



Options to Workers' Compensation: Public Policy Analysis



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I. Abstract

Executive Summary. For over 100 years, Texas has allowed most private employers the option of either purchasing workers' compensation insurance or developing their own system of injured employee care. Today, thirty-three percent of all Texas employers have exercised their Option or "nonsubscribe" from the state workers' compensation system. PartnerSource has 25 years of experience in designing, implementing, administering, and funding these Texas Option programs. This white paper focuses on public policies that have provided Texas the most successful occupational injury management system in the United States – a dual system represented by both traditional workers' compensation and an Option. Following a brief discussion of the need for Options to workers' compensation and the main components of the Texas Option, foundational public policies are examined. Then, this paper breaks new ground by detailing the size and superior performance of the Texas Option compared to Texas workers' compensation. Data is provided regarding fewer lost time claims, faster return to work, fewer claim denials, fewer disputed claims, savings on state government expense, and lower employer costs. These same public policies and claim results undergird the "Oklahoma Option" legislation that became effective in 2014 and are informing and advancing Option legislation now in Tennessee and other states.

This paper will not focus on Option program feasibility analysis, design, implementation or funding for a particular employer. This paper also will not provide a detailed analysis of negligence liability exposures or how to administer a nonsubscriber claim. Resources on those subjects are available upon request.

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Texas Option Fast Facts: (each addressed further herein)

1. **Better for Employees.** Employees receive more communication on their rights and responsibilities, and better medical outcomes. Wage replacement benefits are also frequently higher than under workers' compensation.
2. **Better for Employers.** Employers directly participate in the injury recovery process, resulting in higher employee morale, more productivity, and substantial cost savings.
3. **Substantial Claim Volume.** Approximately 50,000 Texas nonsubscriber Option injury claims are successfully resolved every year.
4. **Substantial Insurance Premium Volume.** A highly competitive Option insurance marketplace has generated well over \$1 billion in direct written premiums over the past decade.
5. **Large Number of Covered Employees.** Approximately 1.43 million Texas employees are covered by injury benefit plans (and many thousands more are covered by Oklahoma Option programs).
6. **Low and Shrinking Number of Non-Covered Employees.** Only 4.9% of Texas workers are not covered by either workers' compensation or an injury benefit plan. The number of non-covered workers in Texas shrank by 6% from 2012 to 2014 and is comparable to the percentage of non-covered workers in at least 10 other states.
7. **Claims Close Faster.** Three-quarters of Texas Option claims are closed by the end of the first year and over 99% are closed by the end of the second year.
8. **Higher Employee Satisfaction.** Employees appreciate the full disclosure of their rights and responsibilities under an Option injury benefit plan, and the customer service they receive. As a result, when compared to Texas workers' compensation, fewer Option claims are initially denied and far fewer claim denials are appealed or otherwise disputed.
9. **Private Industry Employment Base.** Approximately 1,000 Texas employees currently work in the private sector on nonsubscriber injury program development, administration and insurance.
10. **No State Regulatory Expense.** Texas budgeted \$35 million and 517 full-time equivalent positions to regulate the Texas workers' compensation system in fiscal year 2014. In contrast, zero state regulatory resources or expense have been needed to facilitate, oversee, or resolve many hundreds of thousands of nonsubscriber injury benefit claims over the past 25 years.
11. **Economic Development.** Competition created by the Option drives down workers' compensation insurance rates for all employers. The Texas Option has saved billions of dollars off of workers' compensation costs and helped Texas lead the nation in job creation.

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II. The Workers' Compensation-Industrial Complex

The economics and politics of workers' compensation have become super-sized and the methods by which we deliver injured worker care are outdated. In Texas, workers' compensation is at least a \$3 billion business enterprise.¹ Nationally, the figure is over \$70 billion. In addition to the further hundreds of millions of dollars in state regulatory resources dedicated to workers' compensation, there are innumerable service providers (claim administrators, medical providers, medical managers, lawyers, etc.) with multi-million dollar workers' compensation revenue streams who expend vast political capital to protect and grow their business.

To paraphrase Daniel Guérin's discussion of the military-industrial complex in his 1936 book *Fascism and Big Business*, workers' compensation is "an informal and changing coalition of groups with vested psychological, moral, and material interests in the continuous development and maintenance of high levels of [workers' compensation costs], in preservation of [market share] and strategic conceptions of [employee care]."

Similar to the military-industrial complex, workers' compensation systems rely on policy and monetary relationships between state legislators, regulators, system vendors/providers, and the employer base that supports them. These relationships include political contributions, political approval for agency spending, lobbying to support special interests, and oversight of the industry. It is an iron triangle of policy-making relationships among state legislative committees, bureaucracy, and interest groups. It is a network of contracts and flows of billions of dollars and resources among individuals as well as corporations, state agencies, and others.

Little has changed since the first workers' compensation laws were passed – in the Industrial Age – a time dominated by repetitive work performed by cheap labor with virtually no voice or legislative protections. The legitimate drive toward more employee protections through a workers' compensation system has now gone so far as to create a moral hazard in which injured employees often bear little of the consequences and responsibilities of their own actions.

This moral hazard is supported by information asymmetry, in which injured employees commonly have more information about their actions and intentions than the party paying the benefits, creating a tendency or incentive to behave inappropriately. Employers and insurance carriers are often unable to fully monitor the injured employee and, when learning of fraud or

¹ In calendar year 2008, employers paid \$2.5 billion in Texas workers' compensation premiums. "Costs to Employers and Efficiencies in the Texas Workers' Compensation System", Texas Department of Insurance Workers' Compensation Research and Evaluation Group (9/1/11) at http://www.tdi.texas.gov/reports/wcreg/documents/Employers_cost.pdf, report page 7. In calendar year 2012, approximately \$1.7 billion in Texas workers' compensation benefits were paid by insurance carriers and self-insured employers. "Workers' Compensation Benefits, Coverage, and Costs, 2012", August 2014, National Academy of Social Insurance, Table 8. Actual workers' compensation costs are much higher when you consider deductibles, administrative expenses, uninsured claims, and lost productivity.

similar behavior, have no (or severely limited) ability to terminate benefits. State workers' compensation agencies face tens of thousands of fraudulent claims, and must rely on their own or other government agencies (that may or may not be adequately funded or motivated) to prosecute fraud cases.²

Certain, very well-established workers' compensation structures also reduce total social wealth by spending resources with no new wealth created. For example, many medical management and billing practices extract value without making any contribution to improved medical outcomes or productivity.

III. Nonsubscription Fits Realities of Today

Although workers' compensation is regularly referred to as a key pillar of American social justice, here's an important point to remember: **There is no perfect, heavenly-ordained state workers' compensation system!** Every state in the U.S. has its own locally-developed labyrinth of "employee protections" that have been patched together and continue to independently morph from an Industrial Age model transported from Europe to U.S. shores in the early 1900's. In 1913, Texas joined a handful of other states in passing a workers' compensation law to replace the cumbersome common law system in which an injured worker sued the employer directly in state or federal court and often waited a long time for a jury trial. Workers' compensation represents a "Grand Bargain" that generally requires workers to give up the right to sue the employer and demand a jury trial in exchange for a state-sponsored schedule of benefits that are paid without regard to fault of either the worker or employer. In 1917, the U.S. Supreme Court approved the Grand Bargain as long as the benefits provided by a state-run workers' compensation system are "reasonable" and "significant."³

There are variations among all 50 state systems, each of which was created by well-intentioned, but far from divine human beings. These systems imperfectly provide varying levels of benefit coverage and are in a perpetual state of "reform". Regardless of which state's workers' compensation system is at issue, primary opponents to material change are routinely a few workers' compensation insurance carriers, a small group of medical providers, and a large group of trial attorneys (members of the plaintiff and defense bars), all of whom seem to believe their interests as "stakeholders" are equivalent to those of injured employees and the

² Out of over 1,800 reports of workers' compensation fraud in fiscal year 2014, the Texas Department of Insurance (with three employees dedicated to workers' compensation investigations) made only one workers' compensation fraud prosecution. WorkCompCentral article 12/31/14 –

https://ww3.workcompcentral.com/news/story/save_this/true/id/12cd8aa4160f8d03351d82d923b7c602627bd82f. ("TDI Fraud Unit Looks to Step Up Prosecution of Referrals"). TDI's operating budget for workers' compensation fraud was \$360,953 for fiscal year 2014. TDI's webpage on "Fraud in the Workers' Compensation System" has not been updated in almost 20 years. <http://www.tdi.texas.gov/reports/wcreg/fraud.html>

³ The adequacy of workers' compensation system benefits and limitations on this "exclusive remedy" protection for employers are currently being litigated in several states – a topic beyond the scope of this paper.

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employers who ultimately pay all system costs. For example, these groups have focused substantial resources on blatantly misrepresenting the benefit adequacy and administrative process for Texas nonsubscription. They work hard to generate fear among small business owners, good medical providers, insurance agents and state legislators, without pursuing either research or dialogue that would lead to a greater understanding and advancement of a further-improved system. What this odd insurance carrier/provider/attorney alliance most fears is losing tens (and, in some states, hundreds) of millions of dollars annually in their own profits, as they work to politically prop up contentious and economically-debilitating workers' compensation systems across the United States that are more expensive than and do not achieve outcomes as good as Texas nonsubscription.

In the midst of such immense economic power and systemic challenges, the Texas Legislature continues to authorize and support an alternative to the traditional workers' compensation system. Texas nonsubscription recognizes that we are no longer in the Industrial Age. For example:

- A. Employers recognize employees as their best asset and strive to be recognized as a "Best Place to Work";
- B. Employers want choices, not anti-competitive, big-government, expensive programs;
- C. Companies and individuals now have technological capabilities to access, gather, and utilize large amounts of data on their own; and
- D. There are many other state and federal laws (particularly those developed over the past 45 years, like the Occupational Safety and Health Act, the Americans With Disabilities Act, the Family and Medical Leave Act, and the Employee Retirement Income Security Act – "ERISA") that require substantial employee communications and protections against unsafe work environments, wrongful benefit denial, discrimination and employment termination.

We are also in a time when state governments are unable to continue increasing expenses and hiring more employees to oversee inefficient (and often, marginally effective) workers' compensation systems. Now, more than ever, state legislatures and citizens are in need of relief from unnecessary regulatory expense that should be re-channeled into transportation, education, water infrastructure and other priorities that more directly advance society's interests and deliver a return on investment.

The methods by which we achieve injured worker protection should reflect these modern day facts. The time has also come to reconfirm whose interests we are trying to protect and how to do so at the lowest economic and social costs.

Texas nonsubscriber Option has entirely re-imagined occupational injury care, just as virtually every other aspect of human culture and interaction has dramatically changed over the past hundred years. In the national aggregate, a workers' compensation-industrial complex exists that should be re-imagined. The Texas Option is, by no means perfect; but it does refocus attention on the two key parties (injured workers and employers) and does not require slow, expensive, and perpetual legislative and bureaucratic "reforms". We need not be guardians of the status quo.

IV. Brief Overview of Texas Option

By electing to leave or not join the Texas workers' compensation system, an employer rejects workers' compensation system networks, benefits, forms, processes, etc., and replaces them with its own injury benefit program. The general premise is that an employer can and typically will take better care of injured workers, at a lower cost, in a free-market system than in a hyper-regulated, government-centric program. ***The Option creates broad, free-market competition with workers' compensation insurance markets, within a simple statutory framework of employee protections.***

A. A New Grand Bargain.

1. Grand Bargain of Workers' Compensation. As noted above, workers' compensation systems in the United States are all premised on the "Grand Bargain" between employers and employees. In simple terms, employees received the certainty of eligibility for specific forms of injury benefits; and employers received statutory dollar and duration limitations on such benefit payments, and are generally relieved from liability exposure for any negligence that may have caused the injury. Workers' compensation was intended to be a relatively simple program of benefit protection for employees and liability protection for employers. Specialized state regulatory agencies were established to efficiently oversee this delivery of social justice.

However, today, few people seem happy with what this "bargain" has morphed into. Here's a small sampling of recent commentaries from across the United States:

Workers' compensation is a system that has been emasculated by reform to the point of almost complete extinction. So much change has occurred in the workplace and occupational medicine over the last century that the system has not adapted but instead mutated into an ineffective program that fails to meet the intention of its crafters. From a summary and remedial system that was providing social insurance to its beneficiaries, it has turned into a system of delay and denials. – Jon L. Gelman, Esq. (workers' compensation blog 10/13/14).

I will say that this news will be, for many, unexpected as Wisconsin hasn't exactly been the bastion of controversy in the workers' compensation arena of late. There are many other jurisdictions where needed reforms are more apparent – like California where reforming comp is seemingly a full time and permanent position. The cycle of reform, however, seems almost unavoidable, and as other states grappling with recent reforms continue to wrangle over the changes, it is inevitable that another must begin the process anew. Where the dust settles in one region, it must stir again in another. – Bob Wilson (“The Cold Winds of Workers' Comp Reform Are Blowing in Wisconsin” – Bob's Cluttered Desk Blog 1/23/15)

There are some in our community who argue that the only thing that matters is that the employer get good value for the insurance they purchase. There are others that say that the injured worker is the only one that matters because the safety net of work comp was established for those people. There are plenty amongst us that say neither part of the deal is working any longer, that government hasn't done a good job of ensuring the viability and ongoing relevancy of workers' compensation....Is workers' compensation still relevant? Yes, I believe it is. But I also believe that 100 years of competition has stifled innovation. – David DePaolo (“Work Comp and Monopoly Profits” – WorkCompCentral 9/15/14).

Concerns have also been raised that the non-stop “reforms” of workers' compensation systems in virtually every state have so reduced injury benefits that the employer should no longer be entitled to lawsuit immunity;⁴ while others express concerns that more holes are developing in the employer's exclusive remedy protection.⁵

- 2. Grand Bargain of the Texas Option.** Texas nonsubscription relies upon a different (but equally grand) bargain. All benefit payments by nonsubscribing employers to injured workers are voluntarily made. This benefits model is coupled with unlimited employer liability for negligence claims and a loss of certain common law defenses.⁶ Nonsubscribers lose the “exclusive remedy” protection that allows subscribers to pay injury benefits with no negligence liability exposure on virtually all claims. This nonsubscriber liability exposure compels nonsubscribing employers to more strongly focus on workplace safety and to voluntarily implement written injury benefit plans to care for the vast majority of their injured workers. Both steps protect their most

⁴ See, e.g., Florida Workers' Advocates and Workers Injury Law and Advocacy Group and Elsa Padgett v. State of Florida, Office of the Attorney General, Case Number 11-13661 (11th Circuit Court in Miami-Dade County, Florida).

⁵ See, e.g., “The Exclusive Remedy” by John D'Alusio at <http://www.workerscompensation.com/compnewsnetwork/workers-comp-blogwire/15453-the-wc-exclusive-remedy.html> (10/30/2012).

⁶ See below under “Simple, Self-Executing State and Federal Laws”. A complete description of nonsubscriber negligence and other liability exposures and defenses is beyond the scope of this paper.

valuable asset (workers) and minimize the risk of employee lawsuits. The risk of litigation is real, with PartnerSource data through January 2015 reflecting 84 nonsubscriber settlements or judgments of \$1 million or more. And the delivery of benefits is real. Only 4.9% of Texas workers are not covered by either workers' compensation or a nonsubscriber benefit plan.⁷ This figure is comparable to the percentage of non-covered workers in at least 10 other states.⁸ From 2012 to 2014, DWC reports that the number of non-covered workers in Texas shrank by 6%,⁹ which reflects increasing awareness of the need for nonsubscribers to formally adopt an injury benefit plan.

