

LITTLE HOOVER COMMISSION



WORKERS' COMPENSATION CONTAINING THE COSTS

February 1993

LITTLE HOOVER COMMISSION

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Little Hoover Commission

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The Honorable David Roberti
President Pro Tempore of the Senate
and Members of the Senate

The Honorable Willie L. Brown Jr.
Speaker of the Assembly
and Members of the Assembly

The Honorable Kenneth L. Maddy
Senate Minority Floor Leader

The Honorable James Brulte
Assembly Minority Floor Leader

Dear Governor and Members of the Legislature:

For too many years, California has allowed the cost of Workers' Compensation to rise at unconscionable rates, squeezing the prosperity out of businesses and wreaking havoc on the State's economy and ability to provide jobs to its citizens. Although it has long been acknowledged that businesses pay the highest rates and injured workers receive the lowest amounts of compensation in the nation, past reforms have done little to improve the plight of either.

The Little Hoover Commission recognizes that some progress has been made on the glaring problems identified in the Commission's 1988 evaluation of the Workers' Compensation system. However, it has quite simply been too little too late. The astronomical rise in the cost of insurance has driven endless numbers of small businesses to bankruptcy while forcing others to move their operations out of state. Without question, California's Workers' Compensation crisis has been and continues to be a major cause of the State's severe economic problems.

In today's report, the Commission provides many examples of Workers' Compensation's effect on the economic climate:

- * A 68 year old family-owned bakery in Stockton shut its doors in 1992 when it learned its Workers' Compensation costs could rise 200 percent.
- * A furniture manufacturer in Los Angeles employing 125 people has had its premiums increased to \$400,000 a year -- an identical factory operating in North Carolina pays only \$4,000 a year.
- * A frozen food company reports that the California rate for workers who process frozen fruits and vegetables is more than double the rate in Oregon and Arizona.

We are not the first to hear examples such as these. The California Business Roundtable, the Council on California Competitiveness, the California Manufacturers Association, and the Legislature itself has also documented case after case with one common message -- give business relief from the unbearable burden of Workers' Compensation.

The State must act now! California's economy cannot afford to allow special interests to prevent immediate and total containment of escalating costs and long-term reform of the system. In the attached report, the Commission presents four findings and nine recommendations including:

- * Establish managed care as the mode for delivering Workers' Compensation medical services to curb over-treatment and other system abuses. Limit profit-driven medical treatment by establishing practice guidelines and effective fee schedules while safeguarding appropriate treatment for injured workers.
- * Focus vocational rehabilitation on programs that can quickly and efficiently return employees to work. Provide incentives for employers to create modified or alternative jobs and limit their responsibility for vocational rehabilitation costs to a single plan or course of action.
- * Eliminate costly multiple medical/legal evaluations.
- * Limit stress claim benefits to those who have been injured by an on-the-job event of a clearly definable nature.
- * Continue to weed out fraud by both employers and employees with more aggressive investigation, prosecution and punishment.

The Commission urges you to take immediate steps to institute reform. Solving the Workers' Compensation crisis is not simply a way to put more profit in businesses' pockets. A dramatic drop in premiums is the key to arresting the State's growing unemployment, freeing more resources that schools can use in the classroom, and holding down skyrocketing health care costs. The negative impact of Workers' Compensation is so pervasive that addressing this persistent problem is the single most important action necessary to put California's economy back on track.

Sincerely,



Nathan Shapell
Chairman

WORKERS' COMPENSATION

CONTAINING THE COSTS

February 1993

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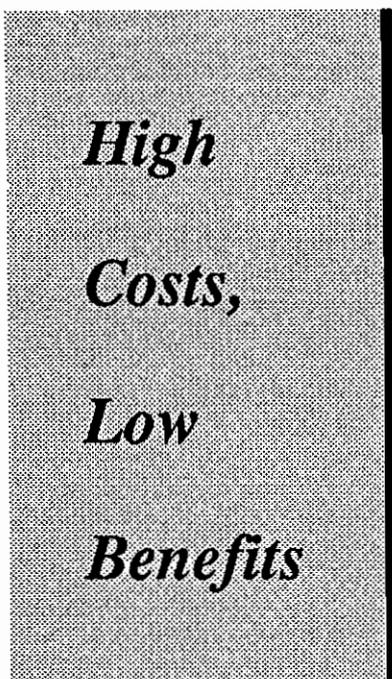
Executive Summary

