

COST SHIFTING FROM WORKERS COMPENSATION OPT-OUT SYSTEMS: LESSONS FROM TEXAS and OKLAHOMA

I. Introduction and Executive Summary

For purposes of workers compensation, an opt-out system is one in which employers can leave the state-regulated workers compensation system and create their own plan for compensating employees who are hurt on the job. By allowing employers to leave the state workers compensation system, **opt-out systems dramatically reduce costs for opt-out employers¹ and promote massive cost shifting for work-related injuries from corporate employers to their workers and families, private payers, and taxpayers.**

Texas has had an opt-out workers compensation system in place longer than any other state. The use of federal Employee Retirement Income Security Act (ERISA) welfare benefit plans as an alternative to workers compensation began in this state over 26 years ago. Texas opt-out employers (also known as “nonsubscribers”) overwhelmingly choose to pay no benefits for work-related injuries. This is referred to as “going bare.” The nonsubscribers who choose to pay benefits make payments far below those required by the Workers Compensation Act by virtue of the employer having absolute control over the design and administration of its plan.² States are preempted from regulating the design and administration of federally protected ERISA welfare benefit plans and cannot collect claims data relating to the delivery of benefits under those plans.³

Oklahoma is another state that has an opt-out system for workers compensation. Although the “Oklahoma Model” looks different from the “Texas Model,” Oklahoma’s alternate injury benefit plans are almost identical to the Texas plans.⁴ In essence, Oklahoma law does not require the “qualified employer” to pay benefits to any worker hurt on the job. The qualified employer is free to choose coverage that excludes eligibility to benefits for any or all work-related injuries and limits access to medical care. The constitutionality of the Oklahoma Opt-Out Act is currently under review by the Oklahoma Supreme Court.⁵

¹ PartnerSource reports claim cost savings of 45-90 percent, “Free Market Competition of the Benefit of Injured Workers and Employers,” revised 02/19/2013, p. 81.

² See the 120 Texas and Oklahoma ERISA employee injury benefit plans linked to the ProPublica report, “Inside Corporate America’s Campaign to Ditch Workers’ Comp,” Oct. 14, 2015; http://www.propublica.org/article/inside-corporate-americas-plan-to-ditch-workers-comp?utm_source=et&utm_medium=email&utm_campaign=dailynewsletter&utm_content=&utm_name.

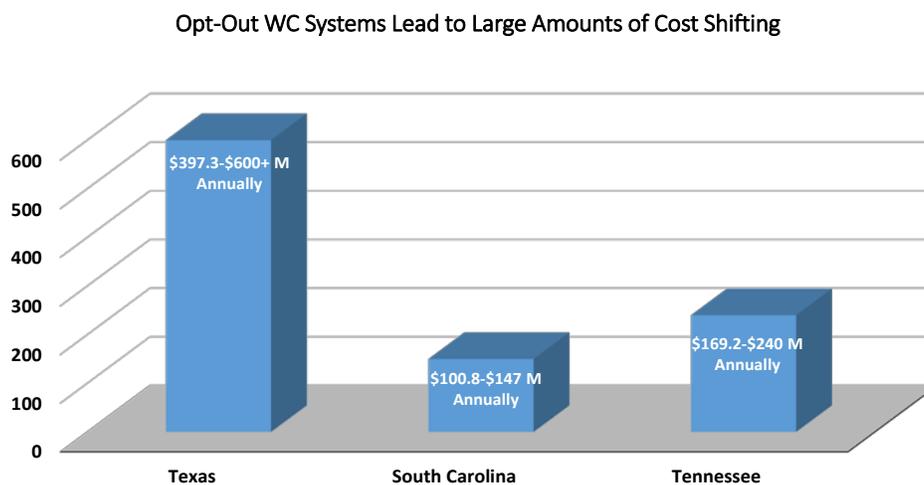
³ Section 514 of ERISA, 29 U.S.C. §1144. Shaw v. Delta Airlines, 463 U.S. 85 (1983); Egelhoff v. Egelhoff, 532 U.S. 141 (2001); NY State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645 (1995); Gobeille, Chair of the Vermont Green Mountain Care Board v. Liberty Mutual Insurance Co., 136 S. Ct. 936 (2016).

⁴ See the 120 Texas and Oklahoma ERISA employee injury benefit plans linked to the ProPublica report, “Inside Corporate America’s Campaign to Ditch Workers’ Comp,” Oct. 14, 2015.

