworn employees (Labor Code 4850).

Legal Fees and Costs

Legal fees are not tracked by either the WCIRB or the DWC. When a case is disputed, legal costs associated with defense attorney, deposition, investigation, and other miscellaneous costs increase the value of the case. Insured policyholders mostly use outside firms, and track this cost, but there are insurance companies that have in-house firms that do not track legal expense fees, including legal clerical support. Due to this inconsistency, the industry would find it difficult to accurately monitor this information.

Self-insured loss data does not include legal expense financial information, as a significant portion of legal defense costs include in-house attorneys and legal support staff, which is common in the government sector, and which represents a large portion of self-insured programs. While these costs are not normally tracked by a municipality's risk management department on a per claim cost basis, they are often tabulated by man-hours; however, that data is not reported to the State, nor is it made public for identifying cost trends. These data gaps are also common with insured policyholders and insurance companies that have in-house legal departments.

11 - <http://www.wcirb.com/>

Recently, the WCIRB published a report on legal trends, but failed to break down the data to reflect the average legal expense on a per claim cost basis for medical, indemnity, and/or future medical losses.¹² This detailed information is critical in understanding this growing cost driver and is a direct reflection of frictional cost.

Utilization Review and Bill Review

Another frictional cost driver in the industry is Utilization Review (UR) and Bill Review (BR). Neither are considered a medical or disability expense and is not tracked by the WCIRB or the DWC even though UR and BR are growing costs and often account for as much as 20% of the cost of a claim. Prior to 2004, claims administrators were empowered with authority levels for treatment, hospital stays, durable equipment, nurse case management referrals, and all other treatment deemed necessary by the physician or medical-legal examiner. Treatment protocols were based on the Packard Thurber publication, replaced in 2004 by the ACOEM guidelines, created and written by a team of occupational specialists, mostly orthopedic surgeons.¹³

Independent Medical Review and Bill Review

In 2012, disputes arising from UR and BR were regulated by the State with either Independent Medical Review (IMR) or Independent Bill Review (IBR). This is a review of records in the dispute resolution process so IMR or IBR costs are categorized under the med-legal expense category. These costs are not individually tracked for non-Carve-out programs and have only been reported active Carve-out programs (2004-2011).¹⁴

Employee Lost Time

In 2014, the State of California started requiring public agencies to report lost time data for their sworn employees (Police, Fire, Corrections), who receive salary continuation per Labor Code 4850. The lack of this information through 2014 has skewed the annual reports published by the Self-insurance Plans, making it difficult to create a baseline for performance throughout the self-insured market.

Other Hidden Costs Not Tracked

Ombudspersons will attest that Carve-out programs have consistently delivered positive results by resolving medical disputes in under 65 days. The insurance industry or the State is not publishing this data.

Frictional costs associated with depositions for delayed or denied claims, investigations or appeals are critical in understanding the before and after savings that arise from implementing a carve-out program. Neither the insurance industry nor the State has been, or is currently, tracking this information. We will address frictional cost in more detail later in this report.

12- Morgan/DWC, R. (n.d.). ALTERNATIVE DISPUTE RESOLUTION/CARVE-OUT PROGRAM Labor Code sections 3201.5, 3201.7 and 3201.9 REPORT ON ACTIVITIES 2004-2011. Retrieved from http://www.dir.ca.gov/dwc/Carveout/CarveOut_Report.pdf (page 62)

13- Young/CWCI, B. (n.d.). California Workers' Compensation Institute - Press Release. Retrieved from http://www.cwci.org/press_release.html?id=374

14- Commission on Health and Safety and Workers' Compensation SUMMARY OF SB 899, by Labor Code Section. (n.d.). Retrieved from <https://www.dir.ca.gov/chswc/Section-by-section-Review-of-SB899.pdf>

Frictional Costs – What We Do Know

“Friction is the force resisting the relative motion of solid objects sliding against each other. In the case of organizational friction, the solid objects are outcomes sliding against policy and procedures.”

