DRAFT PREPARED FOR SEPT. 23, 2016 POUND INSTITUTE/RUTGERS/NORTHEASTERN SYMPOSIUM,
"THE DEMISE OF THE GRAND BARGAIN: COMPENSATION FOR INJURED WORKERS IN THE 21ST CENTURY."
FINAL PAPER TO APPEAR IN 69 RUTGERS U. L. REV. (FORTHCOMING MAY 2017).

Comments by John Burton
September 13, 2016

Workers' Compensation at a Crossroads: Back to the Future or Back to the Drawing Board?

Alison Morantz
August 30, 2016 draft

I. Introduction

The article is a wonderful addition to the literature on workers' compensation. Morantz has provided an insightful summary of the research in recent decades on both the U.S. and other countries' prevention and disability programs, has provided a taxonomy for analyzing the research, and has identified policy issues that deserve to be resolved if the workers' compensation program is to be an important contributor to prevention, compensation and rehabilitation.

My comments fall into two general topics: (1) who are the crucial participants in the workers' compensation delivery system who are not included in Morantz's analysis? and (2) what are important parts of the research literature that should be added to her compendium of relevant results?

II. Other Significant Participants in the Workers' Compensation System

Morantz indicates that the efficacy of the workers' compensation system depends primarily of the efficacy of four critical stakeholders: workers, employers, doctors, and insurers. I believe the effectiveness of the system depends on three additional participants: unions, workers' compensation agencies, and lawyers.

A. Trade Unions

Morantz notes that unionized workers are more likely to receive risk premiums in their wages and more likely to receive workers' compensation benefits if they are injured than are unorganized workers. These are contributions of unions to the operation of the workers' compensation delivery system at the micro level, which counteract employer and insurer action at the individual worker or firm level. But employers and insurers also have a major effect on the operation of the workers' compensation program by their political activity at the state or federal level. In some countries, workers have representation in the political process though injured worker organization, but in the U.S. the representation has largely been provided by unions. From the standpoint of workers, the deleterious developments in the workers' compensation program in recent decades has in part been due to the decline in the union movement. In some states, unions are no longer effective participants in the legislative battles over workers' compensation, and at the national level, the AFL-CIO no longer has a staff members devoted to workers' compensation.

B. Workers' Compensation Agencies

Each state has a workers' compensation agency that is part of the workers' compensation delivery system. (The functions performed by state workers' compensation agencies must be distinguished from the functions performed by the government unit that operates the insurance fund in those states with competitive or exclusive state workers' compensation insurance funds.[1])

Berkowitz and Burton (1987, Chapter 4) as summarized in Burton and Berkowitz (1989) identified four administrative functions for a workers' compensation agency. The **record keeping function,** which is present in all agencies to some extent, begins with a first report of the injury to the agency, which is followed by subsequent reports on the case and by information on the eventual disposition of the case.

Some states go further and also perform the **monitoring function**. This function involves procedures for checking on the performance of carriers, employers, and others in the delivery system. It also encompasses providing advice or sterner strictures if the performances of employers or carriers falls short of standards established by the agency.[2]

Another group of agency procedures has to do with the **evaluation** of individual workers, particularly if the worker has a permanent disability. In a few states, the agency takes on the responsibility for determining the extent of permanent disability. In most states, the agencies do almost nothing in the area; the parties reach an agreement which the agency rubber-stamps. Or the parties resort to the contested procedure.

The fourth function is **adjudication**, which is initially undertaken in almost all states (perhaps all states by now) by the workers' compensation agency as opposed to a state court. (In all states, appeals from the workers' compensation agency are heard by the state courts.)

Burton and Berkowitz (1989, 7) argued that:

> An active state workers' compensation agency – an agency that concentrates on record keeping, monitoring, and evaluation --- is the key to an efficient delivery system. . . . [Nonetheless] the emphasis in most state workers' compensation agencies is on adjudication, not on the other administrative functions, such as monitoring and evaluation. Many state

[1] For example, the workers' compensation agency adjudicates disputes between workers and carriers, including state workers' compensation funds, while the state fund collects premiums and pays benefits. In states with exclusive state workers' compensation funds, these "agency functions" and "state insurance fund functions" may be performed by different units within a single government entity.