B. Main Components. The primary components of an Option to workers' compensation are:

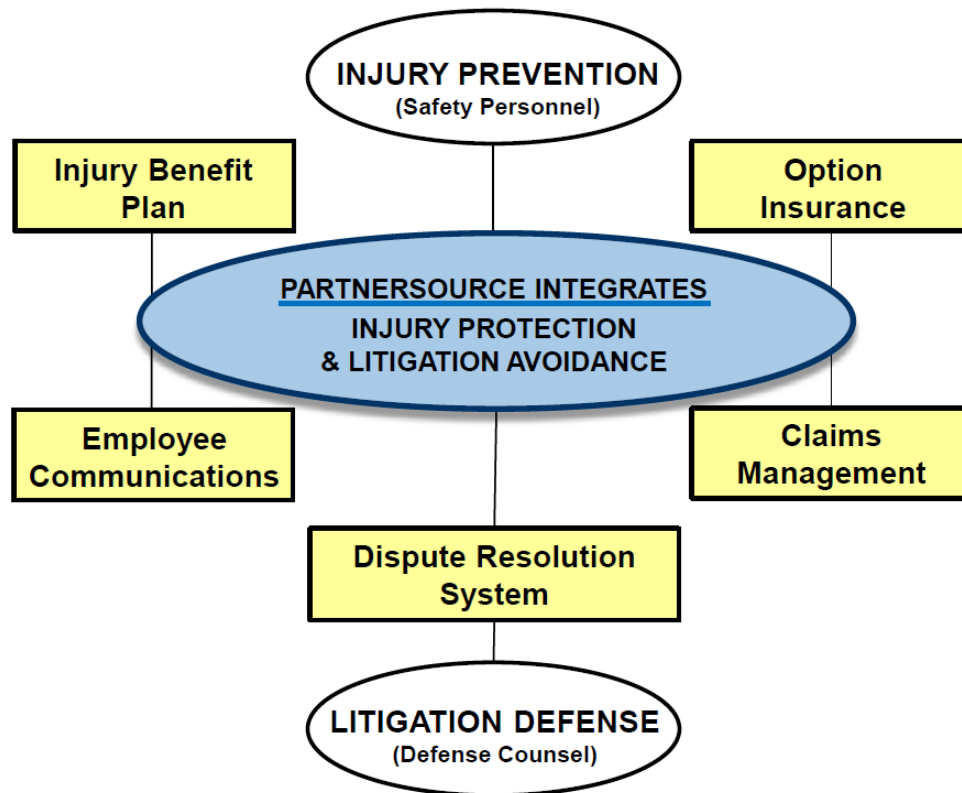
1. **Injury Prevention** with quality safety programs, training and equipment.
2. **Injury Benefit Plan** that describes employer and employee rights and responsibilities for injury benefit payments.
3. **Employee Communication** to current employees and new hires, in language they understand and appreciate.
4. **Dispute Resolution** for injury benefit and negligence liability disputes.
5. **Claims Management**, including a process for notice of injuries, determining compensability, medical management, claims payment, and dispute resolution.
6. **Insurance** available for payment of injury benefit and negligence liability claims and defense costs above a deductible or self-insured retention amount.

⁷ Texas Department of Insurance ("TDI"), Division of Workers' Compensation ("DWC") Biennial Report to the 84th Legislature, December 2014 ("2014 DWC Biennial Report"), at <http://www.tdi.texas.gov/reports/dwc/documents/2014dwcbiennialrpt.pdf>, page 12. See also below under "Low and Shrinking Number of Non-Covered Workers".

⁸ August 2014 report on "Workers' Compensation: Benefits, Coverage, and Costs, 2012", published by the National Academy of Social Insurance in Washington, D.C. (<http://www.nasi.org/research/2014/report-workers-compensation-benefits-coverage-costs-2012> - Table A).

⁹ 2014 Survey of Employer Participation in the Texas Workers' Compensation System, Texas Department of Insurance Workers' Compensation Research and Evaluation Group ("2014 DWC Nonsubscriber Survey"), slides 7 and 22, at <http://www.tdi.texas.gov/reports/wcreg/documents/nonsub.pdf>.

Components of the Option



C. **Benefits Commonly Paid.** An employer electing the Option has virtually complete control over the design of an injury benefit plan, which will be the roadmap for taking care of injured employees. From lessons learned and reinforced over 25 years, we know the injury benefit plan must be designed in a way that ensures the interests of the injured employee are first and foremost. To do otherwise invites unnecessary and expensive litigation over negligence liability. The injury benefit plan must provide a level of benefits that is appropriate to fully address the vast majority (if not all) of the medical, wage replacement, and other financial needs of every injured worker. For example, Texas nonsubscriber benefit plans almost always provide: ¹⁰

- a. Coverage for injury by accident, occupational disease and cumulative trauma,
- b. Medical benefits,
- c. Wage replacement benefits,

¹⁰ 2014 DWC Nonsubscriber Survey at <http://www.tdi.texas.gov/reports/wcreg/documents/nonsub.pdf>, slides 21-35, indicates that, among nonsubscribers that pay occupational injury benefits, varying percentages of employers pay medical, wage replacement, death, dismemberment and other forms of benefits. The DWC survey methodology, terminology used, and results are significantly inconsistent with actual nonsubscriber industry practices. A complete review of the 2014 DWC Nonsubscriber Survey and more information on nonsubscriber employer and insurance industry practices are available, but beyond the scope of this paper.

- d. Death benefits, and
- e. Dismemberment benefits.

Samples of nonsubscriber injury benefit plans can be found on the internet, in public litigation records, and are freely available by law to any covered worker.¹¹

Nonsubscribers generally pay higher wage replacement benefits than Texas workers' compensation. For example:

- a. Starting temporary disability benefits on the first scheduled day of work missed due to an on-the-job injury – instead of the seven-day waiting period under workers' compensation that requires injured employees to either go without pay or use their vacation or sick pay to make up the gap in coverage);
- b. Paying a higher percentage of wage replacement – typically, between 85% and 100%, which should approximate or exceed workers' compensation after taxes and adjustments in personal expenses are considered; and
- c. No maximum per week limit on such benefits – instead of the workers' compensation cost-containment feature that simply cuts back benefits on the employer's most senior and/or valuable, high wage-earners.

These improvements in wage replacement benefits are meaningful on virtually every lost-time claim.

This generosity in wage replacement benefits is supported by the requirement for immediate injury reporting (by the end of the work shift or next day – subject to a good cause exception), in contrast to a 30-day window for injury reporting under Texas workers' compensation.¹²

The promise and payment of substantial medical, wage replacement, death and dismemberment benefits represent a strategy that is most likely to accomplish the employer's dual goals of (1) paying great benefits for the injured worker or surviving family members, and (2) containing negligence liability and defense costs on the claim. Benefit dollar and duration limits are typically set at levels adequate to fully compensate at least 99.9% of historic Texas workers' compensation claims, but also permit administrative closure on any catastrophic benefit claim at a reasonable level from which further legal liability settlement payments can be discussed.

Nonsubscribers definitely should pay for permanent bodily harm to workers injured in the course and scope of employment. However, very few injury claims require long-duration or

¹¹ For example, go to http://www.combinedgroup.com/images/stories/nac_erisaplan2014.pdf and <http://nonsub.servicelloyds.com/documents/employers/employer%20sic%20erisa%20plan%20final%200608.pdf> for sample nonsubscriber insurance carrier ERISA plans and employee communications.

¹² Texas Labor Code section 409.001.

permanency payments when the worker provides immediate notice of injury and receives persistent care from the best medical providers. In spite of workers' compensation systems routinely paying out permanency awards, twenty-five years of Texas nonsubscriber data proves that the need for such payments is much more rare.

Whether for the sake of delivering outstanding benefits to a cooperative employee or for defense strategy reasons with an uncooperative employee, additional payments are frequently made on claims involving permanent bodily damage, pain and suffering, or other harm that is not covered by the benefit plan. Such discussions routinely occur on virtually all catastrophic claims, demonstrating how a balance of injury benefits and liability exposures deliver good results on even the most difficult claims.¹³ Nonsubscribers generally make no injury claim payments outside the written terms of their injury benefit plan without first obtaining a release of liability, which results in faster claim closure to the satisfaction of all parties.¹⁴

Most employers enter into the Option in dialogue with their property and casualty insurance broker, with an understanding that they must adopt, follow and enforce the benefit plan rules. These rules are agreed to between the employer and the employer's Option insurance carrier, then communicated to all employees. Adopting an approved benefit plan and employee communication strategy, and using an approved, professional claims administrator, are mandatory conditions of coverage for Option insurance programs. When coupled with ERISA's disclosure, fiduciary, claim procedure and enforcement rules, these are important checks on any potential employer mischief.¹⁵

D. Medical Management and Litigation Management Models. There are substantial variances among nonsubscriber programs in their design, administration and results. Most do not utilize all of the tools available to achieve the best medical or financial outcomes, but still substantially outperform workers' compensation on both fronts.

Some nonsubscribing employers combine in-house or third party administrator resources with a physician medical director who supports the "True Medical Management" processes described below in "The Foundations of Nonsubscription's Success". Such a medical director helps select and support the most qualified and appropriate specialist providers, but does not serve as a treating provider. Nonsubscribers can also utilize a legal consultant/attorney who can negotiate settlements and provide claim management

¹³ A February 2015 review by Providence Risk & Insurance Services of 155,935 Texas nonsubscriber Option claims shows that only 6 claims had medical incurred (paid + reserves) of \$300,000 or greater; and only 19 claims had total benefits and liability incurred (paid + reserves) over \$750,000. Of those 19 large claims, 18 were resolved through litigation or settlement payments, and only one remains open and in litigation.

¹⁴ See for further discussion, see "Benefits and Liability in Balance" under Section VI., "Foundations of Texas Option Success".

¹⁵ See "Competitive Insurance Markets" regarding insurance carrier approvals of Option benefit plans; and "Employee Protections Supplied by ERISA". Both are subsections under Section VI, "The Foundations of Texas Option Success".

support to defense litigation counsel, but not serve as defense counsel. This medical management model and litigation management model can achieve superior outcomes for injured workers and employers.

V. Option Market Overview

- A. Which Employers Elect the Texas Option?** Primary industries with large concentrations of nonsubscribing employers include retail, healthcare, food service, hospitality, manufacturing, and transportation. But nonsubscribing employers are found in virtually every business segment. Nonsubscribers range in size from one to over 100,000 Texas employees. An overwhelming majority of nonsubscribers have fewer than 50 employees; but over a dozen nonsubscribers have more than 10,000 Texas employees, and over two dozen nonsubscribers are Fortune 500 companies. These are companies we all do business with every day – well-known and respected, many of whom have been recognized as “Best Places to Work”. Texas nonsubscription is accepted (locally and nationally) as a conventional business practice that is good for injured workers and employers.
- B. Low and Shrinking Number of Non-Covered Workers.** DWC’s 2014 Biennial Report to the Legislature estimated that about 5% of the state’s private-sector employees – or 470,000 workers – have no occupational injury coverage.¹⁶ DWC also reports that there are 9,600,000 total Texas workers,¹⁷ so the true percentage (relying solely on DWC’s reports) is 4.9% of Texas workers are not covered by workers’ compensation or a nonsubscriber injury benefit plan. That means 95.1% of all Texas workers are covered by workers’ compensation or a nonsubscriber injury benefit plan. This is consistent with data from the National Academy of Social Insurance.¹⁸

Texas has enjoyed dramatic population increases¹⁹ and DWC states that the percentage of Texas workers employed by nonsubscribers increased from 19% in 2012 to 20% in 2014. For this same two-year period, DWC reports that the number of non-covered workers shrank by 6% from 500,000 to 470,000. This suggests that more and more nonsubscribers are implementing alternative benefit programs.

¹⁶ 2014 DWC Biennial Report, page 12.

¹⁷ 2014 Survey of Employer Participation in the Texas Workers’ Compensation System, Texas Department of Insurance Workers’ Compensation Research and Evaluation Group at <http://www.tdi.texas.gov/reports/wcreg/documents/nonsub.pdf>. See slide 22 (7.7 million employees of subscribers plus 1.9 million employees of nonsubscribers).

¹⁸ August 2014 report on “Workers’ Compensation: Benefits, Coverage, and Costs, 2012”, published by the National Academy of Social Insurance in Washington, D.C. (“2014 National Academy Report”) at <http://www.nasi.org/research/2014/report-workers-compensation-benefits-coverage-costs-2012> - Table A.

¹⁹ Texas population has more than doubled to over 25 million people in the past 40 years.

Consideration must also be given to the fact that many small business owners will self-fund medical bills and wage replacement for injured workers without any formalized benefit plan or insurance. Furthermore, 100% of Texas workers employed by nonsubscribers have the right to bring a lawsuit against their employer to recover damages for any negligence that caused an on-the-job injury.

The 2014 National Academy Report details employee coverage estimates and the U.S. Chamber of Commerce publishes a detailed guide to the many workers' compensation coverage exemptions found in all 50 states.²⁰ For example, workers' compensation systems commonly do not apply to farm and ranch employees, domestic and casual workers, employers with five or fewer employees, certain transportation employees, real estate brokers, etc. No workers' compensation system in the U.S. is mandatory for 100% of employees. Other states with approximately 3%-to-5% of their workers not covered by workers' compensation include Alabama, Arkansas, Florida, Mississippi, Missouri, New Mexico, North Carolina, Oklahoma, South Carolina, and Tennessee.²¹ Texas directly competes every day with many of these states for jobs.

- C. Option Insurance Markets and Coverage.** Employers that elect the Texas Option can fully or partially self-fund or insure injury benefits and negligence liability judgments, settlements and expenses related to an employee injury claim.²² Option employers commonly purchase insurance coverage to reimburse them to the extent such claim costs exceed a certain self-insured retention or deductible amount. Virtually any level of employer retained risk is available, and insurance coverage limits can be achieved up to tens of millions of dollars. Many employers also have their excess or umbrella insurance sit above an Option policy.

Many "A" rated, financially strong insurance companies presently offer insurance specifically tailored to the needs of Option employers. This is a highly competitive marketplace that generates well over \$100 million of annual premiums. Top-rated insurance carriers include ACE, Essex, Great American, North American Capacity, Safety National, Service Lloyd's, Scottsdale, and many others.

Such insurance policies provide coverage for a wide range of benefits in the event of a work-related accident, occupational disease, or cumulative trauma. Such benefits coverage commonly includes medical, disability, death and dismemberment. Coverage is also commonly written for employer's negligence liability or benefits liability settlements,

²⁰ See U.S. Chamber of Commerce 2013 Analysis of Workers' Compensation Laws, Chart II – Coverage of Laws.

²¹ See footnote 18.

²² See below regarding "Competitive Insurance Markets" under Section VI., "The Foundations of Texas Option Success".

judgments and defense costs in the event an injured employee threatens, files or succeeds in winning a lawsuit in state or federal court or arbitration.

Legal defense costs have commonly been treated like any other expense that an employer must pay to erode the policy's self-insured retention or deductible. However, to more closely control claims and in response to an increasingly competitive market, certain carriers offer payment of legal defense costs from first dollar in their policies. These "first dollar" defense coverage payments by the carrier do not erode the policy's self-insured retention or deductible. Such defense coverage is offered on either a "Duty to Defend" basis (with the carrier controlling all aspects of litigation) or a "Right to Defend" basis (with the insured employer controlling most aspects of litigation, subject to carrier approvals). The defense cost coverage feature may provide the insured employer broad (or complete) discretion on choice of defense counsel.

- D. Third Party Administrators and Other Service Providers.** There are many national and regional third party administrators that have dedicated, specialized resources for handling Option claims. National third party administrators include (among others) Broadspire, Corvel, ESIS, Gallagher Bassett, Sedgwick, and York/JI Companies. Regional third party administrators include (among others) Anchor Claims Management, Littleton Group, Providence Risk & Insurance Services, and 1-2-1 Claims. These TPAs are supported by dozens of other companies that provide medical provider networks, medical management and bill review services, claim investigation services, litigation management and defense, information services, software, and other products and services.

