

California Workers' Compensation

System Trends and Performance

Presented by:



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Introduction

The Workers' Compensation Action Network is pleased to provide this overview of key trends in California's workers' compensation system. In analyzing the body of available research on California's system, the emerging trends should be of concern to policymakers and system stakeholders. Improvements in affordability, efficiency and injured worker outcomes stemming from major legislative reforms between 2002 and 2004 have given way to increasing costs and frictional issues. Because workers' compensation represents a direct added cost on employment at a time of double-digit unemployment, California's ability to address these trends will play either a favorable or unfavorable role in the state's economic recovery, its future competitiveness for jobs and ability to afford public services.

About Workers' Compensation

In 2009, California employers paid \$13.3 billion in costs for 492,000 occupational injuries and illnesses.

Workers' compensation was established as America's first social insurance program a century ago. The first state to enact a complete workers' compensation system did so in 1911, followed by numerous other states including California, which established its system in 1913.

Often referred to as the "grand bargain" between employers and labor, the purpose of workers' compensation is to provide prompt medical care to workers injured on the job, as well as deliver cash benefits to compensate injured workers for a portion of lost wages on a temporary or permanent basis. Workers' compensation is designed to function as a "no fault" system.

There is no burden of proof for an injured worker to show employer negligence caused a workplace injury. It acts as the exclusive remedy for workers and employers to resolve workplace accidents without resorting to the court system.

Workers' compensation is typically delivered through one of two mechanisms:

- Insurance – Employers may purchase workers' compensation insurance from a private insurance company or the State Compensation Insurance Fund.
- Self-insurance – Employers, including very large employers and many public agencies, may choose to pay directly for their workers' compensation costs. Smaller employers may also pool their resources to form self-insurance groups.

Regardless of the coverage mechanism, employers pay 100 percent of costs associated with the workers' compensation system, inclusive of direct costs for medical treatment and cash benefits for injured workers, as well as costs associated with managing and litigating claims. In 2009, California employers paid \$13.3 billion in costs for 492,000 occupational injuries and illnesses.¹

In California, employers also pay 100 percent of the costs for the state to administer the workers' compensation program and pay partially or entirely for the state's anti-fraud programs, workplace safety initiatives and compliance enforcement actions. The amount assessed on employers for these costs – formerly funded by the state government – will total more than \$490 million in 2011.

California in a National Context

As a mandatory program in which insurance costs are based on the number of employees and amount of wages paid, workers' compensation can increase an employer's payroll costs by more than 25 percent. The affordability and effectiveness of a state's workers' compensation system, therefore, is an important factor in a state's overall cost burden for employers. According to a 2010 survey of 2,500 California small businesses, for example, the cost of workers' compensation ranks as small business owners' third greatest challenge, behind only the condition of the state economy and state and local business taxes.²

The global recession, high unemployment rates and large state budget deficits have put a spotlight on state competition for attraction and retaining jobs. Indices measuring the "business friendliness" of states frequently rank California as among the most expensive, as shown in Figure 1. Each of these indices includes either general labor costs or workers' compensation costs in their rankings.

Figure 1: Rankings of California's Business Climate

Organization or Publication	Rating Measurement	California's Rank
Small Business and Entrepreneurship Council	<i>Small Business Survival Index 2010: Ranking the Policy Environment for Entrepreneurship Across the Nation</i>	48
<i>Forbes Magazine</i>	<i>The Best States for Doing Business, 2010: Business Costs</i>	44
CNBC	<i>America's Top States for Business 2010: Cost of Doing Business</i>	48
<i>Chief Executive Magazine</i>	<i>Best & Worst States for Business 2010</i>	51

State cost comparisons focused exclusively on workers' compensation costs tell a similar story. California has historically been a high-cost state for workers' compensation when compared to other states. As Figure 2 shows, California has been ranked in the top five most expensive states for workers' compensation except for 2008, when it was ranked 13.

Figure 2: California Workers' Compensation Costs vs. Other States and the National Median³

Year	2000	2002	2004	2006	2008	2010
Rank by Most Expensive	3	1	1	2	13	5
% of National Median	148%	216%	236%	166%	121%	131%

The premium rates California employers pay for workers' compensation coverage are higher despite the fact that there is nothing inherently more dangerous about the state's workplaces.