[2] Burton and Berkowitz (1989, 5-7) indicate that monitoring can be conducted on three levels: (1) **micro-monitoring** (examining individual cases), (2) **macro-monitoring** (looking at a pattern of cases to determine the quality of the performance of carriers, medical providers, or whoever else is charged with providing benefits and services), and (3) **program monitoring** (examining agency or system performance and making recommendations to the legislature for possible changes).

> agencies fell into this role of being an adjudicatory body by default. When state workers' compensation laws were first enacted, the prevalent view was that the programs would be largely self-administering, since benefit amounts and durations were specified in the statutes.
>
> Unfortunately, in practice workers' compensation proved to be a complex program that required numerous controversial decisions. A substantial delivery system was needed to make these decisions, and essentially state had to choose between two types of delivery systems.
>
> One choice for the delivery system allowed the private parties to work out their own arrangements for the administration of the act. State agencies largely acted as quasi-courts to adjudicate those disputes the parties could not resolve by negotiations. This approach was taken in most states.
>
> The alternative type of delivery system turned to the state workers' compensation agency to fill the emerging need for administration; the state agency pursued the record-keeping, monitoring, and evaluation roles. This approach was chosen in only a few states, of which Wisconsin is probably the best example.
>
> The delivery system that makes the workers' compensation agency primarily a quasi-court was chosen in most states for a mixture of reasons. . .. Still another important reason why the passive workers' compensation agency approach was chosen is that efficiency is often equated with a small budget for the workers' compensation agency. State legislators often act as if the expenditures for running a state agency are the only relevant cost of the delivery system. They apparently fail to recognize that by holding down agency budgets they provide a strong incentive for the litigation-based approach to a delivery system. This is a myopic view of efficiency, because what is often not appreciate is that a low-cost agency is not cheap when the total administrative costs of the delivery system are considered.

I would like to report that the *Paean to an Active Workers' Compensation Agency* written some 25 years ago has resulted in progress in state workers' compensation agencies. Unfortunately, states appear to have increasing endorsed hyper-myopic efficiency in their support of state agencies: is there even one state that could now be held out as relying on an active state agency? This topic deserves more attention because in my view the overall quality of the state's workers' compensation program depends more on the performance of the workers' compensation agency than on the type of insurance arrangements available in the state.

C. Attorneys

The most surprising omission from Alison Morantz's list of crucial stakeholders in the workers' compensation system is attorneys, and in particular applicants' attorneys. One consequence of the adoption of the passive workers' compensation agency model by

most states is that workers almost invariably need an attorney to represent their interests when claims are filed that involve moderate or serious injuries. Insurers or employers who self-insure and rely on third-party administrators have their interests protected by claims adjusters. Workers generally need attorneys to protect their interests.

The crucial role of applicants' attorneys is illustrated by the effort to regulate applicants' attorneys' fees in the Florida workers' compensation program. The Florida workers' compensation statute was amended in 2003 to include an attorney's fee schedule that substantially reduced fees in many cases. In *Murray v. Mariner Health*, 994 So. 2d 1051 (Fla. 2008) the Florida Supreme Court upheld the legislation because it permitted a claimant to receive a reasonable attorney's fee even when that amount exceeded the statutory attorney's fee schedule. In response to the Murray decision, in 2009 the Legislature removed any ambiguity about its intent by removing the word "reasonable" in relation to applicants' attorneys' fee. The Florida Supreme Court responded in Castellanos v. Next Door. Co., __ So. 3d __ (Fla. 2016), by concluding

> that the mandatory fee schedule in section 440.34, which creates an irrebuttable presumption that precludes any consideration of whether the fee award is reasonable to compensate the attorney, is unconstitutional under both the Florida and United States Constitutions as a violation of due process.