Unlike workers' compensation service providers that administer one-size-fits-all, state-mandated benefits, a nonsubscriber claim service company must provide service that is specific to each client's injury benefit plan. This can be done consistently across a large number of small employer plans that are standardized and managed by the insurance carrier's owned or contracted claims unit (such as the programs managed by Combined Group, Great American Insurance Company, and Midlands Management). Larger employers (generally, those with a self-insured retention at \$50,000 or higher, who receive insurance carrier approval) have more flexibility in benefit plan terms and may require a higher level of claim procedure customization and adjuster attention to unique benefit plan terms.

A specialized claim service unit must understand the importance of enforcing the benefit plan provisions and definitions in the context of evidence-based medical treatment guidelines and ERISA claim procedures. As part of their standard service, they must also be capable of providing a full liability investigation. Texas nonsubscriber liability exposures can be mitigated through benefit plan payments and other dispute resolution strategies. These

are unique claims with dual exposures (ERISA benefits and negligence liability) that demand dedicated claim resources in order to achieve consistent claim outcomes over time.

- E. **Private Sector Employment.** Over 1,000 Texas employees currently work in nonsubscriber injury program development, administration and insurance. They work for Texas employers, insurance carriers, TPA's and other service providers focused on the workers' compensation Option industry. This private sector service industry has reduced the size of Texas government, saving Texas taxpayers hundreds of millions of dollars that would otherwise be spent on an even larger workers' compensation administrative bureaucracy to oversee the more than 50,000 nonsubscriber injury claims that resolve each year in a free-market environment.

Some of these service providers have also been recognized as "Best Places to Work" by the Society for Human Resource Management and other respected associations and media. So, in addition to providing better medical outcomes to hundreds of thousands of injured Texas workers and substantial economic development created by the billions of dollars saved off of workers' compensation costs, the Option has created many quality jobs across the State of Texas.

VI. Foundations Of Texas Option Success

A. **A Simple Bottom Line.** This paper provides detail on many aspects of the Option to Texas workers' compensation. But at the end of the day, what makes any workers' compensation Option system work can be simply summarized as follows:

1. Employees come first,
2. Employers are more involved,
3. Insurance markets compete to deliver the lowest cost and broadest coverage,
4. Best practices in medical management,
5. Benefit mandates and liability exposures are in balance,
6. Simple, self-executing state and federal laws that support efficient dispute resolution and eliminate expensive government involvement, and
7. Faster claims closure.

Texas has proven that an injury management system with these features can generate dramatic cost savings and economic development.

B. **Employees Come First.** Examples of program features that are simple, logical, and focus on rebuilding a culture of paternalistic care and employee accountability include:

1. **Quality Benefits** for both minor and catastrophic injuries, comparable to and frequently greater than workers' compensation benefits.²³
2. **Faster Notice of Injury and Medical Care** through mandatory, immediate reporting of injuries, such as an injury benefit plan's 24-hour notice requirement for injury due to an accident (subject to a good cause exception). Contrast this with the 30 days allowed to report an accidental injury under Texas workers' compensation.²⁴ This shorter timeframe is entirely reasonable considering the fact that accidents are defined as events that the employee knows about and occur at a specific time and place. Extended timeframes are permitted for occupational disease and cumulative trauma. More prompt notice of injury results in better claim investigation and immediate remediation of unsafe working conditions or training issues that jeopardize co-workers. Faster notice of injury also results in faster medical care, which almost always results in better medical outcomes, including shorter periods of disability. This is a prime example of how many concepts of "employee protection" in the workers' compensation environment (allowing delayed notice of injury) twist logic and serve no purpose other than to relieve employees of accountability and open the door for legal disputes.

²³ See "Benefits Commonly Paid" under Section IV.C., "Brief Overview of Texas Option".

²⁴ Texas Labor Code section 409.001.

3. **Access to the Best Medical Providers.** Employers, third party administrators and insurance carriers can select medical providers based on quality of care, not pricing discounts. Injured employees gain access to some providers that will not accept workers' compensation claims due to the paperwork, reimbursement rates, and disputes common in workers' compensation.²⁵
4. **More Persistent Care.** Option employers commonly require first medical care following the report of injury to occur within a matter of weeks. The injury benefit plan may also specify that a claim will close if no medical care is received within a matter of months. These features incentivize and require more immediate and more persistent medical care, which in turn, results in better medical outcomes for injured workers. These benefit plan design features also help eliminate fraud and abuse by any injured employee who may seek to attribute a non-work-related condition to a prior report of injury. Contrast these requirements with the ability to seek medical care at any time up to one year following notice of a claim under Texas worker's compensation;²⁶ and the provision of open-ended medical coverage for life²⁷ – two features of Texas workers' compensation that are, purportedly, designed to protect the employee, but have the perverse effect of delaying care, resulting in worse medical outcomes, and inviting employee and medical provider fraud.
5. **Good Communication with Employees.** Employers cannot expect employee accountability to timely report injuries and appropriately seek medical care unless there has been good communication. And there is much more communication between the employer and injured worker under the Option than in the workers' compensation system. Option employers actively communicate benefit entitlements and injury claim administration processes as a means of re-building a culture of care and employee accountability.²⁸ Employees are continually reminded of the need to immediately report injury claims, and immediately and persistently obtain care from approved providers as a condition of benefit payments. Such communications, when properly done, have a very positive impact on employee morale.
6. **An Expectation and Incentive to Return to Work.** Return to work is required and wage replacement benefits cease upon release to full or modified duty. Approved medical providers are allowed to make all medical judgments, and there is no doctor shopping for a medical opinion that takes the employee off work. Such requirements hold the injured employee accountable for his or her actions.
 - a. **Disability Payments on Normal Payroll System.** This expectation of return to work and accountability to the employer are reinforced by Option employers paying disability benefits on the employers' normal payroll system. Whether the

²⁵ See "Best Practices in Medical Management" below.

²⁶ Texas Labor Code section 409.003.

²⁷ Texas Labor Code section 408.021.

²⁸ See information on communication requirements under "Employee Protections Supplied by ERISA".

injury benefit plan is insured or self-funded (or a combination of the two), employers can directly pay disability benefits so that (1) no payday is missed and normal payroll deductions are supported for a 401(k) or 403(b) savings and retirement plan, group health insurance, child support garnishments, union dues, etc.; (2) the employer's employee benefits, accounting, and tax remittance responsibilities are all simplified; and (3) the employee sees a disability check directly from the employer, creating direct accountability between the employer and employee for any time away from work. It is much easier for an injured employee to sit at home and ignore employer efforts to drive accountability and return-to-work when the employee is receiving disability checks directly from an insurance company.

7. **Safer Workplaces.** Employers who do not provide safe work environments and adequate care for workers jeopardize the most important asset of their business: their employees. They also pay higher insurance premiums and incur other increased costs to conduct business. These employers can also be held accountable by the U.S. Occupational Health and Safety Administration (OSHA). These facts remain true for employers that purchase workers' compensation or elect the Option. *But Texas nonsubscribers have an even greater incentive to create and maintain a safe workplace due to the negligence liability exposure that comes with the decision to not subscribe.* Many employers that have elected the Option to not subscribe from Texas workers' compensation over the past 25 years have invested heavily in and substantially improved their safety programs in conjunction with leaving the state system, and do so on an ongoing basis, in part, because of this liability exposure.
8. **ERISA Protections,** described in Section VI. G. below.

C. **Employer Involvement.** The workers' compensation system almost entirely sidelines the employer, leaving them with no involvement in program design or claims administration. As a result, we see very little injured employee accountability to the employer. Workers' compensation Options create an opportunity for these two primary system stakeholders to re-engage. When the employer is part of the claim management process, better outcomes are achieved for injured employees. Consider these examples:

1. **"Customer Service".** Helping injured employees understand the available benefits (through mandatory, simple communications required by ERISA) and where to obtain the best medical care allows for improved outcomes. This reduces opportunities for certain "clinics" and other predatory medical providers and attorneys to prey upon the lack of education or language barriers of the employee.
2. **Engagement of Company Personnel.** Larger employers have a group of personnel focused on delivering healthcare and disability benefits to their employees, and these

same people form a part of the Option injury management process. Smaller employers also want the opportunity to be involved in occupational injury matters, just as they are in every other aspect of their business. The Option provides small employers this opportunity by working with insurance carriers that are more accountable to their policyholders, instead of “system” regulators.

3. **Wage Replacement on Normal Payroll System.** Under an injury benefit plan, wage replacement benefits are paid on the employer’s normal payroll system.²⁹
4. **Access to Information.** Another example (among many) is that the Texas Supreme Court recently ruled³⁰ that the attorney-client privilege does not apply to communications between a workers’ compensation insurance carrier’s attorney and the employer. In this situation, communications between the insurance carrier’s attorney and the employer or broker consultant are privileged and protected. The impact has been that if the employer’s workers’ compensation insurance carrier is sued, the employer is no longer receiving access to any information on claims in litigation or in anticipation of litigation, legal correspondence with defense counsel, or legal strategy and status updates. Some carriers and TPAs have broadened this restriction to include client access to ANY claim file information identified as a “legal note” – regardless of whether the claim is in litigation or in anticipation of litigation. Texas nonsubscription, on the other hand, does not suffer from this exclusion of employer involvement. The reason is that, in workers’ compensation, the insurance carrier is legally obligated to pay the claim directly to an injured employee and is therefore considered the “party” to the claim. In this situation, the attorney and any TPA legally “work” for the insurance carrier – NOT the employer. In nonsubscription, almost all insurance policies providing legal liability coverage are reimbursement policies. In other words, the employer pays the claim directly to the injured employee and is later reimbursed by a carrier if amounts paid or payable exceed a self-insured retention. In this situation, the attorney, TPA and broker consultant are considered to “work” for the employer (they are “representatives” of the employer). The employer is typically the “party” defendant on the claim; and in Texas, many forms of communication between a party and its representatives are considered privileged from discovery in a lawsuit. So, for employers who prefer to be actively involved in their litigation, Texas nonsubscription holds this further advantage.

- D. **Competitive Insurance Markets.** Free-market insurance competition has also been critical to the success of workers’ compensation Options.³¹ Insurance companies have competed

²⁹ See “An Expectation and Incentive to Return to Work” under “Employees Come First” just above.

³⁰ In re XL Specialty Ins. Co. and Cambridge Integrated Serv. Group, Inc., No. 10-0960 (Tex. 2012).

³¹ See above regarding “Option Insurance Markets and Coverage” under “Option Market Overview”.

for and written well-over \$1 billion dollars in premiums paid over the past decade by Texas employers for nonsubscriber benefits, liability and defense cost coverage.

Several workers' compensation insurance carriers remain only interested in writing workers' compensation coverage and fight against Options because the competition drives down all premiums and results in lower carrier profits. But workers' compensation carriers have the opportunity to gain additional profits by writing both workers' compensation coverage AND Option insurance coverage. Many do so, competing for business through innovative products and services.

Workers' compensation and Option insurance products compete for market share on the basis of who can deliver the best package of benefits coverage, claims service, medical outcomes, AND price. Such insurance policies typically require employer payment of a deductible or self-insured retention amount per occurrence, and then insure the remainder of the employee injury benefit, negligence liability, and/or defense cost expense. Employers and insurance carriers have flexibility to specify coverage exclusions and limitations that are similar to provisions found in workers' compensation laws, but result in more employee accountability.

These insurance companies also support employer accountability by requiring adoption of standardized or pre-approved injury benefit plan documents, employee communications, and claim procedures that provide consistency and predictability in claims administration. This program control exerted by Option insurance carriers protects the interests of injured employees and is necessary to support the actuarial credibility of the insurance company's premium rates. Neither the policy forms provided, nor the premium rates charged, by Option insurance carriers is regulated by the state Department of Insurance. This results in continuous, persistent innovation in coverages, highly competitive pricing (with carriers determining their own actuarially credible rates), and the ability to adapt to changing market needs very quickly. For example, insurance products can adapt to constant changes in medical technology and practice without the need to wait for further rules to be legislated or agency rules to be promulgated.

Independent insurance agents also remain aligned with the best interests of their employer clients. Employers like competitive choices, not one-size-fits-all solutions. Carriers want broad access through the independent agency system, and are willing to write through any agent that can satisfy basic professional standards and offer quality submissions on groups of any size. Insurance carrier representatives (including general agents and managing general agents) are available to support the small retail agents who may have only one or a few accounts that require expertise and market leverage beyond their means.

ERISA claim procedures under the Option result in carriers, employers and agents seeing more predictable outcomes, fewer disputes, and faster resolution of disputes. This has translated to a low Texas agent error and omission liability exposure, and any such exposure that is unique to the Option is addressed through readily available coverage.

Agent commission rates on standard Texas workers' compensation insurance policies are typically much lower than commissions on nonsubscriber Option products. This has served to take care of the agent community as premium rates decrease under an Option program. But aside from any personal financial issue, the wisdom of insurance agents has been proven by aligning themselves with those seeking better medical outcomes for injured workers and lower costs for Texas employers. As a bi-product, Texas business has grown, more insurance premiums are being written, and more commissions are being earned.

E. **Best Practices in Medical Management.** It has been said that, "The practice of medicine in workers' comp is really no different than the practice of medicine in any other payer class."³² However, there are many differences between workers' compensation and the nonsubscriber Option that support working with the best medical providers and achieving better medical outcomes.

1. **Differences from Workers' Compensation.** Workers' compensation systems are hyper-regulated, often driven more by forms, timelines and required processes than an apparent path to the best medical outcome. They are in a perpetual state of "reform" that includes an endless series of medical management tweaks, sometimes for good and sometimes making no sense at all. For example: (i) preauthorization rules that restrict decisions to the question of "Medical Necessity" – ignoring the actual compensable injury/condition; (ii) mandating peer-to-peer discussions for any preauthorization denial – causing many reviewers to just approve a procedure to avoid having to speak with an argumentative, unpleasant requesting physician; (iii) restricting peer reviewers based on licensure; and (iv) establishing policies to openly encourage treatment to the maximum threshold of the *Official Disability Guidelines*.

Texas medical providers have been supportive of nonsubscription due to:

a. **Connecting patients with the right providers** – physicians appreciate competent channeling of injury claims to appropriate providers;

³² Matt Zurek, Executive Deputy Commissioner for Health Care Management, Texas Division of Workers' Compensation in Texas Medicine, December 2014.

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- b. **Faster access to injured workers** – through immediate injury reporting requirements;
 - c. **Less paperwork** – freeing their staff time for actual medical care and other business priorities;
 - d. **Fast and fair payment for services** – at or above current workers' compensation fee schedules, with the ability to rely on existing PPO contracts or negotiate new agreements with employers; and
 - e. **Excellent medical outcomes** – achieving the medical community's mission through employee accountability to follow the provider's treatment plan.
2. **Medical Provider Reimbursement.** Unlike certified medical provider networks developed for workers' compensation, an Option to workers' compensation is NOT about squeezing savings out of medical provider reimbursement rates. It is about paying fair reimbursement rates in exchange for a collaborative, open relationship focused on injured employee care.

Currently for treating physician services, the Texas workers' compensation system reimbursement rate equates to about 156 percent of Medicare. For surgical services provided in a facility or a hospital, it's approximately 195 percent of Medicare. By contrast, Texas nonsubscribers typically pay Texas workers' compensation fee schedule rates for treating physicians, and up to 250 percent of Medicare on certain preferred provider contracts. Providers and provider networks are able to negotiate directly with employers, insurance carriers and their representatives. Nonsubscribers are often willing to pay more for the best provider. When employers and insurance carriers look at the total claims cost savings produced by the Option, there is no need to try to "nickel and dime" medical providers.