According to the U.S. Bureau of Labor Statistics, California's rate of occupational injury and illness per 100 workers is 3.7, virtually identical to the national average of 3.6 per 100 workers.⁴ According to the National Academy of Social Insurance, California employers pay a disproportionate share of the national costs for workers' compensation benefits, paying 16 percent of all benefit costs in the nation, despite employing just 12 percent of the national workforce.⁵

Workers' comp claims in California remain generally more expensive, take longer to resolve and present more frictional costs than other states.

The Massachusetts-based Workers' Compensation Research Institute (WCRI) annually benchmarks workers' compensation costs and performance in 16 large, geographically diverse states, including California.

WCRI's most recent research provides the following comparative measures for California's system for claims with more than seven days of lost work time occurring between 2006 and 2009, after adjusting for each state's injury and industry mix. When compared to the 16-state median, California's:⁶

- ↑ Average total costs per claim were 13 percent more expensive
- ↑ Incurred medical benefits per claim were 31 percent higher
- ↑ Indemnity (or cash) benefits paid on temporary disability claims were 25 percent higher, although overall cash benefits paid per claim were "typical"
- ↑ At 47 percent of all claims, California had among the highest rates of workers' compensation claims that result in permanent disability payments
- ↑ At an average of 22 weeks, temporary disability benefits were paid longer in California than in most other states and 48 percent longer than the median
- ↑ California's "benefit delivery expense" – comprised of litigation and medical cost containment expenses – was 87 percent higher
- ↑ California had attorneys involved in more than one-third of all workers' compensation claims, which is higher than the 16-state median

Although a series of significant legislative reforms were effective at reducing California's rank as the "most expensive state" in several categories, workers' compensation claims in California remain generally more expensive, take longer to resolve and present more frictional costs than other states.

Key Features of California's System

As a medical and cash benefit program for injured workers, the dominant features of each state's workers' compensation system are:

- the manner in which medical treatment is delivered
- the adequacy of temporary wage replacement benefits
- how permanent disability benefits are calculated for injured workers
- strategies for getting injured workers back to work.

California lawmakers significantly altered each of these key features within the past decade in an attempt to rein in spiraling costs and improve outcomes for injured workers. A detailed description of these legislative reforms can be found in Appendix A.

Medical Treatment

In California, all medical treatment must be in accordance with a Medical Treatment Utilization Schedule (MTUS), which is presumed correct for all medical treatment issues. State law requires that the MTUS be based on medical treatment guidelines that are evidence-based, peer reviewed and nationally recognized. Much of the current MTUS is based on guidelines published by the American College of Occupational and Environmental Medicine, though other guidelines are used.

Employers and insurers may establish Medical Provider Networks (MPNs) to provide care to injured workers. Within these networks, injured workers have the ability to seek second and third opinions from other physicians within the network or appeal to the Division of Workers' Compensation (DWC) for Independent Medical Review if they dispute the diagnosis or treatment. Injured workers may also "pre-designate" their personal physician as their physician for workers' compensation claims. In 2008, 73 percent of medical treatment was delivered through MPNs.⁷

According to a 2008 survey conducted by the DWC of approximately 1,000 injured workers, 80 percent were satisfied or very satisfied with their overall care and 79 percent rated their quality of care as good, very good or excellent.⁸ According to the DWC, these results are consistent with surveys conducted prior to the adoption of evidence-based medicine and results found in surveys of group health patients.

California also requires all employers to establish Utilization Review (UR) programs, which is the process by which qualified physicians review treatment requests to ensure they are supported by evidence-based guidelines. UR programs audited by the DWC in 2010 performed at an average rating of 98 percent for their timeliness and accuracy of responses to medical treatment requests.⁹

Temporary Wage Replacement Benefits

California pays temporary disability (TD) benefits to replace up to two-thirds of an injured worker's lost wages, tax free, while they are out of work. These benefits may be collected up to a maximum of 104 weeks within a five-year period, subject to certain exemptions that extend the availability of these benefits. As a result of statutory benefit increases and indexing TD benefits to increases in the Statewide Average Weekly Wage, the maximum TD rate increased by 100 percent since 2003 and is currently \$986 per week. Consequently, the two-thirds wage replacement level has been increased significantly and is currently reached for 97 percent of all injured workers.¹⁰

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Permanent Disability Ratings

For the purpose of calculating permanent disability (PD) benefits, California utilizes guides published by the American Medical Association (AMA) for measuring permanent

impairment. Significantly, these guides, which are used in some manner by 38 other states, provide a tool for physicians to objectively measure and rate the level of an injured worker's impairment. This rating is then multiplied by factors for age, occupation and diminished future earning capacity to arrive at the percentage of permanent disability.