The apparent reason for the Florida limitation on applicant attorneys' fees is the assumption that attorney involvement increases the amount of benefits paid to injured workers. But this assumption needs to be used with care. Casual inspection of workers' compensation data reveals that cash benefits tend to be higher in cases in which attorneys are involved, and there is a natural tendency to assume that attorneys are therefore responsible for the higher benefits. However, this assumption overlooks the likelihood that more serious injuries both result in higher benefits and attract lawyers, which means that the lawyers' involvement may not be a source of the higher benefits.

Thomason and Burton (1993) is one of the few studies that has examined the effect of attorney involvement on the amounts of workers' compensation benefits. The authors examined the payment of permanent partial disability (PPD) benefits in New York to workers with non-scheduled injuries (mainly back cases), which at the time were the only category of benefits in the state for which lump sum payments (equivalent to compromise and release (C&R) agreements) could be made. The study found that the involvement of applicants' attorneys increased the probability of lump-sum settlements, reduced the amount of those settlements compared to the settlements received by workers with equivalent injures who did not rely on attorneys, and had no statistically effect of the awards in litigated cases. The authors reached this conclusion:

> As predicted, retention of legal counsel increases the probability of settlements and decreases settlement size, indicating that claimant attorneys are acting contrary to their clients' interests. Specifically, attorneys appear to undervalue the claim, inducing claimants to accept smaller settlements.

Burton (1993, 22) added this commentary to the results:

> Unfortunately, these results are not surprising, given the method used to determine claimants' attorneys fees in New York (and in most jurisdictions), namely a contingency fee system with the amount of the fee tied to the size of the lump-sum settlement.
>
> Suppose we were to use a system for compensating attorneys that tied the amount of the fee to the degree of success in reemploying the workers after the work injury. Or suppose we were to pay attorneys who negotiate lump-sum settlements (or more generally, C&R agreements) as if the benefits were being paid on continuing basis. These fee systems would likely lead to drastic changes in the behavior of attorneys and in the operation of workers' compensation programs.

Here are three suggestions for the research agenda: First, recognize that attorneys are crucial participants in the workers' compensation system. Second, develop an analytical framework that spells out the incentives for applicant and defense attorneys, similar to the set of incentives or moral hazards discussed by Morantz that are currently used to analyze the behavior of workers, employers, and carriers. One interesting incentive issue concerns the consequences of shifting applicants' attorneys' fees to employers or carriers) when the fees are the consequence of unwarranted delays in payment or frivolous denials of liability.[3] Third, conduct more empirical studies of the effects of various methods of compensating applicant and defense attorneys.

III. Other Observations: Insurance Arrangements

Morantz begins her discussion of Insurer Incentives by indicating that

> The incentives of the insurer depend, first and foremost, on the nature of the insurance market and whether the insurer is public or private. For the private insurer in a competitive market, the overriding incentive is to maximize profits by using national, regional, and company-specific information to correctly predict future workers' compensations costs.

I am not sure what the phrase "in a competitive market" means. The rest of the sentence spelling out "the overriding incentive is to maximize profits" appears to be applicable to private carriers in all states (except those that have exclusive state workers' compensation funds). But there is another meaning of a competitive market that does not seem to be what Morantz had in mind and that represents the most significant change in the delivery system for workers' compensation benefits in the last 35 years.

[3] I was surprised in recent conversations by the importance that Florida applicants' attorneys place on fee shifting as a remedy for inappropriate delays and denials in the state's workers' compensation program.