⁵ Jonnie Yvonne Vasquez v. Dillard’s Inc. (Oklahoma Supreme Court Case No. 114,810); The OK WC Commission determined that the OK Opt-Out Act was unconstitutional under the equal protection clause and that the plans did not provide benefits that were equivalent to or better than statutory workers compensation benefits.

Using verifiable and relevant data, this paper presents PCI's estimate of the cost shifting of medical expenses from an opt-out workers compensation system in Texas, as well as in South Carolina and Tennessee, which states considered and recently failed to enact opt-out legislation. Similar to Oklahoma, these two states' bills did not require qualified employers to pay any benefits to any worker hurt on the job; allow the employer to choose coverage that excludes eligibility for benefits for any or all work-related injuries; and limit access to medical care. In effect, qualified employers in South Carolina and Tennessee would be allowed to go bare.

Based on PCI's analysis, the **annual cost shifting of medical expenses resulting from the Texas opt-out workers compensation system is a minimum of nearly \$400 million; the actual amount is more likely to exceed \$600 million** due to additional considerations. If qualified employers in South Carolina and Tennessee opt out of their workers compensation systems and if these employers behave similarly to those in Texas and Oklahoma, then **the annual cost shifting is estimated to be \$100.8 to \$147 million (South Carolina) and \$169.2 to \$240 million (Tennessee).**



PCI's research is relevant for all states, despite certain criticisms by opt-out proponents. For example, some proponents point out that Oklahoma's statutory language requires the benefit levels and duration to be the equivalent of or better than workers compensation. This would appear to give Oklahoma workers and other payers more protection from cost shifting. However, most Oklahoma ERISA benefit plans effectively cut off medical benefits after 104 weeks or 156 weeks by excluding "diagnostic tests, surgery, injections, counseling, physical therapy, or pain management devices or equipment" as part of "continuing medical maintenance." Other limitations in the ERISA plans can effectively terminate medical benefits long before the expiration of 104 or 156 weeks.⁶

II. PCI's Research Findings

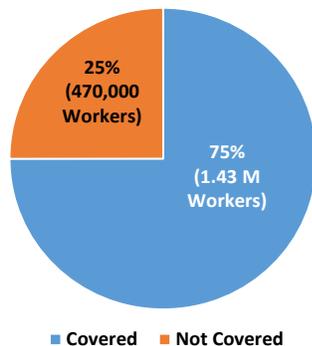
⁶ See ERISA welfare benefit plans referenced in footnote 2.

A. Relevant Reported Data in Texas

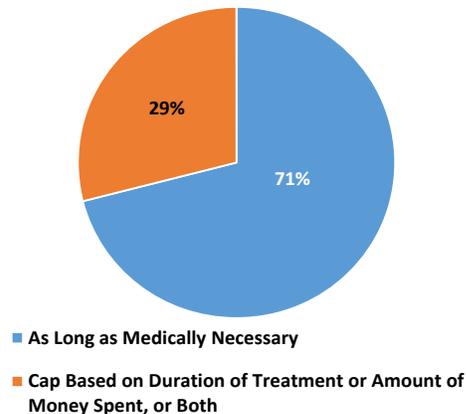
Data compiled by the National Council on Compensation Insurance (NCCI) show that the Texas injury frequency rate is 679 lost-time claims and 1875 medical-only claims per 100,000 workers. In addition, the average indemnity payment per lost-time claim is \$18,400 and the average medical paid per lost-time claim is \$27,400.⁷ Based on a Texas Department of Insurance (TDI) report, the average cost of a medical-only claim is \$2,044.⁸

According to the TDI’s Workers’ Compensation Research and Evaluation Group (WCREG), one-third of Texas employers (119,000) do not have workers compensation insurance to protect their employees in the event of a work-related injury. These nonsubscribers employ 1.9 million workers.⁹ Among those employed by nonsubscribers, 470,000 are not covered by any alternative benefit plan in the event of a work-related injury.¹⁰ Of the 1.43 million workers covered by an alternative benefit plan, 14 percent of the plans do not provide medical benefits. Consequently, about 266,000 more workers of nonsubscribers have no medical benefits in the event of a work-related injury. Among the non-subscribing employers with plans that pay medical benefits, 71 percent pay these benefits as long as they are medically necessary and 29 percent cap these benefits based on the duration of treatment and/or amount of money spent on medical treatments or both.¹¹

Breakdown of 1.9 M Employees in Texas With and Without a Non-Subscriber Alternative Benefit Plan



Breakdown of Non-Subscribing Employers That Pay Medical Benefits



Despite the high proportion (71 percent) of employers that pay medical benefits as long as they are medically necessary, PCI research has failed to identify any Texas plan that provides “lifetime” medical benefits. The most generous plans terminate medical benefits at the end of 156 weeks and

⁷ NCCI, “Texas State Advisory Forum 2015,” pp. 60, 64 and 70.