Even when paid at the same reimbursement rates as the Texas workers' compensation system, medical providers come out way ahead. Option program medical providers are not burdened with completing a myriad of reports and office personnel are not constantly on the telephone with insurance adjusters to get approval for treatment. The Option greatly simplifies paperwork and streamlines approval processes so that medical providers can be more focused on the delivery of quality medical care, less focused on workers' compensation bureaucracy, and run a more profitable medical practice.

3. **True Medical Management.** Options to workers' compensation provide an environment that can significantly impact medical outcomes. This is not "Workers' Comp-Lite". Specific techniques may include (but are not limited to):

- a. **Immediate Medical Treatment** by approved providers and pre-approval of subsequent treatments and referrals to specialists.
- b. **Medical Director** – A specific physician can be designated as the injury benefit plan's Medical Director and assigned to each significant claim from a particular employer to achieve accountability, continuity, and consistency. The Medical Director is charged with providing access to timely, appropriate medical care with the most appropriate physicians and facilities. The Medical Director can ensure that an accurate assessment of the extent of injury is made, and manage claims with adherence to evidence-based diagnostics and treatment, coordinate all peer reviews, specialist referrals, medical case management and other utilization review activities. The Medical Director can also provide ongoing assessment of outcomes, such as the number of office visits incurred, the amount of physical therapy ordered (pre- and post-op), prescribing patterns, surgical re-do rates and employee/patient satisfaction. Free-market, competitive forces allow top performing medical providers to rise to the top.
- c. **Referral Criteria** – Claims that satisfy specific criteria (defined by the employer or insurance carrier in the injury benefit plan claim procedures) must be referred by the claims adjuster to the Medical Director. Referral criteria support early intervention in difficult claims and help ensure that timely claim analysis and medical care are provided in cases that might otherwise be put on the claims adjuster diary for another 30 day follow-up.
- d. **Causation Analysis** – First-line medical providers are often focused more on making a diagnosis and providing the appropriate treatment for a specific condition, not on establishing the causal or contributory factors to the employee's presentation. The Option allows for development of medical management procedures that require such a causation analysis (relying, for example, on the American Medical Association's Causation Guides), which may eliminate fraudulent injury claims and help ensure the right treatment is provided to the body parts actually injured on the job.
- e. **Proper Use of Medical and Disability Guidelines** - The "Official Disability Guidelines" from the nationally-respected Work Loss Data Institute and other medical treatment guidelines should not be used as a blank check. Just because a guideline says a treatment is acceptable does not mean it is appropriate to authorize or will be effective. To effect material change with the adoption of any guideline, or with the use of an evidence-based approach to medical practice, concurrent, strong utilization review protocols must be in place.
- f. **Scrutiny on Common Areas of Medical Abuse** – Occupational injury medical care faces many challenges. For example, multi-location clinics are back filling with Nurse Practitioners, Physician Assistants, and temporary employee physicians. Fewer clinic

providers have any occupational training. Providers frequently “punt” difficult claimants (often to “pain management”). Claims adjuster behavior will commonly allow physical therapy as long as it is consistent with some guideline; and authorize MRIs any time ordered by a physician. So a Medical Director can be engaged, particularly on cases involving (for example):

- i. **Early Magnetic Resonance Imaging** for work-related, acute low back pain – The majority of cases have no early MRI indications. Medical studies show that iatrogenic effects of early MRI (induced in a patient by a physician's activity, manner, or the procedure itself) lead to prolonged disability, higher medical costs, and greater utilization of surgery. Despite the multiple evidence-based guidelines recommending that early MRI use be reserved only to diagnose serious conditions requiring immediate intervention and then should be reserved for those being considered for surgery for persistent neurological dysfunction, many clinicians are not following these guidelines in the occupational injury setting.³³
- ii. **Physical Therapy** – What if there is no injury? Physical therapy in asymptomatic persons or in persons without an identifiable clinical condition is considered not medically necessary. Physical therapy in persons whose condition is neither regressing nor improving is also considered not medically necessary.
- iii. **Opioids** – The use and abuse of opioids and compounded drugs in workers' compensation cases has been gaining national attention. Workers receiving narcotics are more likely to be off work, and the longer they are off work, the greater the likelihood that they will become addicted and ultimately be unemployable, and deemed disabled. In the Texas nonsubscriber Option, opioid use and abuse has not been an issue, mainly due to the adherence to evidence-based practice by the approved physicians and surgeons. Drug compounding has also been a non-issue given that internal referrals to physician-owned pharmacies or “work-comp” shop pharmacies has been prohibited and the approved physicians do not ascribe to that pattern of practice.

A qualified Medical Director can be part of the injury claims management team under the Option to advise and monitor situations like these.

- g. **Emphasis on Return to Work** – The treating provider needs to see the injured employee's job description and the requirements of any available modified duty work. Work can then be used as a treatment modality.

³³ See “Relationship of Early Magnetic Resonance Imaging for Work-Related Acute Low Back Pain With Disability and Medical Utilization Outcomes” by Barbara S. Webster, BSPT, PA-C, and Manuel Cifuentes, MD, MPH, ScD, *Journal of Occupational and Environmental Medicine (JOEM)*, Volume 52, Number 9, September 2010; “Imaging Idolatry: The uneasy intersection of patient satisfaction, quality of care, and overuse” by Deyo RA, *Archives of Internal Medicine*, 2009; 169:921-3.

4. **Texas Workers' Compensation Medical Provider Network Performance.** The Texas Department of Insurance Workers' Compensation Research and Evaluation Group (REG) publishes an annual report card comparing the performance of certified workers' compensation health care networks with each other as well as non-network claims on a variety of measures. Texas had "voluntary" or "informal" networks for the delivery of workers' compensation health care. These networks used discount fee contracts between health care providers and insurance carriers. ***The Texas Legislature eliminated all voluntary and informal networks as of January 1, 2011, with fee guidelines replacing free-market, contracted discounted rates.***

Important findings from REG's 2014 network report card include:³⁴

- a. Overall, the gap between network and non-network costs may be closing, but average medical costs in networks remain higher than non-network average medical costs. Half of the network costs were higher than non-network and half of the networks have lower costs.
- b. Overall, networks tended to have higher utilization of professional and pharmacy services than non-network.
- c. Injured employees reported no higher satisfaction with network treating doctors than non-network treating doctors. Only about 50% of injured employees indicated that they were satisfied with the quality of medical care received for their work-related injury.
- d. A huge percentage of employees (ranging from 27% to 77%, depending upon the network) who had been released to return to work had not done so.

Like much of the system data reported by REG, this latest network report focuses on improvements, which continue and are significant. But three years after the elimination of free-market networks and the use of certified networks, there has been no overall improvement in costs or employee satisfaction. And this report card reflects the continuing problems that a hyper-regulated system that minimizes employee communications and accountability will have with return to work.

- F. **Benefits and Liability in Balance.** As discussed above,³⁵ workers' compensation systems have been designed to reflect a "grand bargain" in which injured employees are entitled to a substantial level of injury benefits (that vary from state-to-state) and employers are entitled to "exclusive remedy" protection. In other words, injured employees are

³⁴ 2014 Workers' Compensation Network Report Card Results, Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, found at <http://www.tdi.texas.gov/reports/wcreg/documents/nw2014report.pdf>

³⁵ See "Grand Bargain of the Texas Option" under "Brief Overview of Texas Option" above.

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automatically eligible for workers' compensation benefits without any showing of fault by the employer in causing the injury; and such benefits are the employee's exclusive remedy against the employer. The employee has no ability to pursue negligence or other tort claims against the employer. As reflected in the core design of all workers' compensation systems across the United States, it is not fair to require employers to pay a high level of statutorily mandated injury benefits AND have any exposure to legal liability damage claims regarding the cause of injury.

1. **Inverse Relationship Between Benefit Mandates and Liability Exposures.** Several approaches are available to state legislators when considering injury benefit mandates and employer liability exposures for an Option to workers' compensation. Each of the models described below reflects an inverse relationship between the level of injury benefit mandate and the extent of employer liability exposure:

Lower Benefits → More Liability

Higher Benefits → Less Liability

Overview of Three Option Models:

Texas	Oklahoma And South Carolina	Tennessee
No Benefit Mandate Combined with Unlimited Negligence Liability	Mirror or Exceed WC Benefit Mandate Combined with Exclusive Remedy Rule	Strong Benefit Mandate combined with Limited Negligence Liability

2. **Texas Model** – No Benefit Mandate combined with Unlimited Negligence Liability.
 - a. **Benefits.** The Texas nonsubscriber Option model relies on employers making an entirely voluntary, contractual commitment to benefit payments. This has the obvious downside of some employers not making a reasonable level of injury benefit commitment. But benefit adequacy in Texas has been achieved by coupling employer discretion in benefit commitment with negligence liability exposure. The more employer discretion that is built into a workplace injury model, the more negligence liability exposure should rest on the employer's shoulders. That liability exposure serves to "keep the employer honest",

incentivizing a strong benefit commitment that takes care of the injured employee's needs and eliminates the employee's primary measure of damages. It took more than a decade for the Texas nonsubscriber insurance industry and case law development to create the current balance that delivers a high level of injury benefits to the vast majority of Texas workers who are covered by nonsubscriber programs.³⁶ Texas nonsubscribers are under no state or federal law obligation whatsoever to pay ANY benefits to injured workers, but they can, and often do, provide richer benefits for their employees than what is required by law.³⁷ The lesson is clear: Employers can afford and generally desire to be very generous on benefit payments to injured workers under a system that supports employee accountability, better medical outcomes, and more efficient dispute resolution. Other states considering alternatives to workers' compensation may mandate some level of benefits and reduce employer liability exposure (as Oklahoma has done) primarily to avoid the long period of industry maturation that Texas has now achieved.

- b. Liability.** No benefit mandate is combined with unlimited negligence liability exposure. That liability exposure compels Texas nonsubscribers to focus on workplace safety and formally adopt a written injury benefit plan to care for injured workers and minimize the risk of employee lawsuits. The Texas statute is so bare bones, it has taken decades of expensive litigation and case law to define the parameters of this liability exposure and available employer defenses.

Any discussion of benefit mandates on Texas nonsubscribers must begin with an understanding of this inverse relationship. And any proponent of mandated benefits for Option employers must also be willing to discuss limitations on negligence liability exposures.

3. Oklahoma or South Carolina Model – High Benefit Mandate combined with Exclusive Remedy Rule.

- a. Benefits.** This approach requires employers electing the Option to mirror or exceed key benefit requirements of the state workers' compensation law. The same types of benefits are payable, subject to payment of at least the same dollar, percentage and duration limits. Option benefit programs have the flexibility to drive more employee accountability, better medical management, direct employee/employer engagement, and more free-market competition among insurance carriers.

³⁶ 95.1% of all Texas workers are covered by workers' compensation or a nonsubscriber injury benefit plan. See "Low and Shrinking Number of Non-Covered Workers" under the heading "Nonsubscriber Market Overview"; and "Employer Participation in the Texas Workers' Compensation System: 2014 Estimates", Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, at <http://www.tdi.texas.gov/reports/wcreg/documents/nonsub.pdf>.

³⁷ See "Benefits Commonly Paid" under Section IV, "Brief Overview of Texas Option".

- b. **Liability.** From a public policy perspective, this high benefit mandate must be coupled with the exclusive remedy rule, which avoids state court litigation over any employer or employee fault that caused the injury. Availability of this exclusive remedy rule can address employer concerns in states with an active plaintiff attorney bar and/or that have not passed significant tort reform. The State of Oklahoma also decided to couple the exclusive remedy rule with a high benefit mandate that mirrors the existing workers' compensation system because of unique Oklahoma constitutional concerns regarding creation of different benefit and liability structures. However, most states already acknowledge that some differences in the rights and responsibilities of various employment groups are permissible. Also, when considering this model, note that (like traditional workers' compensation systems) removing all employer negligence liability exposure at least partially removes the incentive to promote workplace safety.

4. **Tennessee Model – Limited Benefit Mandate combined with Limited Negligence Liability.**³⁸

- a. **Benefits.** This approach is a hybrid of the Texas and Oklahoma models. Like the Oklahoma model, it requires every employer electing the Tennessee Option to formally establish and seek approval of a formal injury benefit plan that covers every Tennessee employee. However, this model mandates the same types of injury benefits, at the same or higher levels, as those commonly maintained by Texas nonsubscribers. These benefits are also comparable to those paid by many Tennessee governmental entities that have elected to not provide workers' compensation coverage under current Tennessee law. Like the Oklahoma model above, employers can (and frequently will) specify benefits above these state law minimums. This Tennessee model does not mandate certain benefits available under workers' compensation law, such as unlimited, lifetime medical expense, compensation for bodily impairments that do not result from severance or loss of use or a member of the body, or disability benefits to retirement age. Other government programs (like Social Security Disability) and claim settlements and judgments for employer's liability can make up any such difference in benefit entitlements on the very rare occasion when such payments are appropriate. This coordination of injury benefit plan payments, federal government program payments, and liability payments works successfully in Texas nonsubscription and with current Tennessee public entity alternative programs. Lastly, like Texas nonsubscription and the Oklahoma

³⁸ See Tennessee Senate Bill 721 (by Sen. Green) and House Bill 997 (by Rep. Durham) filed in February 2015.

Option, the Tennessee Model leverages the same employee communication, fiduciary protection, and claim procedure protections of ERISA that apply to group health plans, supporting smaller state government without giving up any state's rights.

- b. **Liability.** Like Texas nonsubscription, Tennessee employers electing the Option can be sued by an injured employee if the employer caused the injury. But a key difference is that certain statutory defenses are specified in the Tennessee law to avoid the decades of expensive courtroom litigation that has been required to develop such defenses for Texas nonsubscribers. The Texas Option provides a cap on punitive damages for an employer's negligence liability, and a cap on non-economic damages for healthcare employer liability. The Tennessee Model includes such a punitive damage cap, makes the non-economic damage cap applicable to all employers electing the Option, and also caps economic damages. This economic damage cap is fair in view of the benefit mandate. An injured employee can recover under both the injury benefit plan (with mandated benefit levels) AND recover negligence liability damages (subject to the specified defenses and dollar caps). Employers and injured workers can engage in direct discussions regarding payments beyond those provided in the injury benefit plan in exchange for a release of liability (subject to employee protections in the law regarding the timing and content of such a release of liability). Employers will routinely initiate such discussions to address the needs of their most important asset (employees) and/or to avoid the time, expense and risks of litigation.

This Tennessee Model of a **limited benefit mandate** and **limited negligence liability exposure** combines these best features of the Texas Model and the Oklahoma Model:

1. It provides either workers' compensation or mandated Option benefits coverage to every injured worker;
2. It delivers a high level of benefit payments for injured workers while also providing some certainty of maximum financial exposure for employers;
3. Benefit mandates and negligence liability exposure are in balance;
4. Defining certain liability defenses in the statute avoids decades of expensive, clarifying litigation;
5. It avoids disputes over which provisions of the Tennessee Workers' Compensation Law must be followed by employers that elect the Option;
6. It supplies a system of employee protections that requires employers to directly communicate and resolve any disputes with employees, without the need for expensive government administration;

7. More insurance competition will drive down premiums for both workers' compensation and Option insurance coverage; and
 8. It will make Tennessee a better place to do business, resulting in substantial economic development.
5. **Benefit Plan Exclusions and Limitations.** All forms of medical, disability, death and other occupational (or non-occupational) injury benefits rely on various exclusions and limitations that are intended to balance benefit adequacy, incentives to return to work, and cost containment. Anyone who suggests otherwise by claiming that workers' compensation systems ignore this balance and contain no such exclusions and limitations are uninformed or disingenuous. For example, temporary disability (wage replacement) benefits under all workers' compensation systems are payable at less than 100% of the injured employee's normal rate of pay for a limited number of weeks.