Three types of regulatory arrangements are used for workers' compensation insurance in the U.S. (Thomason, Schmidle, and Burton 2001a, 38-45).[4] The first category is *pure administered pricing*, in which a rating bureau develops manual rates for a detailed set of occupational and industrial insurance classifications. Manual rates are based on pure premiums (loss costs based largely on previous benefit payments), which are increased by a loading factor, which consists of an allowance for loss adjustment and other expenses and for profits. The manual rates are approved by the state regulatory agency and must be adhered to by all insurance carriers. Individual employers may receive premium discounts, depending on the amount of their premiums, and may have their premiums adjusted by experience rating modifications, depending on the firm's previous experience. These modifying factors are approved by the insurance commissioner and must be adhered to by all carriers. Most carriers can pay dividends, but only after the expiration of the policy. In short, there is virtually no chance for carriers to compete in terms of the price of the insurance at the beginning of the policy.

A second type of regulatory arrangement involves *partial deregulation*, although there are several variants of partial deregulation. For example, some states allow deviations, in which individual carriers can deviate from the published manual rates by a specified percentage, sometimes limited to employers in particular insurance classes. Deviations are generally subject to the approval of the state insurance commissioner. Some states allow schedule rating plans, in which a carrier can adjust the premium changed to an individual policyholder based on subjective factors

A third type of regulatory arrangement is *comprehensive deregulation*, in which rating bureaus only publish loss costs (not manual rates) and insurers are permitted to set their own rates without first seeking approval of state regulators.

Prior to the 1980s, all states with private carriers relied on pure administrative pricing to regulate workers' compensation premiums. The changes in the regulatory environment since then have been tracked by the NCCI (2016 and earlier editions, Exhibit 2) with the date for each state when the "Competitive Rating Law Effective," which is a term broad enough to include both comprehensive deregulation and partial deregulation. Arkansas adopted a competitive rating law in 1981, followed by 33 other jurisdictions by 1995. As of 2016, there are 38 jurisdictions (including the District of Columbia) in which a competitive rating law is effective, nine states with private carriers that still rely on administered pricing, and four states with exclusive state funds.

Thomason, Schmidle, and Burton (2001a and 2001b) examined the effects of deregulation relying on state-level data from 1975 to 1995 which is the period when most states deregulated their workers' compensation insurance markets. We found that most forms of partial deregulation were associated with higher costs for employers. However, we found that comprehensive deregulation – loss costs systems that do not require prior approval of each carrier's rates – was associated with about an 11 percent reduction in

[4] A brief article summarizing the book is Thomason, Schmidle, and Burton (2001b)

the employers' costs of workers' compensation insurance after controlling for other factors that affect the costs.

BIBLOGRAPHY

Berkowitz, Monroe and John F. Burton Jr. 1987. Permanent Disability Benefits in Workers' Compensation. Kalamazoo, MI: W.E. Upjohn Institute for Employment Relations.

Burton, John F. Jr. and Monroe Berkowitz. 1989. "Paean to an Active Workers' Compensation Agency." *Workers' Compensation Monitor*, Vol. 2, Number 7: 1-7, 22.

Burton, John F. Jr. 1993. "Digests of Important Publications: Economic Effects of Workers' Compensation in the Uni8ted States: Private Insurance and the Administration of Compensation Claims." *Workers' Compensation Monitor*, Vol. 6, No. 6: 21.

National Council on Compensation Insurance (NCCI). 2016. *Annual Statistical Bulletin*. Boca Raton, FL: National Council on Compensation Insurance.

Thomason, Terry and John F. Burton Jr. 1993. "Economic Effects of Workers' Compensation in the United States: Private Insurance and the Administration of Compensation Claims." The Journal of Labor Economics, Vol. 11, No. 1, Part 2: S1-S37.

Thomason, Terry, Timothy P. Schmidle, and John F. Burton Jr. 2001a. *Workers' Compensation: Benefits, Costs, and Safety under Alternative Insurance Arrangements*. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research.

_____. 2001b. "The Employers' Costs of Workers' Compensation under Alternative Insurance Arrangements." *Workers' Compensation Policy Review*, Vol. 1, Issue 2: 3-7. (Can be downloaded from www.workerscompresources.com)

[Burton Comments on Morantz V01]