⁸ Texas Department of Insurance, Workers’ Compensation Research and Evaluation Group, “Health Care Cost and Utilization in the Texas Workers’ Compensation System 2000-2014,” Dec. 2015, p. 7 (\$859 reflects medical services and \$1,185 reflects hospital/institutional services).

⁹ WCREG, “Employer Participation in the Texas Workers Compensation System: 2014 Estimates,” Nov. 2014, p. 22.

¹⁰ WCREG, “Employer Participation in the Texas Workers Compensation System: 2014 Estimates,” Nov. 2014, pp. 22-23.

¹¹ WCREG, “Employer Participation in the Texas Workers Compensation System: 2014 Estimates,” Nov. 2014, p. 27.

very few have that duration limit. In addition, the most generous Texas plans have a \$250,000 cap on aggregated wage replacement and medical benefits. So, the medical benefits in the most generous plans may terminate long before the expiration of 156 weeks.¹² According to NCCI data, approximately one-third of aggregated medical expenses on an accident-year basis are incurred more than 156 weeks after the date of injury.

A common condition and limitation on eligibility for ERISA plan benefits in Texas and Oklahoma is the requirement that the work-related injury be reported immediately and not later than the end of the work shift. National NCCI data indicate that only 20 percent of lost-time work-related injuries are reported on the date of the accident. Consequently, opt-out employers may deny benefits for up to 80 percent of the reported lost-time work-related injuries that would otherwise be compensated in the state workers compensation system.¹³

B. Estimated Cost Shifting of Medical Expenses Not Covered by Texas Opt-Out Employers

The following findings on Texas cost shifting are based on the preceding WCREG data and NCCI frequency and severity results:

a. 470,000 employees not covered by any plan

- 3,191 lost-time injuries per year resulting in **\$87.4 million** in medical expense
- 8,812 medical-only claims per year resulting in **\$18.0 million** in medical expense

b. 266,000 employees covered by an alternative plan with no medical coverage

- 1,806 lost-time injuries per year resulting in **\$49.5 million** in medical expense
- 4,987 medical-only claims per year resulting in **\$10.2 million** in medical expense

c. 1,164,000 employees covered by an alternative plan with medical coverage

- 7,904 lost-time claims per year, of which 80 percent (6,323) are at risk of benefit denial or benefit reduction resulting in up to **\$173.2 million** in medical expense shifted to other payers
- 1,581 (= 7,904 – 6,323) lost-time claims per year that are not at risk of being denied on the basis of reporting but subject to other medical conditions and limitations, including the 156 week limitation, resulting in more than **\$14.4 million** in medical expense annually shifted to other payers
- 21,825 medical-only claims per year resulting in **\$44.6 million** in medical expense

¹² See the Texas ERISA employee injury benefit plans linked to the ProPublica report, "Inside Corporate America's Campaign to Ditch Workers' Comp," Oct. 14, 2015; http://www.propublica.org/article/inside-corporate-americas-plan-to-ditch-workers-comp?utm_source=et&utm_medium=email&utm_campaign=dailynewsletter&utm_content=&utm_name.

¹³ NCCI, "The Relationship Between Accident Report Lag and Claim Cost in Workers Compensation Insurance," Jan. 2015, Exhibit 2, p. 4.

Summing the above dollar amounts creates a **total minimum annual cost shift of over \$397.3 million for medical expense alone in the Texas opt-out system. The total annual cost shifting is substantially higher**, however, since this very conservative figure fails to take into account the following opt-out facts:

- 1) Most of the costs arising out of catastrophic injuries (quadriplegia, paraplegia, closed head injury, multiple amputation) are shifted to other payers early in the claim process.¹⁴
- 2) The alternative plans do not cover all work-related injuries. There are many exclusions in the alternative plans that are not commonly found in workers compensation law, including no eligibility for benefits if the injury is a result of a work-related assault, act of terrorism, exposure to asbestos particles or silica dust. In addition, the prevailing definitions of “accident” and “injury” found in the plans render almost every reported injury subject to denial.
- 3) Opt-out employers may terminate medical benefits long before the expiration of 156 weeks, even in the most generous plans.¹⁵
- 4) Wage replacement cost shifting has not been factored in.
- 5) Plan benefits may cease or may be modified once the employee is terminated or voluntarily leaves the employment.
- 6) Plan exclusions, conditions and limitations are used to force settlements for less than the actuarial values.
- 7) Injuries to employees who have been misclassified as independent contractors have not been factored in.