The Texas nonsubscriber Option insurance market has evolved dramatically over the past two decades and has formed "best practices" (or industry norms) regarding the types of ERISA injury benefit plan exclusions that are appropriate. Texas Option insurance carriers (operating in a free market environment) must ensure that the expectations of employers that purchase such coverage are met (providing outstanding care for injured employees), while curbing employee, medical provider, and attorney abuses that are common within workers' compensation systems.

Some Option employers tailor the definition of covered medical expenses similar to the way they do in their group health plans. This may be narrower than the Texas Workers' Compensation Act. For example, the injury benefit plan may state:

- a. First medical treatment must be within XX days after the date of an accident; and
- b. Medical care must occur at least every XXX days in order for a benefits claim to remain open.

These features incentivize immediate medical care and continuing medical care on a regular basis, discouraging injured employees from indefinitely delaying needed follow-up doctor visits.

Some employers (subject to approval from their insurance carrier) may also exclude charges like:

- a. Services or supplies which are experimental, investigative, or for the purposes of research, including, but not limited to, services and supplies that have not been approved by the American Medical Association or the Federal Drug Administration;
- b. Canceled appointment charges for unexcused cancellations;

- c. Services or supplies relating to preexisting conditions, except to the extent of an identifiable and significant aggravation (incurred in the course and scope of employment) of a preexisting condition;
- d. Acupuncture and hypnosis;
- e. Charges for the purchase, rental or repair of bedding, or environmental control devices; and charges for hot tubs, saunas, vans, or structural changes to the employee's residence or moving expenses; and
- f. Charges for services performed by a family member of the injured worker.

Exclusions and limitations on coverage can be driven by a variety of factors, such as insurance industry ideas or practices in group health, accident, or other lines of insurance, cost containment, notions of the adequacy of employee care, defense strategy, or any number of other factors. We have seen such exclusions and limitations range from the over-reaching (which results in too many benefit denials) to the non-existent (which results in payments far beyond what can reasonably be considered the result of an injury on the job). But over time, the employer's discretion in making benefit plan adjustments and the insurance marketplace's free ability to compete has brought these plan features into balance. And – as one of the biggest advantages of the Option – if the market learns that such coverage features are not in balance, they can be amended and communicated to employees very quickly, without the need to wait for new legislation to be passed or regulations to be finalized. This free-marketplace is far more efficient and effective than any workers' compensation system in the United States.

G. Simple, Self-Executing State and Federal Laws. Benefit entitlement and system administration rules for workplace injury are commonly specified by state workers' compensation statutes in excruciating detail, with thousands of pages of minute directives. This approach has led to an endless process of regulatory interpretation and amendments by "reforms" that never reach a point of equilibrium. Hyper-detailed state statutes on demand regulatory interpretations and administrative rules that add more to system complexity and bureaucratic cost, and less toward achieving better medical outcomes and higher employee satisfaction.

On the other hand, the Texas nonsubscriber Option is a considerably more simplified, hybrid state and federal system. The Texas Legislature created a short and direct framework for nonsubscribers to have no benefit mandate and high negligence liability exposure under Texas law. Other than provide for negligence liability claims against

nonsubscribers,³⁹ Texas law does not specify any extensive employee communication,⁴⁰ fiduciary, claim procedure, enforcement or other employee protections applicable to nonsubscribers.

Only private employers can elect the Option in Texas⁴¹ so virtually all must comply with employee protection requirements under the Employee Retirement Income Security Act ("ERISA").⁴² These ERISA provisions apply by operation of federal law to all "employee welfare benefit plans", which includes a Texas Option injury benefit plan. These are the same laws that apply to most employer-sponsored group health plans. For over 40 years, both employers and employees have found these rules to be largely self-executing – meaning that no active state or federal administrative agency or judicial oversight or enforcement is needed to successfully accomplish claim notices, payments, and resolution of any disputes.

The application of state labor and insurance laws, as well as federal labor and employee benefit laws, to employer-sponsored benefit plans has been the norm in Texas and other states for many decades. Even workers' compensation systems are hybrid state and federal systems. Federal laws such as the Family Medical Leave Act (FMLA) and Americans With Disabilities Act (ADA) directly impact workers' compensation claims administration. Workers' compensation is also impacted by the Occupational Safety and Health Act (OSHA) and Fair Labor Standards Act (FLSA). However, workers' compensation laws are not simple,⁴³ are far from self-executing,⁴⁴ and strip industry participants of virtually all ability or incentive to self-regulate.

1. **State Laws Kept Simple.** Pursuant to the Tenth Amendment to the U.S. Constitution (and as supported by ERISA), the State of Texas retains complete control over what an employer must do to be exempt from the workers' compensation act, as well as the impact of that decision on the employer's negligence liability exposure.
 - a. **Coverage is Elective.** "Except for public employers and as otherwise provided by law, an employer may elect to obtain workers' compensation insurance coverage."⁴⁵ Thus, Texas nonsubscribers do not "opt-out" of workers' compensation, they simply do not "opt-in".

³⁹ Texas Labor Code section 406.033.

⁴⁰ Texas Labor Code section 406.005 and 406.007, and Texas Administrative Code section 110.101 require simple written and posted notices to employees that the employer is a nonsubscriber, may have liability exposure and may provide injury benefits.

⁴¹ Texas Labor Code section 501.021 and 504.011 (mandatory workers' compensation coverage for governmental employees).

⁴² See below section VI.G.2. on "Applicability of the Employee Retirement Income Security Act".

⁴³ The task of determining how many pages of statutes, regulations, bulletins, etc. comprise the Texas workers' compensation system appears impossible. An estimate by DWC regulators would be most welcome.

⁴⁴ See subsection g.6 below on "Minimal State Resources or Expense, and No State Employees Dedicated to Nonsubscription" regarding the 2014 DWC budget.

⁴⁵ Texas Labor Code section 406.002(a).

b. Reporting and Disclosure.

- i. Annual Notice to the State.** Employers who do not have workers' compensation insurance coverage or who terminated coverage must notify the DWC, in writing, that the employer elects not to obtain coverage. A nonsubscriber must submit the DWC Form-005, Employer Notice of No Coverage or Termination of Coverage.⁴⁶
- ii. Notices to Employees.** Employers who do not have workers' compensation insurance coverage or who terminated coverage must notify their employees in writing and through workplace posters, in English, Spanish, and any other language that is appropriate.⁴⁷
- iii. Monthly Reports of Injury, Illness or Fatality.** Nonsubscribers with five or more employees must report each work-related fatality, occupational disease, and injury that results in more than one day of lost time to the DWC. Nonsubscribers must submit the DWC Form-007, Employer's Report of Non-covered Employee's Occupational Injury or Disease.⁴⁸
- iv. Penalties.** Failure to provide the required notifications to the DWC or to employees can result in enforcement actions and/or administrative penalties up to \$25,000 per day, per occurrence.⁴⁹
- v. Enforcement.** The Division of Workers' Compensation within the Texas Department of Insurance has enforcement authority for the above reporting and disclosure requirements.⁵⁰

c. Negligence Liability.

- i. Exposure and Loss of Certain Common Law Defenses.** In an action against an employer who does not have workers' compensation insurance coverage to recover damages for personal injuries or death sustained by an employee in the course and scope of the employment, it is not a defense that (1) the employee was guilty of contributory negligence; (2) the employee assumed the risk of injury or death; or (3) the injury or death was caused by the negligence of a fellow employee. The plaintiff must prove negligence of the employer or of an agent or servant of the employer acting within the general scope of the agent's or servant's employment.⁵¹

⁴⁶See the DWC summary of these requirements, including links to forms and citations to Texas Labor Code provisions and administrative rules at <http://www.tdi.texas.gov/pubs/factsheets/noncoveremp.pdf> and <http://www.tdi.texas.gov/wc/employer/index.html#nocov> ("Information for Employers without Workers' Compensation Insurance Coverage") and <http://www.tdi.texas.gov/wc/employer/nonsubscriber/nonsubscribers0115.pdf> ("Reporting Requirements for Employers without Workers' Compensation", January 9, 2015).

⁴⁷Id.

⁴⁸Id.

⁴⁹Id.

⁵⁰Id.

⁵¹Texas Labor Code section 406.033(a) and (d).

- ii. **Pre-Injury Waivers.** This negligence cause of action may not be waived by an employee before the employee's injury or death. Any agreement by an employee to waive that cause of action or reinstate the above common law defenses before the employee's injury or death is void and unenforceable.⁵²
 - iii. **Post-Injury Waivers.** This prohibition against pre-injury waivers of negligence liability is coupled with limitations on the use of post-injury waivers of negligence liability (i.e., settlement agreements).⁵³ These are the only two nonsubscriber benefit payment or program administration issues that the Texas Legislature has determined (based upon expressions of interest or concern from employers and injured workers) to require legislative intervention in over 20 years. The negligence cause of action may not be waived by an employee after the employee's injury unless (1) the employee voluntarily enters into the waiver with knowledge of the waiver's effect; (2) the waiver is entered into not earlier than the 10th business day after the date of the initial report of injury; (3) the employee, before signing the waiver, has received a medical evaluation from a nonemergency care doctor; and (4) the waiver is in a writing under which the true intent of the parties is specifically stated in the document. Such waiver provisions must be conspicuous and appear on the face of the agreement. To be conspicuous, the waiver provisions must appear in a type larger than the type contained in the body of the agreement or in contrasting colors.⁵⁴
2. **Applicability of ERISA:** The Employee Retirement Income Security Act ("ERISA") applies to "employee welfare benefit plans" established by private employers. For this purpose, an "employee welfare benefit plan" means any plan, fund, or program established by an employer to provide employees and their beneficiaries, through the purchase of insurance or otherwise, medical, disability or similar benefits.⁵⁵ The term "employee welfare benefit plan" is construed broadly. It includes, for example, even informal or unwritten policies that do not even purport to comply with ERISA.⁵⁶ Clearly, this encompasses a Texas or Oklahoma employer's injury benefit plan. Caselaw holds that a program falls within the scope of this definition even if unwritten and administered on a case-by-case basis. Injury benefit plans established by private employers under an Option to workers' compensation clearly satisfy this definition.

⁵² Texas Labor Code section 406.033(e).

⁵³ Texas Labor Code section 406.033(f). This law was enacted in 2001. In the 2011 Texas Legislature, Senate Bill 1714 was conceived, drafted and supported by the Texas Alliance of Nonsubscribers for the express purpose of closing a loophole that one Texas employer was exploiting to circumvent this prohibition on pre-injury waivers. This is one of many examples from the past 25 years where the nonsubscriber industry has self-regulated or actually advanced reasonable state regulation of nonsubscription.

⁵⁴ Texas Labor Code section 406.033(f) and (g).

⁵⁵ 29 U.S.C.A. section 1002(1).

⁵⁶ See *Donovan v. Dillingham*, 688 F.2d 1367, 1372 (11th Cir. 1982) (in banc) and citations thereto.

However, ERISA exempts from federal law any “governmental plan”, “church plan”, or plan “maintained solely for the purpose of complying with applicable workmen’s compensation laws”.⁵⁷

a. Government Plan Exemption. Governmental plans (*e.g.*, plans established by federal, state, or local governmental entities) are exempt from ERISA.

b. Church Plan Exemption. Church plans are exempt from ERISA, unless they opt into ERISA.

c. Workers' Comp Exemption. ERISA does not apply to any employee benefit plan if “maintained solely for the purpose of complying with applicable workers' compensation laws”. Texas law clearly states that, “an employer may elect to obtain workers' compensation insurance coverage”⁵⁸ and does not mandate any benefit coverage for injured workers. This exemption is the reason why employers do not hear of the need to comply with ERISA with respect to their workers' compensation program (the benefit entitlements and administrative rules are prescribed solely by the applicable state’s workers' compensation act). The employer is not obligated by law to offer any benefits whatsoever. The design and administration of an injury benefit program is entirely up to the discretion of the nonsubscribing employer, and is not done “solely for the purpose of complying” with any Texas law.

3. Purpose of ERISA. ERISA’s primary function is to provide a well-established regime of employee protections. Congress enacted ERISA to protect “the interests of participants in employee benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information with respect thereto, by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts.”⁵⁹ ERISA is a comprehensive statute designed to promote the interests of employees and their beneficiaries in employee benefit plans.”⁶⁰ This is the same federal law that has ensured the efficient processing of group health claims in Texas and across the United States for over 40 years, as well as the efficient processing of Texas nonsubscriber Option injury benefit claims for over 25 years.

⁵⁷ 29 U.S.C.A. section 1003(b).

⁵⁸ Texas Labor Code section 406.002(a).

⁵⁹ 29 U.S.C. section 1001(b).

⁶⁰ Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 90 (1983).

4. **Employee Protections Supplied by ERISA.** Employers electing the workers' compensation Option must adopt an ERISA-compliant benefit plan and meet the Act's many requirements designed to protect the interests of employees. ERISA standards of conduct and responsibility include:
- a. **Clear Communication and Disclosure of Employee Rights and Responsibilities –**
- i. **Establish a Plan Document –** A plan fiduciary must establish a plan document that (1) names fiduciaries who have the responsibility to manage the operation and administration of the plan, (2) describes procedures for the plan's funding and benefit payment processes, and (3) describes the plan's amendment and plan administration processes.⁶¹
 - ii. **Summary Plan Description.** ERISA plan fiduciaries must provide each covered employee with a summary plan description ("SPD") of the official plan document (the legal document that governs the plan). The SPD must explain, in a manner calculated to be understood by the average plan participant, how the plan works, what benefits are provided, any exclusions and limitations, and how benefits can be obtained.⁶² Such open communication with employees is hugely beneficial to gaining employee appreciation and compliance with the accountability requirements of the injury benefit plan. This includes, but is not limited to, a clear explanation of benefits and all claim procedures before getting injured). Interpretive assistance for non-English reading employees may also be required under U.S. Department of Labor rules.⁶³ An SPD must be provided to all plan participants (1) within 120 days after a new plan is enacted, or (2) within 90 days after an employee becomes a participant in the plan. The SPD must be updated every five years to incorporate all changes made during the prior five years.
 - iii. **Summary of Material Modifications.** Any change to an SPD that is "material" must be communicated to affected plan participants, in the same manner as the SPD itself, within 210 days after the end of the plan year in which the change was made (or for a material reduction in covered medical services or benefits,

⁶¹ 29 U.S. Code § 1102 (a)(1).

⁶² United States Code, Title 29, Chapter 18, Subchapter I, Subtitle B, Part 1, sections 1021(a)(1), 1022, and 1024(b). 29 CFR § 2520.102-2 provides (in addition to numerous more specific information requirements): (a) Method of presentation. The summary plan description shall be written in a manner calculated to be understood by the average plan participant and shall be sufficiently comprehensive to apprise the plan's participants and beneficiaries of their rights and obligations under the plan. In fulfilling these requirements, the plan administrator shall exercise considered judgment and discretion by taking into account such factors as the level of comprehension and education of typical participants in the plan and the complexity of the terms of the plan. Consideration of these factors will usually require the limitation or elimination of technical jargon and of long, complex sentences, the use of clarifying examples and illustrations, the use of clear cross references and a table of contents. (b) General format. The format of the summary plan description must not have the effect to misleading, misinforming or failing to inform participants and beneficiaries. Any description of exception, limitations, reductions, and other restrictions of plan benefits shall not be minimized, rendered obscure or otherwise made to appear unimportant. Such exceptions, limitations, reductions, or restrictions of plan benefits shall be described or summarized in a manner not less prominent than the style, captions, printing type, and prominence used to describe or summarize plan benefits. The advantages and disadvantages of the plan shall be presented without either exaggerating the benefits or minimizing the limitations.