Executive Summary

California's Workers' Compensation system was designed to support injured workers, yet much of the program's \$11 billion annual cost ends up in the pockets of attorneys, physicians, insurers and rehabilitation specialists. This has resulted in powerful interest groups that have been more concerned with preserving the present system than in pursuing reforms that would result in lower costs for businesses and higher benefits for employees.

In times of booming economic growth, the ever-spiraling cost of Workers' Compensation was absorbed by businesses. But the cumulative, devastating effect of runaway costs in the program now can be seen in businesses fleeing to other states and small firms closing their doors. Experts agree that Workers' Compensation has played no small role in pushing the State's unemployment rate above 10 percent and in the elimination of some 600,000 jobs in the past two years.

Faced with a program that has the highest costs and lowest benefits in the nation, California needs to focus on the driving forces behind those high costs and the disincentives for economic and efficient operation of the program. Areas of concern include medical care, rehabilitation services, fraud prevention, medical/legal reports and stress claims.



High Workers' Compensation costs are choking business but at the same time are producing little in the way of benefits for injured workers.

Escalating Workers' Compensation costs significantly affect business owners and their employees. While the system cost more than \$10 billion in 1990, only \$3 billion was paid out in benefits, while another \$3 billion covered medical care costs. That left approximately \$4 billion for the "middle men" of the system: insurers, consulting doctors and lawyers.

High Workers' Compensation costs prevent businesses from expanding, drive some employers out of business entirely, and encourage other California businesses to relocate out of state. While employers have borne the brunt of the rising cost, employees have failed to see comparable increases in their benefits.

The Workers' Compensation system is failing to meet the original goals set forth when the program was created. The cost to companies -- which was meant to be limited and finite -- is spiraling. The benefits for injured workers -- which were supposed to be enough to compensate them for their impairment -- are too low and slow in coming.

Recommendation:

1. **The Governor and the Legislature should convene a special session to focus on the Workers' Compensation system and facilitate the rapid implementation of reforms.**

Medical Costs

Medical costs have increased because of inefficiency, price-gouging and unnecessary treatments.

Employers are responsible for providing the necessary medical care for workers injured on the job. The costs for such care have rapidly increased, with physician's services rising from \$90 million in 1971 to \$2.7 billion in 1991. During the same period, hospital costs rose from \$100 million to \$1.2 billion.

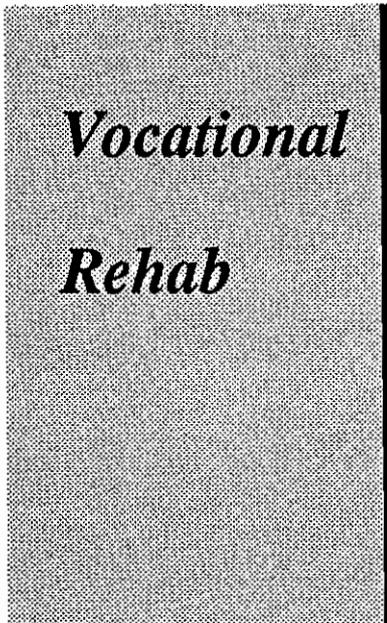
Several factors make up the mix of escalating costs:

- * The Workers' Compensation system is "liberally constructed;" that is, the injured worker is to be provided any and all treatment that is suggested by his or her condition.
- * There are insufficient incentives to hold costs down. Physicians are charging for more intensive and more costly procedures. Follow-up visits have become more common and physical therapy is prescribed more often.
- * Medical fees are regulated by a periodically adjusted state fee schedule, but many expensive procedures are not covered by the schedule.
- * Costs have shifted from other medical programs to Workers' Compensation, and there is a lack of coordination between Workers' Compensation and other forms of health coverage.
- * There is evidence of abuse and overutilization of medical services.