In 2004, lawmakers adopted the AMA-based impairment rating system to replace a PD rating system that relied on subjective factors and was generally described as “costly, inequitable, inconsistent and prone to disputes.”¹¹ Under this system, PD cases in California accounted for 82 percent of all benefit payments, well above the national average of 59 percent.¹²

Although California's PD frequency is still higher than average, it is no longer the highest of any state.

California's PD system requires physicians who evaluate workers to identify any percentage of permanent disability that is not caused by the specific workplace injury. This process, known as “apportionment to causation,” mandates that permanent disability caused by previous workplace injuries or preexisting medical conditions that contribute to the permanent disability are not compensable.

Since 2003, the frequency of PD claims in California has declined by 20 percent. Although California's PD frequency is still higher than average, it is no longer the highest of any state.¹³ The vast majority of these cases – 79 percent – result in PD ratings of less than 25 percent.¹⁴

Return to Work

According to the RAND Center for Health and Safety in the Workplace, effective return-to-work outcomes achieve the dual benefit of improving benefit adequacy for injured workers and reducing benefits costs for employers.

California's system includes several mechanisms for facilitating improved return-to-work rates for injured workers. These measures include the adoption of evidence-based medicine to enhance the quality of medical treatment and speed recovery, grants to small businesses to finance workplace modifications to accommodate workers' disabilities, and financial incentives to encourage employers to bring injured workers back to work. This latter mechanism, generally referred to as the “bump up, bump down,” allows PD benefits to be decreased if there is an offer for alternative or modified work or increased if there is no such offer.

Since 2002, the “return to work” rate for injured workers has increased by as much as 11 percent.¹⁵ According to RAND, “the biggest gains were experience by workers with the most severe injuries.” The long-term wage loss of permanently disabled workers between 2004 and 2006 was 20 percent lower than it would have otherwise been as a result of the return-to-work improvements.¹⁶

Current Trends Impacting California's System

Claims Costs Rising Rapidly

After several years that brought about a 65 percent reduction in the cost of workers' compensation insurance per \$100 of payroll, rates began to increase again in 2009.