Most organizations fail to grasp the full effect of direct and indirect costs associated with organizational friction in the Workers’ Compensation Insurance benefits delivery system. Frictional cost increases the short term and long term economic outcomes of occupational injuries and illnesses. The impact of friction in California’s Workers’ Compensation insurance market has fueled several studies, as the statutory system continues to fall short on regulating sustainable solutions to control costs in spite of decades of reforms. These studies have found that there are many sources of frictional costs that can be reduced or eliminated with a well-designed Carve-out program.

To understand how organizational friction effects the Workers’ Compensation system, we will define some the most common forms of friction and explore their financial impact.

Process Delays

Process delays stem from late reporting, injury causation investigations and medical necessity disputes. When benefits are delayed or denied, injured workers often seek legal representation, which can result in a protracted path for treatment. Additionally, the remedy for resolving injury causation disputes is the Qualified Medical Examiner process, which is now taking up to a year for resolution. Frictional cost for these delays and for claims that do not resolve in the first year, result in extra expense that can double each subsequent year. The “Day of Injury Study 2005”, examines the financial impact of late reporting and lag times or delays in receiving timely benefits. PERI summarized findings of The Hartford report¹⁵ of 53,000 permanent partial and temporary disability claims as follows:

- Claims with lag times between 7-14 days were 18% more expensive than claims filed in 1-6 days
- Claims with lag times between 15-28 days were 30% more expensive.
- Claims with lag time >29 days were 45% more expensive.

Carve-out designs that weigh heavily on claim initiation, early intervention, successful contacts and transparency in the investigation process can eliminate delays and distrust that result in protracted benefits, prolonged recovery and eventual litigation.

Access to Medical Care

A 2006 Update report by CHSWC cited a DWC survey of injured works in 2003 in California¹⁶ showed 13% of the respondents reporting barriers in accessing appropriate and timely medical care. These barriers included problems accessing medical care, seeing requested providers and transitioning to subsequent providers for follow-up care or specialty care. Depletion of physicians in the Workers’ Compensation system is an additional trend arising from this study.

In a Washington State Study summarized by Lexis Nexus¹⁷, 47% of injured workers polled from June 2007 to April 2008 cited barriers in accessing medical care. From 2003 to 2008, a five year period, access eroded nearly threefold. In fact, it was noted in this study that employers were not giving access within the 24 hour requirement, instead using an ambiguous self-imposed three day time frame. Accordingly, 54% of injured workers failed to recover within 10 to 12 months from their injury.

15- Chandler/CCI, J. (2005). The Day of Injury Study 2005 Final Report. Sacramento, CA: Chandler Consulting, Inc.

16- Workers’ Compensation Medical Care in California: Access to Care (2006 Update). (2006). Retrieved from Commission on Health and Safety and Workers’ Compensation website: <http://www.chcf.org/~media/MEDIA%20LIBRARY%20Files/PDF/W/PDF%20WorkersCompAccess06.pdf>

17- School of Public Health, University of Washington. (2008). Access, Quality and Outcomes of Health Care in the California Workers’ Compensation System 2008: Review & Commentary. Retrieved from LexusNexus website: <http://www.lexisnexis.com/legalnewsroom/workers-compensation/b/workers-compensation-law-blog/archive/2010/06/04/access-quality-and-outcomes-of-health-care-in-the-california-workers-compensation-system-2008-review-amp-commentary.aspx>

Direct Litigation Costs

For forty years the California Workers Compensation Research Institute (CWCI) has interviewed injured workers regarding the source of litigation, polling perceptions and attitudes behind their choice to seek legal representation. In 1975, when the study began¹⁸, 6 percent (6%) of all work injury claims and twelve percent (12%) of all lost time claims were represented. From 2005 through 2010, despite legislative reforms, ninety four percent (94%) of all permanent disability claims had legal representation, and 38.1% of all lost time, with or without permanent disability claims, involve legal representation.¹⁹ This friction point has shown that:

- Represented lost time claims, on average, realize a claim cost of 8 times that of unrepresented claims.
- Benefits and expenses for attorney represented lost time injuries averaged \$30,319 vs. \$5,598.
- Benefits and expenses for attorney represented injuries with permanent disability averaged \$66,208 vs \$25,300.

These statistics are in stark contrast to the Carve-out statistics represented in this document that show the vast majority of injuries resolving either internally or with the aid of an ombudsperson.