⁶³ 29 CFR § 2520.102-2(c).

within 60 days after the change is made). There is no prescribed format for preparing the Summary of Material Modifications. However, it must be written in a manner calculated to be understood by the average plan participant.⁶⁴

- iv. **Requests for Plan Documents.** Plan fiduciaries must provide plan documents to a plan participant upon request within 30 days after the request is made. These documents would include, but not be limited to (1) the official plan document, (2) summary plan description, (3) summary of material modifications, (4) Form 5500 annual return, (5) summary annual report, and (6) the administrative record for any claim filed by the plan participant.
- b. **Employer Accountability and Fiduciary Responsibility** – ERISA helps bring balance to a free-market environment. It supplies an entire regime of employee protections. The claims administrator and other plan fiduciaries must perform their duties solely in the interest of the covered employees and beneficiaries. When providing injury benefits and handling administration expenses, plan fiduciaries must follow a “prudent man” standard of care and must administer the plan in accordance with the plan documents governing the plan.⁶⁵ *Dealing with ERISA claim procedures is typically much more simple and efficient than any workers' compensation commission and court processes.* This access to justice can typically be pursued without the expense of hiring an attorney due to the transparency of the process.
 - i. **Claim Procedures** – ERISA requires every benefit plan to establish reasonable procedures for administering plan benefits.⁶⁶
 - A. **Full and Fair Review.** These procedures provide a method for workers and beneficiaries to receive a full and fair review of their claim,⁶⁷ and to resolve almost all disputes over benefits inexpensively and expeditiously.
 - B. **Consistency.** These claim procedures must contain administrative safeguards to ensure that benefit determinations are made in a manner consistent with the plan document and the plan provisions have been applied consistently to similarly situated claimants. The claims administrator of an Option injury benefit plan must apply these claim procedures when reviewing any benefit denial and handling of appeals.
 - C. **Key Features** for all Option plans subject to ERISA include (1) the process for filing a claim; (2) an initial benefit determination by the employer or insurance carrier and notification to the employee; (3) right to an internal appeal of any denial of benefits; and (4) access to the courts for an external, independent review of any denial of benefits.

⁶⁴ 29 CFR §§ 2520.104a-4, 2520.104a-7, and 2520.104b-3.

⁶⁵ 29 U.S.C. § 1104(a).

⁶⁶ 29 U.S.C. § 1133; 29 CFR § 2560.503-1 et seq.

⁶⁷ Many courts have acknowledged since ERISA was enacted over 40 years ago that a “full and fair” review of claims is a cornerstone requirement for all employee benefit plans. As just one example, see the case summary at <http://www.erisalawyerblog.com/2013/01/erisa-fifth-circuit-rules-that-8.html>.

- D. Process and Timing Requirements.** ERISA prescribes strict timelines for handling of different types of benefit claims. For example, the injury benefit plan must act on pre-service medical claims within 15 days of receipt (and only 72 hours for urgent care, pre-service claims).⁶⁸ Any benefit denials must be in writing, making reference to the pertinent provisions of the plan supporting denial.
- E. Internal Appeal Rights.** A claimant may appeal any adverse benefit determination by writing to the plan within 180 days of the denial. For claims that are appealed, the plan must offer the claimant a full and fair review of the claim and the adverse benefit determination. Appeals of claim denials under an ERISA plan will typically be heard by a "final review officer" or committee of individuals appointed by the employer or the insurance carrier. Some opponents of workers' compensation Options argue that this is unfair. However, they are simply unfamiliar with this process that has worked well for over 40 years with virtually all other private employer-sponsored benefit plans due to the following checks and balances: As noted above, any person hearing an appeal is a plan fiduciary (the highest level of trust and obligation recognized by law), and is obligated by law to administer the plan in accordance with its terms⁶⁹ and in the best interest of employees. No person convicted of a felony or similar crimes specified under ERISA may serve as a plan fiduciary. Such persons hearing appeals must not be subordinate to the persons handling the initial claim review; and such persons must bring in a new medical provider to advise on matters of medical judgment. These plan fiduciaries must not have been involved in or give any deference to the initial adverse benefit determination. The claimant may submit written comments for the decision maker's consideration. The claimant may request reasonable access to the claimant's benefit claim file, free of charge. The committee or individual hearing the appeal must make a decision within specific deadlines, namely, 30 days for pre-service medical appeals, 60 days for post-service medical appeals, 45 days for claims involving disability benefits, and 60 days for any other claims. Limited extensions are permitted. A denial on appeal must be written and include the specific reason for the denial, reference to the plan provisions on which the denial is based and other required content depending on the denial type.
- F. Access to the Courts.** Benefit disputes that (on rare occasion) cannot be

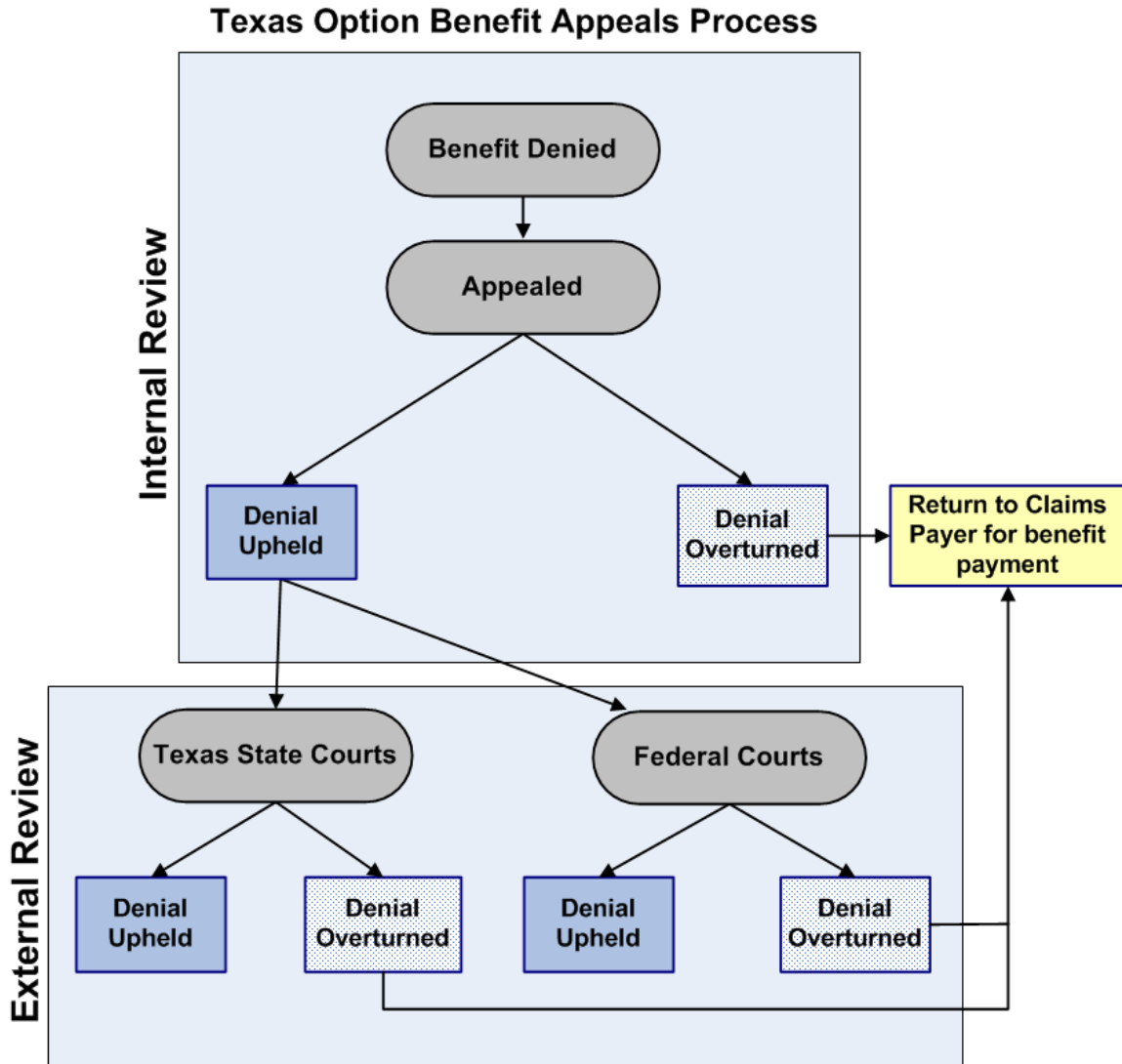
⁶⁸ Id.

⁶⁹ Note that, in addition to satisfying all ERISA requirements, such a plan under Oklahoma law must comply with benefit mandates prescribed in Sections 200-213 of Title 85A of the Oklahoma Statutes for employers that desire to be exempt from workers' compensation coverage requirements.

resolved through the above internal administrative processes can proceed to state or federal district court. ERISA provides that state courts of competent jurisdiction and district courts of the United States shall have concurrent jurisdiction of actions “to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan.”⁷⁰ Whether the claim is in front of a state or federal district court, the employee’s rights to benefits will be determined under the terms of the injury benefit plan and the same applicable law. In either forum, the state or federal court must (1) review the administrative record from the plan administrator’s prior decision(s) on the claim, and (2) determine whether the plan administrator’s decision on the claim should be upheld as being consistent with the terms of the plan and the plan administrator’s fiduciary obligation to administer the program in the best interests of employees, or reversed as being arbitrary and capricious. A party dissatisfied with the state or federal district court decision can further pursue the claim at the appropriate courts of appeal, including the state Supreme Court or United States Supreme Court. The following diagram reflects the internal and external claim review processes described above:

⁷⁰ 29 U.S.C.A. section 1132(e)(1). For further discussion of these court procedures in the context of the Oklahoma Option, see Q&A 26-34 in an FAQ at

<http://www.partnersource.com/media/23221/fagonoklahomaooption14-1215.pdf>. Similar rules apply to Texas nonsubscriber benefits litigation and any other state Option to workers’ compensation for private employers.



This system of justice relies on well-established legal precedents. Few changes have been made to ERISA over the past 10 years because it is a mature, widely-accepted system of administration that is supported by over 40 years of regulations and a large body of case law that defines a fair balance of employee and employer interests. For over 20 years, this same set of administrative rules has also reliably and successfully resolved hundreds of thousands of occupational injury claims for employers who elect an option to the Texas workers' compensation system.

- ii. **Reporting Requirements** – ERISA requires plan fiduciaries to prepare and file a Form 5500 annual report with the Department of Labor (“DOL”) within 210 days after the end of each plan year. This report is required for injury benefit plans

that cover more than 100 employees and provides (1) contact information for the plan sponsor, plan administrator and any other plan fiduciaries (2) information regarding plan benefits and funding, (3) insurance carrier and insurance premium/fee information, (4) financial information regarding any plan assets and how these amounts were used.

iii. **Administration and Enforcement** – Employers are held accountable under ERISA. As explained further below, an ERISA benefit plan is a legal plan that an employee can hold employers to. In addition to enforcement authority of the Texas Department of Insurance for state laws applicable to employers electing the nonsubscriber Option, ⁷¹ nonsubscribers are subject to enforcement actions from covered employees, beneficiaries, their representatives, and the U.S. Department of Labor. ⁷² The DOL can file an injunction to stop any action that violates ERISA or seek other appropriate equitable relief or redress. ⁷³ The Internal Revenue Service (particularly on matters of taxation injury benefits) and the Federal Bureau of Investigation (for example, for any theft of assets from a funded injury benefit plan) may also get involved in an Option program. These rights are not found in the Texas Workers' Compensation Act, so ERISA provides additional employee protections that would not otherwise be available. For example:

A. Breach of Fiduciary Duty. Any person who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by ERISA can be held personally liable to make good any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. ⁷⁴ If a plan participant or beneficiary recovers damages in an ERISA lawsuit, a court that finds a breach of fiduciary duty can also award an additional 20% of the amount of any recovery obtained in the lawsuit. ⁷⁵

B. Wrongful Denial of Benefits. ERISA also allows plan participants to bring a civil lawsuit in state or federal court to recover benefits due to him/her under the plan, or enforce his/her rights under the plan. If a plan fails to establish or follow the claims procedures described above, a claimant shall be deemed to have exhausted the administrative remedies under the plan and can go directly to the courthouse.

⁷¹ See "Reporting and Disclosure" under the heading, "State Laws Kept Simple" in subsection. G.1.b. above.

⁷² United States Code, Title 29, Chapter 18, Subchapter I, Subtitle B, Part 5, sections 1131 through 1141.

⁷³ 29 U.S.C. §§ 1132(a).

⁷⁴ 29 U.S.C. § 1109.

⁷⁵ 29 U.S.C. § 1132(l)(1).

- C. **Discrimination, Wrongful Termination or Retaliatory Discharge.** ERISA prohibits discrimination or wrongful termination.⁷⁶ Note that the wrongful termination provisions of ERISA, FMLA, ADA and other state and federal laws should silence uninformed critics of the Texas Supreme Court's decision that holds the workers' compensation retaliatory discharge law does not apply to nonsubscribers.⁷⁷ These other provisions of law amply discourage retaliatory discharge and provide wronged employees a remedy.
- D. **Failure to Provide Information.** The DOL can assess a civil penalty of up to \$110 per day for a plan fiduciary's failure or refusal to comply with a request for any information which it is required to furnish to a participant or beneficiary. In addition, the plan fiduciary may be personally liable and a federal court may order such other relief as it deems proper. Each violation with respect to any single participant shall be treated as a separate violation.⁷⁸
- E. **Continuing Violations.** A plan participant can also enjoin the plan from continuing any act or practice that violates ERISA, or seek other equitable relief or redress.⁷⁹
- F. **Failure to File Reports.** The DOL can assess a civil penalty of up to \$1,100 per day from the date of the plan fiduciary's failure or refusal to file a Form 5500 annual report with the DOL. The IRS can also impose separate penalties of \$25 per day (up to \$15,000 per plan) for not filing a Form 5500 annual report. (Note that, unlike the DWC for state-required reports, the DOL has an amnesty program that reduces civil penalties for employers who fail to file or file late their required annual Form 5500 reports. Employers who voluntarily agree to file under the Delinquent Filer Voluntary Compliance ("DFVC") Program are permitted to pay reduced civil penalties. The DOL has made it clear that the DFVC Program only applies to employers who come forward voluntarily. Those found to be in violation of filing requirements by federal investigators are subject to the traditional penalties outlined above.)
- G. **Attorneys Fees** – A court hearing an ERISA claim may, in its discretion, award attorney fees and costs with respect to any legal action provided under ERISA.⁸⁰
- H. **Criminal Penalties** - Any individual who willfully violates any provision of ERISA can upon conviction be fined up to \$100,000 or imprisoned up to 10 years, or both. If the criminal penalty is assessed against a company, the

⁷⁶ 29 U.S.C. § 1140.

⁷⁷ Texas Mexican Railway Co. v. Bouchet, No. 96-0194 (Tex. 1998).

⁷⁸ 29 U.S.C. § 1132(c)(1).

⁷⁹ 29 U.S.C. § 1132(a).

⁸⁰ 29 U.S.C. § 1132(g).

company can be criminally fined up to \$500,000.⁸¹

5. **Balanced with ERISA's Employer Protections.**

- a. **Damage Limitations.** The only damages available to a plaintiff under ERISA are a declaratory judgment on entitlement to benefits under the plan, an order requiring the plan administrator to pay benefits, removal of the administrator, and an award of contractual benefits under the plan if benefits are determined to be payable.⁸² There are no rights to punitive damages, pain and suffering damages, or similar recoveries (although such recoveries are available in a negligence liability claims against a nonsubscriber).
- b. **No Jury Trials on Benefit Disputes.** A plaintiff is not entitled to a jury trial on ERISA benefit disputes. Issues under ERISA are for the judge to decide.⁸³
- c. **Preemption of Other State Law Claims.** ERISA levels the playing field with overly aggressive plaintiff attorneys by limiting injured employee claims to the benefit entitlements under the injury benefit plan. For example, courts have held that the following state law claims are preempted by ERISA:
 - i. Claims for intentional infliction of emotional distress from employer's wrongful denial of benefits.⁸⁴
 - ii. Claims for breach of good faith and fair dealing with respect to employer's handling of claims under its ERISA plan.⁸⁵
 - iii. Misrepresentation claims concerning details of ERISA plan.⁸⁶
 - iv. Improper processing of claims under the plan.⁸⁷
 - v. Contract claims for wrongful denial of benefits under plan.⁸⁸
- d. **Interpretive Discretion Over Injury Benefit Plan.** ERISA provides the claims administrator with an "arbitrary and capricious" standard of review for benefit payment decisions. This administrative discretion is available only when clearly reserved in the plan document.
- e. **Predictable Claim Outcomes.** Use of ERISA in the Texas nonsubscriber Option environment over the past 26 years has proven successful in the processing of hundreds of thousands of occupational injury claims. Ample benchmarking data across many industries demonstrates the results to expect from a system relying

⁸¹ 29 U.S.C. § 1131.