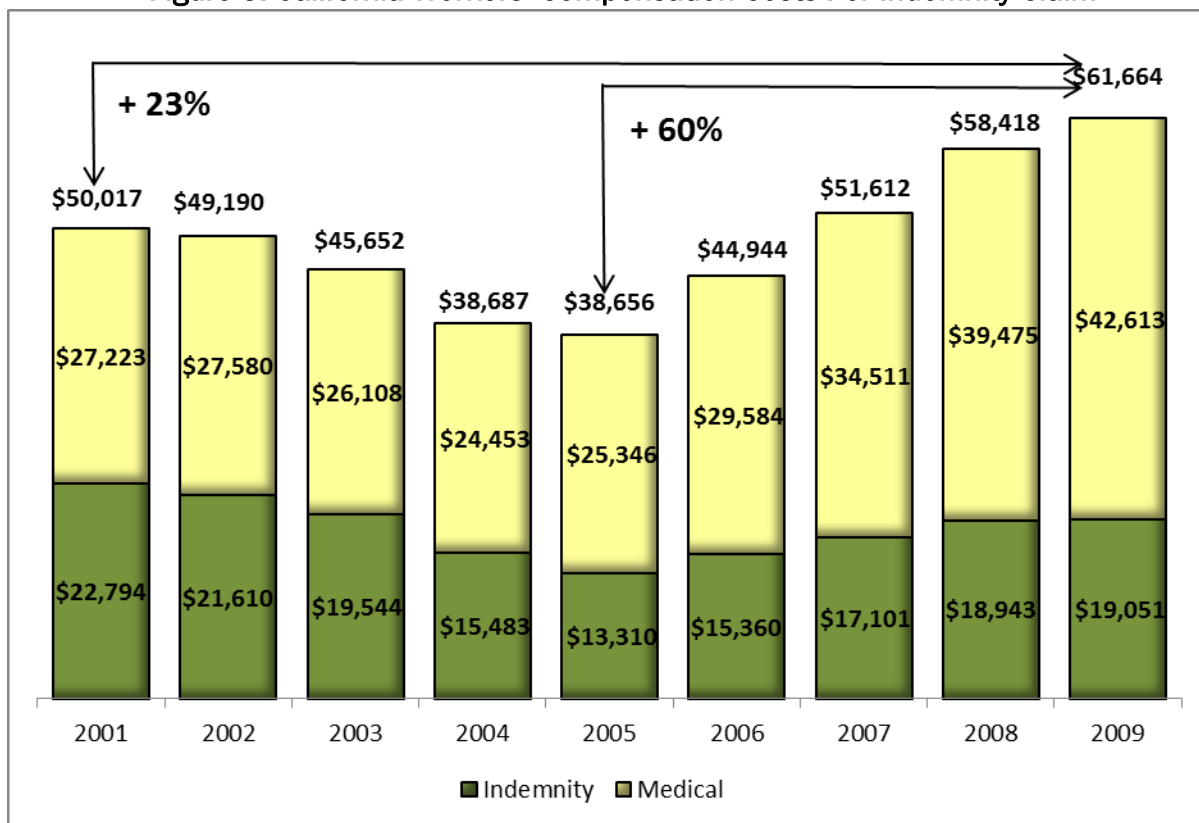
Between January 2009 and January 2010, average rates filed with the Department of Insurance increased by an average of 19 percent. These increases were fueled by a 60 percent increase in the cost per workers' compensation claim between 2005 and 2009. The total cost per claim in 2009 was 23 percent more expensive than California's previous all-time high reached in 2001, a period generally acknowledged as a "crisis" in the state's workers' compensation system.¹⁷

Although workers' compensation insurance rates began to increase in 2009 in response to rising claims costs, average rates were insufficient to pay for the cost of claims as insurers paid out \$1.27 in losses for each \$1.00 of premium earned in 2010.¹⁸

In addition to its impact on insurance rates, rising claims costs have impacted employers who do not purchase insurance coverage. Between 2005 and 2010, for example, California school districts, cities and other public agencies that self-insure saw their costs increase by \$58 million – a 22 percent overall cost increase – despite the fact that the number of claims increased by only two percent.¹⁹

Claims cost increases have also hit the State of California as it struggles to close a \$26 billion budget gap. For fiscal year 2008-09, the state paid \$460 million for workers' compensation costs against a state payroll of \$15 billion. In the most recent year, 2009-10, the state paid \$503 million in workers' compensation costs even though the state payroll declined to \$14 billion.²⁰

Figure 3: California Workers' Compensation Costs Per Indemnity Claim



The vast majority (75 percent) of the increase in claims costs are due to higher costs for medical treatment. Cumulatively, workers' compensation medical costs increased by \$500 million between 2005 and 2009.²¹

According to Workers' Compensation Research Institute, this increase is due in part to a regulatory increase in the amounts that physicians are reimbursed for treatment, which took effect in February 2007. According to the California Workers' Compensation Institute, individual medical costs per claim between 2005 and 2009 grew by the following amounts:

- ↑ 149 percent increase for physician medical-legal reports
- ↑ 68 percent increase for pharmaceuticals and medical equipment
- ↑ 29 percent increase for physician "evaluation and management," driven by more doctors' office visits and more treatments per visit
- ↑ 23 percent increase for all outpatient services
- ↑ 15 percent increase for physical medicine
- ↑ 9 percent increase for surgery costs