Employee Backfill and Replacement Cost

According to the Merck/Rutgers Study²⁰, hiring and training new employees to reach 100% productivity required approximately 13 months, consuming 30-36% of co-workers' time for training. For a public safety officer, the overtime cost can soar due to the need to backfill injured employee's positions as they recover from their work related injuries. In the City of San Jose alone, a recent analysis of their 2013/2014 fiscal year dated September 30, 2014, overtime expenditures increased 4% from the year prior to 363,280 with 28.5% accounting for disability and 12.8% modified duty absences. The total combined percentage due to disability or modified duty was 41.3%.²¹

With an average rate of \$50/hour, the total estimated overtime cost to backfill absences due to disability and modified duty was approximately \$7.9 million or the equivalent of 79 full time employees' annual salary. Detail was not provided to indicate the percentage of total hours attributed to Workers' Compensation claims, although the lack of accommodation available due to the nature of work supports this conclusion. This cost is distributed among 638 positions, which equates to nearly 12% of the fire department's workforce. With an additional half shift (overtime), 24% of the healthy firefighters would be filling in for those off work due to industrial injuries. This raises a potential cost risk by putting the healthy firefighters at risk for injury due to overwork and fatigue.

San Jose FF Absence Hours	FY 2011/2012	FY 2012/2013	FY 2013/2014	2011-2013 % Change
Disability Hours	67,566	103,469	95,590	41.5%
Modified Duty Hours	17,551	46,466	61,665	251%
Disability & Mod Duty Total	85,117	149,935	157,255	85%
Full Time Hours	43	75	79	84%

Table 3 - San Jose Backfill and Replacement Costs

18- Young, B. (2014). Attorney Involvement in AY 2005-2010 California Workers' Compensation Claims. CA: California Workers' Compensation Institute.

19- Young, B. (2014). Attorney Involvement in AY 2005-2010 California Workers' Compensation Claims. CA: California Workers' Compensation Institute.

20- Elliott, MA, B. (2008, April). Vocational Rehabilitation The Voucher Future Earning Capacity [PowerPoint].

21- Torres, R. (2014, September 30). City of San Jose - 2013-2014 ANNUAL REPORT - Appendix VI. Retrieved from <https://www.sanjoseca.gov/DocumentCenter/View/35730>

Your Organization's Scorecard

Every CEO, CFO and Risk Manager logically understands the negative financial impact of organizational friction. However, with no sources of reliable comparative data for Workers' Compensation Carve-out performance, considering a Carve-out is reduced to a thought exercise. Using known factors of cost increases derived from frictional cost drivers, it is possible to estimate, to a reasonable degree, the expected savings outcome by using the enclosed Self Assessment Worksheets.

Self Assessment Worksheets

These worksheets are tools for decision makers to fully understand the impact of frictional cost drivers on their organization and estimate potential cost savings by implementing a well designed Carve-out program. The first worksheet extrapolates findings from the carve-out charts discussed in this report, focusing on paid costs, disputes, and litigation rates. The second worksheet provides a basis to compare other cost drivers discussed in this report, including reporting delays, medical access delays and litigation costs.

Instructions For Worksheet 1

Paid cost growth is a marker for controlling cost drivers. Even though your organization's paid costs may not be even close to those indicated in the carve-out table, the annual increase trend is the more important element to compare with. For that reason, we have taken the paid costs and distilled it into a percentage, comparing each of the prior years in the carve-out table. The following instructions will guide you through the process.

Step One – Paid Cost:

1. Collect your undeveloped paid costs for each year (snap-shot or valuation date at the end of each policy year). The worksheet has given specific years, but you can go back further to 2004, if you desire.
2. Document your percentage of growth from year to year in the worksheet.

Step Two – Average Med-Legal Cost percentage per claim (%):

1. Gather Medical-Legal paid per claim data
2. Determine the average paid Med-Legal cost per claim for cases with Med-legal costs paid.