In addition, OSHA data indicate that many opt-out employers have a very poor safety record and account for a disproportionate number of fatalities. This finding suggests that injury frequency and severity among opt-out employers may be higher than among employers that protect their employees with workers compensation insurance. This would further increase the costs that are shifted to other payers.¹⁶

¹⁴ See the “Coordination of Benefits” clauses in all of the published Texas and Oklahoma ERISA employee injury benefit plans.

¹⁵ See the 120 Texas and Oklahoma ERISA employee injury benefit plans linked to the ProPublica report, “Inside Corporate America’s Campaign to Ditch Workers’ Comp,” Oct. 14, 2015; http://www.propublica.org/article/inside-corporate-americas-plan-to-ditch-workers-comp?utm_source=et&utm_medium=email&utm_campaign=dailynewsletter&utm_content=&utm_name.

¹⁶ Review of the OSHA Severe Violator Log (February 2015) found that 52 percent of the Texas employers listed were non-subscribers. In addition, the OSHA Fatality Log for 2014 shows that 40 percent of the Texas fatalities investigated by OSHA were to employees of non-subscribers. Texas has the highest worker fatality rate in the country.

The annual cost shifting in Texas as a result of an opt-out workers compensation system is more likely to be in excess of \$600 million annually. According to PartnerSource, which has written approximately 20,000 ERISA opt-out plans for Texas non-subscribers that represent about 1/6 of the Texas opt-out employers, clients have saved in excess of \$1 billion in claims costs over the past decade.¹⁷ This would equate to \$100 million annually in cost shifting for 1/6 of the market or at least \$600 million annually for the total Texas opt-out market.

C. Estimated Cost Shifting in South Carolina and Tennessee

Using the PCI analysis to estimate medical cost shifting in the Texas opt-out system, the results for South Carolina and Tennessee medical cost shifting can also be estimated. If these two states allow qualified employers to opt out of the state workers compensation system and the behavior of their opt-out employers is consistent with those in Texas and Oklahoma, the amounts of medical cost shifting experienced in South Carolina and Tennessee are computed to be:

- **At least \$100.8 million to \$147 million annually (South Carolina).**¹⁸
- **At least \$169.2 to \$240 million annually (Tennessee).**¹⁹

III. Conclusion

Using relevant and verifiable claim frequency and severity data, this PCI analysis gives policymakers an opportunity to examine the potential impact of opt-out workers compensation systems on states. What essentially results from this type of conversion is a shifting of costs that are substantial – these amounts are likely hundreds of millions of dollars.

In short, when an opt-out employer decides not to cover the costs of some or all work-related injuries, the medical and wage replacement costs of those injuries do not go away. These costs are shifted back to the injured workers and their families, to other private payers (health and auto insurance), and to taxpayers. State citizens bear the brunt as well, as they face the risk of paying higher private insurance rates and higher taxes over time.

*The **Property Casualty Insurers Association of America (PCI)** is a trade association consisting of nearly 1,000 insurers of all sizes and types. PCI members represent 35 percent of both the total general insurance business and the total workers compensation business (including non-monopolistic state funds) in the nation.*

¹⁷ PartnerSource, “Free Market Competition for the Benefit of Injured Workers and Employers,” revised 02/19/2013.

¹⁸ Bureau of Labor Statistics: 2.147 million South Carolina citizens employed in Dec. 2015; and NCCI, “South Carolina State Advisory Forum,” May 28, 2015: state injury frequency of 2.9 per 100 employees and indemnity severity of \$32 thousand per lost-time claim and \$27.1 thousand medical severity per lost-time claim.

¹⁹ Bureau of Labor Statistics: 2.9 million Tennessee citizens employed in Dec. 2015; and NCCI, “Tennessee State Advisory Forum,” Sept. 22, 2015: state injury frequency of 3.3 per 100 employees and indemnity severity of \$16.8 thousand per lost-time claim and \$36.7 thousand medical severity per lost-time claim.