The increase in pharmaceutical costs has included a dramatic increase in the prescribing of "schedule II opioids" – narcotics such as oxycodone – and "compound drugs" that include medical foods. Between 2005 and 2009, according to CWCI research, reimbursements for Schedule II drugs increased from 3.8 percent to 23.6 percent of total prescription drug payments in the California workers' compensation system – an increase of more than 500 percent. Recent research has found that more than half of these drugs are prescribed by less than three percent of medical providers in California.²² These providers collect nearly two-thirds of all reimbursements for these drugs. During the same time period, prescribing of compounds, the most common of which are mixtures of topical creams, grew from 2 percent of all workers' compensation prescription costs in 2006 to 12 percent in 2009 – an increase of more than 400 percent.²³

Since 2009, the DWC has been working on a 12-point plan for regulations to "monitor and help control medical costs in California's workers' compensation system." Among these measures are regulations to end double payments for hardware used during spinal surgeries – which currently adds \$55 million in annual, duplicate costs for these procedures – and bring payments for surgical procedures performed at ambulatory surgery centers more in line with the rates Medicare pays such facilities.

Cash benefits payments are also driving the increase in costs per claim. TD benefits paid per claim increased by six percent between 2008 and 2009, driven by a one-week increase in the average length of TD claims.²⁴ According to the RAND Institute for Civil Justice, PD ratings have increased by eight to 10 percent each year between 2007 and 2009.²⁵ The increase in ratings has been driven primarily by three court decisions – *Almaraz-Guzman* and *Ogilvie* – that allow claimants to challenge their AMA-based impairment ratings and dispute the application of the modifier for their Diminished Future Earning Capacity. In total, these cases were estimated to increase employer costs by \$800 million.

Adjudication of Claims Slowing, Litigation Increasing

After gains made in lowering the litigation rate and increasing the rate at which workers' compensation claims are resolved, California's system has become less efficient in recent years by both measures. The percentage of PD claims that were settled at the 18 month interval, decreased by 13 percent between 2005 and 2009, indicating that these claims are taking longer to resolve.²⁶

Additionally, the number of litigated claims – those filed for adjudication by the Workers' Compensation Appeals Board (WCAB) – increased by 17 percent between 2008 and 2009.

This increase marks the first time the number of cases filed with the WCAB has increased since 2003.²⁷

The speed at which hearings are held on litigated claims has also worsened, with the number of days from a hearing request to the actual hearing growing by 45 percent. None of the three types of hearings were completed within statutory deadlines. Reasons cited for increase in litigation include additional litigation on PD cases arising out of the *Almaraz-Guzman* and *Ogilvie* decisions and time spent at the WCAB adjudicating lien claims.

Liens arise mostly due to disputes between medical providers and employers or their insurance company over whether and how much they should get paid for medical treatment. According to the study performed by the Commission on Health and Safety and Workers' Compensation, the 470,000 liens expected to be filed in 2011 is double the number filed in 2005. According to the report, these liens are costing California employers an estimated \$200 million per year and creating significant backlogs in the adjudication of workers' compensation claims. In the Los Angeles WCAB office, for example, liens account for 35 percent of the court's workload and it is adding 2,000 liens per month to its current backlog of 800,000 pending liens.²⁸

Opportunities and Challenges for Policymakers

An affordable, efficient workers' compensation system is vital to a healthy jobs environment in California. The track record shows that periodic reform of California's system has reduced costs for employers and taxpayers, improved outcomes for injured workers and brought California's system more in line with national averages. These results represent an opportunity for policymakers to use future improvements in workers' compensation to reduce the overall cost of doing business in California and make the state's economy more competitive.

Currently, California's is showing the symptoms of an ailing system: costs are spiraling upward, conflict is increasing and loopholes are being exploited to the detriment of the employers and injured workers the system was established to serve a century ago. These symptoms represent challenges that policymakers must address so that jobs, vital public services and benefits to injured workers are not lost to inefficiencies and unnecessary workers' compensation costs.

About WCAN

WCAN is a statewide, broad-based grassroots coalition of employer and insurer trade groups, businesses, non-profit organizations and public entities working together to ensure predictability and stability in California's workers' compensation system, reduce costs for employers and improve services to injured workers. WCAN works to inform employers, policymakers and the media about California's system and advocate for policies that ensure injured employees are given necessary medical care promptly and receive benefits timely, fraud is eliminated, legitimate disputes are resolved fairly and quickly, and system costs are reduced where inefficiencies and inequities exist.