Step Three – Average Legal Expense Cost per claim:

1. Gather legal expense data from your insurance carrier or claims administrator;
2. If an in-house attorney is utilized, gather the time-reporting data used to charge back to the department for all legal fees, including clerical.
3. Once you have the legal expense data, estimate costs for those cases where the defense attorney has been involved with the file.
4. With the same information, calculate your litigation rate by dividing the number of cases assigned to a defense attorney by the number of open files.
5. Compare your actual litigation rates with the average Carve-out litigation rates in tables included in the "Eight Years of Carve-out Programs" section. (Table 1 and Table 2)

Sheet 1 – DWC Reported Carve-Out Data vs Your Program Cost

Your Cost Comparison	2008	2009	2010	2011
Your Avg. Paid Cost/Claim				
Carve-out comparison	-45.24%	7%	-18.70%	13%
Average Paid Legal				
Carve-out Comparison	2%	3%	2.50%	<1%
Your Disputes				
Carve-out comparison	83%	82%	80%	72%
Your Avg. Litigation Rate				
Carve-out comparison	2.4	3.9	2	1.4

Table 4 - Comparison Worksheet 1

Intructions for Worksheet 2

This second worksheet allows you to compare the development of costs due to delays and litigation expense outcomes. Some of this data may require a recent audit report, however, if your system permits, it would be best to extract the data from your loss runs.

Step One – Late Claim Reporting:

1. Conduct a sort on your electronic claims management database isolating the date of injury or occurrence, from the date of reporting (date of employer knowledge).
2. Conduct a subsequent sort on each delay segment, isolating the financial or paid cost totals (medical, indemnity, legal paid costs) for each period: 7-14 days, 15-28 days, etc.
3. For each of the three delay periods, sort your data, list it in the corresponding columns.
4. Calculate the expected outcomes below each row listing the percentages with the following formula:
 - a. For 7-14 days, reduce it by 18%: Multiply the value by 0.18 and subtract it from your original value. Apply this formula to the following two calculations.
 - b. For 15-28 days, reduce your paid cost total by 30%:
 - c. For over 29 days, reduce your paid cost total by 45%:
 - d. Repeat for each year.

Step Two – Medical Access Delays:

1. Sort your losses with paid medical costs and further refine by:
 - a. Utilization review delays;
 - b. Delays in receiving initial treatment
2. For each day medical care is not provided, \$92 is spent. To estimate the actual cost, you may need to perform an audit on a 10% sample of cases. You can filter out the cases that have a gap in medical care from the injury date, until the date of first treatment; total the costs and reduce it by 25% to show potential savings for avoiding delays through a well-designed carve out program.

Step Three – Direct Litigation Costs

1. Again, sort your losses by paid cost. Place the following totals in Table 5 for each year and calculate the potential savings gained from a well-designed carve-out program as follows:
 - a. Total your paid costs for lost time claims with medical, temporary disability and legal expense. Record the value in Table 5 for each year.
 - b. Divide the value by 5.5, record the number on the chart and compare potential savings that could be realized from a legal alternative dispute resolution component of a well-designed carve-out program.
 - c. Total your paid costs for claims with permanent disability: medical, temporary disability (if any) and permanent disability.
 - d. Divide the value by 8, record the number in Table 5 and compare potential savings that could be realized from a legal alternative dispute resolution component of a well-designed carve-out program.

Sheet 2 – Published Frictional Cost vs Your Program Cost

Your Cost Comparison 2008 2009 2010 2011

Late Claim Reporting

7-14 days (Your Delays)				
Potential Carve-out cost value = (above - 18%)				
15-28 days(Your Delays)				
Potential Carve-out cost value = (above - 30%)				
29 days or more (Your Delays)				
Potential Carve-out cost value = (above - 45%)				

Medical Access Delays

Total Medical Costs				
Potential Carve-out cost value = (above - 25%)				

Direct Litigation Costs

Include Medical & TD				
Potential Carve-out cost Divide above value by 5.5				
Include Medical TD, PD				
Potential Carve-out cost Divide above value by 8				

Table 5 - Comparison Worksheet 2



Elite Force Management Group, Inc. is a professional services firm specializing in Workers' Compensation Carve-out program assessment of need, design, implementation and on-going support. EFM promotes research and investigation into industry carve-out performance to give companies a measuring device to compare the results of their own pre carve-out needs analysis results.

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