⁸² *Pilot Life Insurance Co. v. Dedeux*, 481 U.S. 41 (1987); *Forbau v. Aetna Life Insurance Co.*, 876 S.W.2d 132 (Tex. 1994) 29 U.S.C. § 1132(a)(3).

⁸³ *Borst v. Chevron*, 36 F.3d 1308, 1314 (5th Cir. 1994).

⁸⁴ *Pyle v. Beverly Enterprises*, 826 F.2d 206, 210 (N.D. Tex. 1993).

⁸⁵ *Pyle*, *supra*.

⁸⁶ *Ramirez v. Inter-Continental Hotels*, 890 F.2d 760, 762-63 (5th Cir. 1989).

⁸⁷ *Metropolitan Life Insurance v. Taylor*, 481 U.S. 58 (1987).

⁸⁸ *Degan v. Ford Motor Co.*, 869 F.2d 889, 893-95 (5th Cir. 1989).

upon ERISA principles for system administration.⁸⁹ ERISA also represents a uniform body of law that promotes predictability of trial outcomes.

- f. **Acceptance by the Insurance Community.** Insurance markets and insurance agents have an appreciation for the familiarity of ERISA, which has governed system administration for employer-sponsored group health and disability plans for over 40 years. They also appreciate the predictability of claim outcomes (described above) and existing resources to understand ERISA, both of which have a positive impact on the integrity of insurance carrier underwriting models and lower insurance agent errors and omissions exposures.

VII. Validation of Texas Option Success

A. **Independent Studies.** There have been three truly independent and credible studies of the Texas nonsubscriber Option:

1. **“Opting Out of Workers’ Compensation in Texas: A Survey of Large, Multistate Nonsubscribers”** by Alison Morantz, associate professor of law and the John A. Wilson Distinguished Faculty Scholar at Stanford Law School, Regulation vs. Litigation – Perspectives from Economics and Law, National Bureau of Economic Research, 2010. This research was supported by National Science Foundation Grant. Professor Morantz’ report can be found at <http://www.nber.org/chapters/c11965.pdf>. Key findings include:
 - a. Virtually all respondents (94 percent) said they deemed the program a success.
 - b. Virtually all respondents (98 percent) cited cost savings as a benefit of nonsubscription, and most (86 percent) cited the magnitude of cost savings as a positive surprise. The average reported cost savings for all groups exceeded 50 percent.
 - c. A substantial majority of respondents also cited greater control over medical providers and/or benefits, and higher-quality medical care for injured employees, as advantages.
2. **“Workers’ Compensation Opt-Out: Can Privatization Work?”** by Peter Rousmaniere and Jack Roberts. This insightful 2012 report can be found at <https://www.sedgwick.com/NewsRelease/WCOpt-OutStudy.pdf>. Key findings include:
 - a. Nationwide, employers perceive that persistent problems afflict the statutory workers’ compensation system, resulting in excessive claims costs and abetting fraud and abuse. Opt-out systems can remove or mitigate these problems.

⁸⁹ PartnerSource conducts biennial benchmarking studies of Texas nonsubscriber claims across six different industries. See “Ultimate Claim Cost Comparisons” in Section VII under “Validation of Texas Option Success”.

- b. Decades of employer experience with ERISA for medical, accident and disability benefits and ERISA regulation by the Employee Benefits Security Administration within the Department of Labor have brought about a high level of predictability with compliance requirements, the dispute resolution process and the strength of the federal pre-emption. This certainty enables employers, with counsel, to plan for the efficient deployment of an opt-out program and insurers to design insurance products and underwrite with confidence.
 - c. ERISA plans demand more aggressively than statutory systems that injured workers be responsible for their own health behaviors.
 - d. State oversight of an opt-out system can be lean and effective.
3. **Aon Risk Solutions 2014 Retail Benchmark Analysis** by Tim Banick and Andrea Bode. Aon (the world's largest property/casualty insurance services firm) recently issued their 2014 retail industry benchmarking analysis for workers' compensation (the "Aon Study"). This study considered:
- a. Over 2.6 million non-zero value work compensation claims
 - b. Over \$19.1 billion of incurred work compensation loss and allocated loss adjustment expense ("ALAE")
 - c. Over \$16.6 billion of paid work compensation loss and ALAE
 - d. Over \$1.1 trillion of payroll
 - e. 73 participants
 - f. Over 86,000 store locations representing all 50 states, as well as United States unincorporated territories.

Texas workers' compensation and nonsubscriber Option claims data was thoroughly analyzed using multiple actuarial methods. Notable findings include this statement: "A very favorable impact in loss severities and loss costs has been experienced by those retailers who have opted out of the Texas work comp environment and formed a Texas nonsubscriber program. In the most recent years, retailers have experienced Texas nonsubscriber severities and loss costs approximately 40% to 50% lower than retailers who subscribe to the work comp environment." ***Aon ranked the costs of all programs in the United States (and its territories), and Texas nonsubscription has the lowest cost.***

* * *

Many other Option employers, insurance carriers, third party administrators, brokers and consultants have statistically credible data and can also vouch for employee satisfaction that is consistent with the findings of the above three studies. ***The Texas Legislature does not have to mandate disclosure of such data and create additional employer expense and government bureaucracy in the process. Voluntary employer and independent third party releases of Option data will become more common. In the meantime, an efficient and effective way to pursue such information would be for key legislators and regulators to simply request nonsubscribing employers and service providers for an opportunity to confidentially review.*** Consider the following overview:

B. Broad Comparison of Workers' Compensation and Texas Option Performance.

PartnerSource Texas nonsubscriber Option data can be compared to workers' compensation system data published by the Texas Department of Insurance.

	TX Workers' Comp	TX Option
Estimated Annual Industry Claims Count	200,000 ⁹⁰	50,000 ⁹¹
Injury Reporting Requirement	Within 30 days	Within 24 hours ⁹²
Percent Returning to Work within Six Months⁹³	83% ⁹⁴	96% ⁹⁵
State Expense to Administer and Oversee Claims	\$35 million ⁹⁶	\$0
State Employees Required	517 FTE's ⁹⁷	None

⁹⁰ The numbers and percentages in this table include all lost time and medical only claims. Note that this total claim count does not match the number of claims reported to the Division of Workers' Compensation since only fatalities, occupational diseases and injuries that result in at least one day of lost time are reportable according to the Texas Workers' Compensation Act. Estimated total number of injury claims for workers' compensation are based on Texas Department of Insurance, Division of Workers' Compensation, System Data Reports updated through December 2013 ("System Data Reports") at https://wwwapps.tdi.state.tx.us/inter/perlroot/wc/systemreports/PDF/sysrpts_Benes.pdf and Setting the Standard: An Analysis of the Impact of the 2005 Legislative Reforms on the Texas Workers' Compensation System, 2014 Results ("Setting the Standard") (figure 5.2), at <http://www.tdi.texas.gov/reports/dwc/documents/2014regbiennialrpt.pdf>.

⁹¹ PartnerSource provides support and oversight on over 25,000 Texas and Oklahoma Option claims annually. Option industry estimates are based on the largest database of nonsubscriber claims, as well as the total number of workers covered by nonsubscriber injury benefit plans in the 2014 Survey of Employer Participation in the Texas Workers' Compensation System, Texas Department of Insurance Workers' Compensation Research and Evaluation Group at <http://www.tdi.texas.gov/reports/wcreg/documents/nonsub.pdf>. This mix of 80% of claims in workers' compensation and 20% of claims in nonsubscription is also validated by the 2014 DWC Nonsubscriber Survey (slide 7) report that 20% of all Texas workers are employed by nonsubscribers.

⁹² Most common Option program requirement, but can vary by employer. Delays in injury reporting often result in (a) delayed medical care, (b) worse medical outcomes, and (c) unnecessary exposure of fellow workers to the unsafe working condition that led to the injury.

⁹³ Percent of injured employees receiving income benefits who went back to work within six months.

⁹⁴ Texas Department of Insurance, Workers Comp & Research Evaluation Group 2015

⁹⁵ Based on 476 Texas Nonsubscriber Option claims with incurred indemnity. Texas Nonsubscriber Option injury benefit plans commonly start wage replacement on the first day of disability, but Texas Workers' Comp starts on the 8th day. So, both sets of data eliminate claims with less than 8 days of disability.

⁹⁶ TDI's fiscal year 2014 operating budget reflects over \$35 million and 517 *full-time equivalent positions* dedicated to regulating the Texas workers' compensation system. See <http://www.tdi.texas.gov/reports/documents/2014operatingbudget.pdf> (Goal 4). Actual TDI expense for workers' compensation may be much higher. See subsection below on "State Budget Savings from Nonsubscription".

⁹⁷ Id.

	TX Workers' Comp	TX Option
Retail Average Cost Per Claim ⁹⁸	\$8,306	\$3,128
Retail Benchmark Cost per \$100 payroll ⁹⁹	\$1.03	\$0.61

In summary, when compared to Texas workers' compensation, the Option results in:

- 1. Faster Injury Reporting and Medical Care,**
- 2. Faster Return to Work,**
- 3. No Regulatory Expense to Oversee Claims, and**
- 4. Dramatically Lower Employer Costs.**

Additional data reflecting fewer lost time claims and claim disputes, as well as other metrics validating the success of Options to workers' compensation, are currently being updated.

Opponents of the Texas nonsubscriber Option have long claimed that, due to its "unregulated" nature, nonsubscription programs have vastly inferior performance when compared to workers' compensation system performance, and that Option employers lack care and concern for workers. However, all available workers' compensation system and nonsubscriber data points in the opposite direction.

As described herein, the Option substantially increases productive communication between employers and employees on their rights and responsibilities. A written injury benefit plan must specify definitely determinable benefits. The employer must formally adopt that plan and the plan terms must be fully communicated to employees in language they understand. ¹⁰⁰ Employee accountability is improved through simple, logical injury reporting and medical management requirements that lead to better, more predictable medical outcomes. When employees are being well-cared for and have a high level of satisfaction with how they've been treated, we see fewer and faster resolution of disputes. ¹⁰¹ Both stakeholders are engaged and at the table, working together for better medical outcomes and return to work. This must be contrasted with trying to resolve workers' compensation claims through application of thousands of pages of statutes, regulations, and case law that require a team of attorneys to navigate and tens of millions of taxpayer dollars to oversee and administer.

⁹⁸. Aon Risk Solutions 2/1/2014-2015 Retail Benchmark Analysis, Retail Stores, 2014 Average Severity Per Claim, Limited to \$1 Million Loss and ALAE Per Occurrence Retention ("Non-Zero *Claim Severity* is the main driver to differentiating loss costs...").

⁹⁹. Aon Risk Solutions 2/1/2014-2015 Retail Benchmark Analysis, Retail Stores, 2014 Loss Costs Per Hundred Dollars of Payroll, Limited to \$1 Million Loss and ALAE Per Occurrence Retention.

¹⁰⁰. See section VI.G. regarding ERISA summary plan description requirements.

¹⁰¹. It is interesting to note that there currently are 347 members of the Workers' Compensation section of the State Bar of Texas. In contrast, only a few dozen Texas plaintiff and defense attorneys regularly handle negligence and wrongful denial of benefit lawsuits against Texas nonsubscribing employers.

- C. **Ultimate Claim Cost Comparisons and Benchmarking.** The opportunity for dramatic cost savings can be readily seen in the success achieved by employers across the U.S. through their Texas nonsubscriber Option programs. First year savings moving from Texas workers' compensation to nonsubscription consistently exceed 40% and range up to 90%.¹⁰² Normally, the savings are immediate and, in most cases, they are predictable and sustainable, if properly managed. In support of Option employers that incur tens of thousands of injury claims per year, PartnerSource performs formal claim benchmarking studies across six industries. Results from the 2013 and 2014 benchmarking studies are shown below. These actuarially credible, fully developed and trended nonsubscriber claim results can be contrasted with the latest available Texas workers' compensation average claim costs reported by the National Council on Compensation Insurance as follows:

¹⁰² PartnerSource developed and trended client data.

Public Policy Analysis

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Texas WC Averages from 2014 NCCI Annual Statistical Bulletin

Policy Period	Average Claim	Trend 5% per Year to 2015	Trended Average
01/06-12/06	\$8,612	1.551	\$13,360
01/07-12/07	\$9,196	1.477	\$13,587
01/08-12/08	\$10,447	1.407	\$14,700
01/09-12/09	\$10,294	1.340	\$13,795
01/10-12/10	\$10,063	1.276	\$12,843
Average	\$9,722		\$13,657

Above numbers exclude ALAE* so assuming ALAE is 15%:

Policy Period	Average Claim	Average Including 15% ALAE	Trended Average
01/06-12/06	\$8,612	\$9,904	\$15,364
01/07-12/07	\$9,196	\$10,575	\$15,624
01/08-12/08	\$10,447	\$12,014	\$16,905
01/09-12/09	\$10,294	\$11,838	\$15,864
01/10-12/10	\$10,063	\$11,572	\$14,769
Average	\$9,722	\$11,181	\$15,705

*From page 399: "Direct defense and cost containment expenses (allocated loss adjustment expenses) are not included."

Texas Nonsubscriber Benchmarking Studies

	Average Developed & Trended to 2015
2013 Trucking & Distribution	\$7,787
2013 Manufacturing	\$5,089
2013 Hospitality	\$2,923
2014 Health Care	\$2,621
2014 Restaurant	\$2,668
2014 Retail	\$3,283

Trend used is 5% per year. Above nonsubscriber numbers include ALAE.

D. Where Do the Savings Come From? In a nutshell...

- 1. Improving Medical Outcomes:** Employee and medical provider accountability required in the injury benefit plan as a condition of benefit payments results in –
 - Faster notice of injury
 - Immediate medical treatment
 - Best medical providers utilized
 - Earlier and more persistent medical treatment
 - Strict adherence to doctor's orders
 - Elimination of experimental, investigational, and unproven medical procedures
- 2. Encouraging Return to Work:** The treating medical provider controls return to work, not the injured employee's self-reporting of ability to return.
 - Medical providers are provided with descriptions and requirements for full duty and available modified duty positions.
 - Return to work is viewed as a medical treatment modality.
 - Wage replacement stops when released to full or modified duty
- 3. Mitigate Fraud and Abuse:** The injury benefit plan can specifically exclude or deny claims involving (for example)...
 - Untruthfulness or a demonstration of bad faith in connection with administration of the injury benefit plan, including, but not limited to, any aspect of the required information supplied as part of the injury reporting, medical treatment or employment process.
 - Conduct following an injury that is determined by the treating approved physician to be an injurious practice that is hindering the employee's recovery from the Injury.
 - Pre-existing conditions and underlying degenerative disease and disorders of aging.
- 4. Employee Paradigm Shift** – Nonsubscription relies on employee "Accountability." It's no longer about workers' compensation benefit "Entitlement!"