Contact WCAN at (916) 554-3467 or contactus@fixworkerscompnow.org or visit our website: www.fixworkerscompnow.org.

Appendix A: California Workers' Compensation Legislation

Legislation	Key Provisions			
	Medical Treatment and Utilization	Temporary Disability	Permanent Disability	Other Reforms
Assembly Bill 749 (Calderon) Year: 2002	<ul style="list-style-type: none"> Eliminates the treating physician's presumption of correctness, except for a predesignated, personal physician or chiropractor Requires Administrative Director to develop fee schedules for pharmaceuticals and outpatient surgery centers 	<ul style="list-style-type: none"> Annual benefit increases 1/03, 1/04 and 1/05 Future benefit increases tied to increases in Statewide Average Weekly Wage 	<ul style="list-style-type: none"> Annual benefit increases for Permanent Total Disability 1/03, 1/04 and 1/05 Future benefit increases for Permanent Total Disability tied to increases in Statewide Average Weekly Wage Annual benefit increases to maximum PD benefits for certain rating intervals 1/03 – 1/06 Increase in scheduled number of weeks for PD benefits 1/04 	<ul style="list-style-type: none"> Increase aggregate life pension and death benefits in '06 Weekly life pension and death benefits subject to COLA adjustments after 1/03 Allows for lump-sum settlement payment for vocational rehabilitation
Assembly Bill 227 (Vargas) & Senate Bill 228 (Alarcon) Year: 2003	<ul style="list-style-type: none"> Requires Administrative Director to adopt a new medical treatment utilization schedule, which will be presumptively correct with regard to extent and scope of medical treatment Requires that ACOEM guidelines be used until the new schedule is developed Requires that for injuries not covered by ACOEM, treatment be based on other evidence-based treatment guidelines generally recognized by the medical community Requires development of new fee schedules for physician services, inpatient hospital services, pharmaceuticals and outpatient facility services Generally limits chiropractic and physical therapy to 24 visits <i>NOTE: AB 1073 (Nava) 2007 prohibits limitation on physical medicine from applying to postsurgical treatment if provided according to postsurgical treatment guidelines</i> Requires employers to develop a utilization review process 			<ul style="list-style-type: none"> Repeals vocational rehabilitation Requires that an injured worker receive a supplemental job displacement voucher if he/she does not return to work within 60 days of termination of TD payments Requires employers to pay any bill for medical treatment within 45 days
Senate Bill 899 (Poochigian) Year: 2004	<ul style="list-style-type: none"> Repeals primary treating physician's presumption of correctness for all issues and all dates of injuries Requires that the presumption given to the treatment utilization schedule/ACOEM may only be contested by a preponderance of scientific medical evidence Requires that employers pay for up to \$10,000 worth of medical treatment while determining whether to accept or deny a claim Allows employers to establish Medical Provider Networks (MPN) for the treatment of injured workers Provides injured workers in MPNs the right to 2nd and 3rd medical opinions and Independent Medical Review for disputed diagnosis and treatment Generally limits occupational therapy to 24 visits 	<ul style="list-style-type: none"> Caps TD payments at 104 weeks within 2 years of first TD payment, with some exceptions <i>NOTE: AB 338 (Coto) 2007 extends timeframe from 2 years of first TD payment to 5 years from date of injury</i> 	<ul style="list-style-type: none"> Repeals use of work restrictions for determining PD awards Requires the use of AMA guides for determining physical impairment Requires Administrative Director to create a new Permanent Disability Rating System by 1/1/05, which must include modifiers for age, occupation and loss of future earning capacity Increases scheduled number of weeks from 9 to 16 for PD ratings above 70%; reduces scheduled number of weeks by 1 for PD ratings below 15% Increases PD award by 15% if there is no offer to return to modified work; decreases PD award by 15% if there is an offer to return to modified work Requires that employer is only liable for the permanent disability caused by work-related injury 	

Endnotes

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- ¹⁸ *Summary of Insurer Experience September 30, 2010*, Workers' Compensation Insurance Rating Bureau
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- ²³ The Cost and Utilization of Compound Drugs, Convenience Packs and Medical Foods in California WC, California Workers' Compensation Institute, August 2010
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