E. Faster Claim Payment and Closure. As stated in the above Aon Study, "Loss Development Patterns vary significantly for Texas non-subscriber programs. Both incurred and paid development patterns display much shorter tails than typical work comp loss development." Data from Aon and data from PartnerSource and the National Council on Compensation Insurance tell the same story. Texas nonsubscriber Option claims are paid out and close faster. Consider the following comparison of payout patterns based on Texas workers' compensation paid development factors from NCCI ¹⁰³ and PartnerSource nonsubscriber Option development factors:

¹⁰³. National Council on Compensation Insurance Annual Statistical Bulletin, 2014 edition.

Year	Texas Option	Texas WC
1	54.8%	32.5%
2	80.1%	62.6%
3	90.1%	73.2%
4	97.4%	77.4%
5	99.6%	79.7%
6	100.0%	81.5%

At the end of the first year, over half of the cost of nonsubscriber Option claims has been paid, compared to only 32% of workers' compensation claims. At the end of three years, only 10% of the nonsubscriber claim is still outstanding while 27% of the workers' compensation claim is outstanding. By year 6, the nonsubscriber claim is completely paid, while workers' compensation still has 18.8% to go. Incurred loss development patterns are also consistent.

Generally, the longer an injury benefit claim remains open, the more expensive it becomes and the less likely the injured employee will ever return to work. The nonsubscriber Option has significantly improved the claim closure rate compared to the Texas workers' compensation system. The table below shows the development of 70,000 closed Option claims over time.

Year	1	2	3	4	5
TX Option Closed Claims	77.5%	99.1%	99.6%	99.9%	100.0%

Three-quarters of Texas Option claims are closed by the end of the first year and by the end of the second year virtually all claims are closed. Slower closure of workers' compensation claims has little to do with the availability of lifetime medical coverage in workers' compensation and a more limited duration of medical coverage under most Texas nonsubscription plans. Instead, it has much more to do with the immediate reporting of Texas injury claims, immediate medical treatment, the need for the injured worker to follow the treating provider's directions, the ability to achieve return work faster, and the ability to resolve any disputes faster.

In the event of a benefits dispute, the injury benefit plan readily and economically resolves the issue through a simple claim review process under ERISA.¹⁰⁴ In the event of a negligence liability dispute, resolution can be achieved fast through mediation or arbitration (if incorporated into the employer's program). Employers accrue less liability on their financial

¹⁰⁴ See "ERISA Protections" in section VI.B., "Employees Come First".

statements for fewer open claims, and they post no collateral with insurance carriers or the state because they are directly liable for the payment of benefit claims to employees. Faster claims closure works to the advantage of the two key system stakeholders: employees and employers. Virtually every employer that has elected the Option to Texas workers' compensation can attest to this advantage.

Faster claims closure is also supported by the ERISA plan administrator having authority to settle long-term injury claims by entering into a voluntary settlement with the injured worker (or in the case of death, the workers' family). Voluntary settlements are matters of contract between the employer and injured worker, and can be developed based upon the advice of treating medical providers. Such agreements may take into account the workers' personal desire for particular forms or durations of payment (for example, a lump sum payment, or a "life care plan" involving continued medical care and annuity income payments). The claim is funded and finalized. Such agreements are also subject to statutory protections applicable to post-injury waivers of negligence.¹⁰⁵

F. Impact of the Option in Reducing Workers' Compensation Premium Rates.

Companies that are most likely to nonsubscribe from Texas workers' compensation commonly come from the retail, health care, food service, transportation, distribution, and manufacturing sectors. This includes companies that we do business with and rely upon every day and are well-known as responsible corporate citizens (including dozens of Fortune 500 companies). Employers in other industries with significant injury frequency (like banking call centers) and even companies with high severity exposures (like oil and gas companies) may also gravitate toward an alternative to workers' compensation in order to achieve more employee accountability, higher employee satisfaction, and claim cost savings. On the other hand, companies primarily made up of office workers or that otherwise experience few on-the-job injuries more commonly provide workers' compensation coverage.

Small companies that experience few, if any, on-the-job injuries typically purchase workers' compensation insurance coverage on a guaranteed cost or low deductible basis. However, small companies with few, if any, claims may elect the Option when they hear of its advantages.¹⁰⁶ Option insurance carriers have made the process fairly easy by providing turnkey documentation kits and services that include standardized injury benefit plan documents, employee communications, and claims administration services. There are large books of Texas nonsubscriber insurance business with hundreds or even thousands of small employer policyholders that never (or rarely) incur any injury claims.

¹⁰⁵ See "Post-Injury Waivers" under Section VI.G. "Simple, Self-Executing State and Federal Laws".

¹⁰⁶ See section VI. on the "Foundations of Texas Option Success".

Larger employers are much less likely to elect the nonsubscriber Option unless they have some frequency of Texas on-the-job injuries. They tend to require an objective, financial return-on-investment for the time, effort, and expense required to:

1. Establish a new occupational injury benefit plan,
2. Rollout special employee communications,
3. Comply with new state and federal reporting and disclosure requirements,
4. Establish a new injury claims administration process, and
5. Buy special insurance coverage for this unique risk.

With few injury claims, risk managers for larger employer elect to provide workers' compensation coverage so they can simplify their lives to focus on other business priorities.

Over the past decade, Texas workers' compensation premium rates have been cut in half!¹⁰⁷ By taking large employee populations that tend to have more injury frequency and high losses out of workers' compensation, the workers' compensation insurance carriers who provide coverage to the remaining employers have suffered fewer losses and been able to reduce workers' compensation premiums. Even with 33% of all Texas employers electing to not subscribe, the "pool" of Texas workers' compensation premium is over \$2 billion – a figure certainly large enough to spread the risk and absorb many catastrophic claims.¹⁰⁸

Removing approximately 50,000 Texas injury claims per year from the workers' compensation system via the nonsubscription option has made implementation of system reforms more manageable and required workers' compensation insurance carriers to move more quickly to gain the economic advantages of such reforms as they compete harder for business. All employers who have remained in the workers' compensation system over the

¹⁰⁷. "Setting the Standard: An Analysis of the Impact of the 2005 Legislative Reforms on the Texas Workers' Compensation System, 2014 Results", at

<http://www.tdi.texas.gov/reports/dwc/documents/2014regbiennialrpt.pdf>, Executive Summary on page vii.

¹⁰⁸. Direct written premium for Texas workers' compensation in 2011 was \$2.2 billion. BestLink – State/Line P/C or Best's Special Report, Segment Review, Nov. 12, 2012 at

http://www.ambest.com/directories/bestconnect/USWorkersComp_SR_2012_171.pdf, Exhibit 3. See "Costs to Employers and Efficiencies in the Texas Workers' Compensation System", Texas Department of Insurance Workers' Compensation Research and Evaluation Group (9/1/11) at http://www.tdi.texas.gov/reports/wcreg/documents/Employers_cost.pdf, Table 7, estimating Texas net premium from 2003 to 2008 ranging from \$3.2 billion down to \$2.6 billion. In that same report, page 18 (Standard and Net Premium Levels): "Premiums are reported in various terms depending on particular analytic needs or data reporting requirements. For example, premiums are reported as earned premium or written premium, designated statistical reporting (DSR) level premium, company standard premium, or net premium, and by policy year, calendar year or injury year. Often gross and net premiums are differentiated on the basis of returned premium and reinsurance. Reported premiums may also be restricted to certain type of policies. Such disparity often works as a deterrent to comprehensive and meaningful comparison and analyses of the premiums and other costs reported by the insurance carriers. After settling on a particular definition of the premium, there still exist problems in estimating non-reported, out-of-pocket costs of the employers." This report also notes that even after numerous adjustments are considered, "the average premium may differ substantially from those [reported]." Id. at page 21. See Id at page 23 for estimates on the mix of payroll and Texas workers' compensation premiums in 2008 by employer size.

past decade have enjoyed the benefits of the 2005 future workers' compensation reforms and are more likely to benefit from further reforms faster due to the nonsubscriber Option "relief valve" that has pulled huge numbers of significant claims out of the system.

Workers' compensation insurance carriers, legislators and regulators routinely give credit to House Bill 7, which was passed in 2005, and other reforms as being solely responsible for improvements in Texas workers' compensation costs. But this ignores the fact that:

1. The nonsubscriber Option has created a greater sense of urgency among regulators and workers' compensation insurance carriers to manage claims better so they can reduce premium rates to compete with the alternative system;
2. The Option has made implementation of workers' compensation reforms more manageable across a smaller base of claims; and
3. Workers' compensation premium rates have decreased, in part, because employers with more frequent (and many severe) claims have chosen to move to the alternative system.

This has particularly worked to the advantage of small employers who pay most of the workers' compensation system premiums.¹⁰⁹ A big advantage of a truly competitive marketplace!

G. State Budget Savings Resulting from the Option. As reported in the 2011 Sunset Final Report on the Texas Department of Insurance and its Division of Workers' Compensation:¹¹⁰

1. **State Employees for Workers' Compensation.** Of TDI's 1,572 staff, 697 are dedicated to workers' compensation-related functions within the agency, and 240 operate from DWC's 24 field offices across the state.¹¹¹
2. **State Funding for Workers' Compensation.** DWC is primarily funded from a maintenance tax assessed on all workers' compensation insurance carriers writing policies in Texas (and is paid for by Texas employers). Of TDI's total budget of \$164

¹⁰⁹ "Costs to Employers and Efficiencies in the Texas Workers' Compensation System", Texas Department of Insurance Workers' Compensation Research and Evaluation Group (9/1/11) at http://www.tdi.texas.gov/reports/wcreg/documents/Employers_cost.pdf, report pages 22-23 (premiums by employer size).

¹¹⁰ Sunset Advisory Commission Final Report on the Division of Workers' Compensation – Texas Department of Insurance and the Office of Injured Employee Counsel, July 2011 at https://www.sunset.texas.gov/public/uploads/files/reports/Workers%27%20Compensation%20Division%20of%20TDI_Office%20of%20Injured%20Employee%20Counsel%20Final%20Report%202011%2082%20Leg_0.pdf (page 9).

¹¹¹ Compare to 2014 budget numbers at footnotes 104 and 105.

million, about 39 percent, or \$64 million, was dedicated to workers' compensation-related functions at the Department in fiscal year 2009. In 2009, TDI expended about \$52 million on the regulation of workers' compensation.¹¹²

In contrast, the delivery of nonsubscriber Option benefits to 20% of all Texas workers (according to the 2014 DWC Survey of Nonsubscription) and the resolution of many hundreds of thousands of Option injury claims over the past 25 years has required **ZERO state regulatory agency employees or cost**. Also, minimal state judicial resources have been needed to resolve nonsubscriber claims, with only 0.1% of PartnerSource-supported nonsubscriber claims actually requiring a state court or arbitrator decision. How many more state government regulatory and judicial employees and expense would be needed to handle reporting, administration, dispute resolution and enforcement on the 50,000 claims per year that are now running through nonsubscriber Option benefit plans?

H. Minimal Federal Expense and No Federalization of Workers' Compensation. The Texas nonsubscriber Option minimally touches the federal government through filing of IRS/DOL Form 5500 (Annual Returns/Reports) for injury benefit plans that cover more than 100 employees; and the U.S. Department of Labor may receive a rare inquiry from a covered employee regarding their rights under the terms of the benefit plan or ERISA. There is not one federal employee whose time is dedicated to Texas Option issues, and the Option provides zero support for hiring more federal workers. The Texas Option has resulted in no new employees being added to federal payrolls over the past 25 years. The Option also does not require any form of federalization of workers' compensation through new laws or bureaucracy. For example, the Patient Protection and Affordable Care Act ("PPACA") does not have any applicability to Option benefit plans. Like mandatory workers' compensation systems, PPACA removes employer choice. The Option provides employer choice. The requirements of PPACA apply only to traditional group health plans and specifically exclude plans that deliver "excepted benefits" such as:

1. Workers' compensation or "similar insurance,"
2. Coverage only for accident (such as accidental death and dismemberment benefits) or disability income insurance or any combination thereof,
3. Liability insurance, including general liability and auto liability, and
4. Coverage issued as a supplement to liability insurance (such as medical benefits that are secondary or supplemental to liability coverage).

This same list of "excepted benefits" is used in the HIPAA medical privacy rules, HITECH (an amendment to HIPAA), and the Mental Health Parity Act and makes clear that the United

¹¹²TDI's fiscal year 2014 operating budget reflects over \$35 million and 517 *full-time equivalent positions* dedicated to regulating the Texas workers' compensation system. This disjoint in expense deserves further study.
<http://www.tdi.texas.gov/reports/documents/2014operatingbudget.pdf> (Goal 4).

States Congress had no intention, whatsoever, to have national healthcare reform apply to workplace injury benefits. Thus, any risk of a workers' compensation Option federalizing workers' compensation or otherwise attacking the sovereignty of the State would be much exaggerated and simply contrary to the law.

- I. **Economic Impact.** Employers want to know that their money is being well spent. When uncertain about that, they pull back on business operations (such as declining to locate new business facilities in states that pose such uncertainty). When employers are considering which state to locate a manufacturing facility, call center, truck terminal, distribution center, etc. (which bring jobs) they look at the cost to do business. They know the nonsubscriber Option gives Texas an advantage and is a big part of Texas' successful jobs growth formula.

Consider these facts:

1. **Billions Saved.** Texas employers have saved billions of hard dollars, ¹¹³ generating massive economic development and delivering higher injured employee satisfaction through an Option to workers' compensation.
2. **Jobs Created.** The nonsubscriber Option has helped Texas lead the nation in job creation and is contributing to its standing as one of the best places to do business in the country. Texas Governor Greg Abbott agrees that allowing private employers to decide what's best for them has helped make Texas an economic powerhouse. "There are several things that have led to Texas growing jobs more than any other state," he said. "One was the reform that allowed employers to choose whether or not they were going to purchase workers' compensation insurance." ¹¹⁴ That's many thousands of jobs on top of the 1,000+ Texas employees who currently work in Option injury program development, administration and insurance (mentioned above regarding private sector industry employment).

¹¹³ PartnerSource has confirmed that its nonsubscriber clients alone saved over \$1 billion on workers' compensation claim costs between 2001 and 2011.

¹¹⁴ The Texas Tribune, July 1, 2014 ("Keep Workers' Comp Voluntary, Abbott Says").

VIII. Conclusion:

History has a way of eventually sorting out matters of self-interest that are bad for employers AND bad for injured workers. Texas lawmakers that have embraced the nonsubscriber Option have been shown to be on the right side of history.

It should be no surprise that Oklahoma, Tennessee, and other states are now working hard to replicate Texas nonsubscription's success.¹¹⁵ The "Texas Option", the "Oklahoma Option",¹¹⁶ and the "Tennessee Option"¹¹⁷ all consistently reflect:

1. An inverse relationship between benefit mandates and liability exposures,
2. The same foundations of success discussed herein, and
3. An opportunity to achieve better medical outcomes for injured workers and substantial economic development.

¹¹⁵ See information on the Association for Responsible Alternatives to Workers' Compensation at www.arawc.org ("ARAWC" - pronounced, "A Rock")(a national organization formed in 2014, comprised of employers that are building upon their success in nonsubscription to Texas workers' compensation and the Oklahoma Option to develop the same or similar alternatives to workers' compensation in other states).

¹¹⁶ Sections 200-213 of Title 85A of the Oklahoma Statutes at <http://www.oscn.net/applications/oscn/Index.asp?ftdb=STOKSTB1&level=1>. Extensive information on the Oklahoma Option can be found at <http://www.partnersource.com/oklahoma-option/>, including educational resources such as an FAQ.

¹¹⁷ Senate Bill 721 at <http://wapp.capitol.tn.gov/apps/BillInfo/Default.aspx?BillNumber=SB0721>. Bill synopsis and other materials on the Tennessee Option are available from ARAWC.