Recommendations:

2. **The Governor and the Legislature should enact legislation to establish managed care as the mode of delivery of medical services under the Workers' Compensation system.**

3. **The Governor and the Legislature should enact legislation that would establish system-wide limits for medical care under the Workers' Compensation system.**



The Vocational Rehabilitation Program lacks sufficient incentives to return employees to work quickly and to control cost.

Vocational rehabilitation is designed to help injured workers with a disability get back to productive employment. The benefit is important because it serves the social goals of promoting personal dignity, family stability and tax-paying capacity through returning a person to the labor force. Of California's 12 million workers, more than 56,000 are identified each year as potential candidates for vocational rehabilitation.

Those who have examined vocational rehabilitation programs closely over a span of years have concluded that the least expensive, most expeditious methods are the most effective in returning workers to jobs -- but are also the least used options. Despite a hefty growth in dollars spent on vocational rehabilitation, these services have been only partially effective in returning workers to jobs.

Lacking in the operation of vocational rehabilitation services are controls that would result in employees receiving only the most effective and suitable form of retraining. To achieve the most benefit for the injured worker and the least cost for businesses, California should institute controls to direct rehabilitation efforts.

Recommendations:

4. **The Governor and the Legislature should enact legislation that focuses vocational rehabilitation services on effectiveness for returning injured workers to the labor force.**
5. **The Governor and the Legislature should enact legislation that would limit employer liability for vocational rehabilitation.**

*Fraud,
Evaluations
and Stress*

The high incidence of fraud, the multiplicity of expensive medical/legal reports and the subjectivity involved with stress claims all place an overwhelming burden on the Workers' Compensation system without benefitting the injured workers the program was designed to protect.

Some components of the Workers' Compensation system involve services provided directly to injured workers, such as medical care and vocational rehabilitation. In those areas, the State has an interest in balancing carefully any cost containment efforts against the goal of adequately and fairly redressing workers for injuries. Other aspects, however, that have become part of the Workers' Compensation system over time add tremendous costs to the system without directly benefitting the on-the-job injured employees who Workers' Compensation was designed to protect. Chief among those factors are:

- * **Fraud.** Some critics of the system contend that up to 30 percent of the cost of Workers' Compensation -- a potential \$3 billion -- is wasted through fraud. This provides no benefit to deserving workers and, in fact, deprives them of the higher benefits and employers of the lower premiums that could be possible if money were not siphoned away from the system illegally.
- * **Multiple medical/legal reports.** Both the employee and the employer may fall into the "dueling doctor" syndrome, with each side obtaining multiple medical opinions to bolster their viewpoint of the degree of injury and its job-relatedness. Such reports cost the system \$700 million in 1990 -- almost half the total cost of litigation. Once again, these are costs that deprive the system of resources that could otherwise be spent on increased benefits.
- * **Subjectivity of stress claims.** While these claims represent only a fraction of all Workers' Compensation claims, they are a difficult-to-prove and highly

contentious type of claim that serves to undermine the credibility and viability of the system. With the State requiring very little of the cause of stress to come from a job and with the rapid growth in stress claims, this area of Workers' Compensation threatens to divert more and more dollars away from the benefits from workers with more traditional or directly job-linked types of injuries.

Recommendations:

- 6. The Fraud Assessment Commission should report to the Governor and the Legislature on the effectiveness of the 1992 anti-fraud laws by July 1, 1993.**
- 7. The Governor and the Legislature should enact legislation that would require employers to pay for only one medical/legal evaluation, which would be performed by a professional chosen by the injured worker.**
- 8. The Governor and the Legislature should enact legislation to restrict stress claims to on-the-job sudden or extraordinary events.**
- 9. The Governor and the Legislature should enact legislation to prohibit stress claims for "good faith" personnel actions.**

Of the three major issues that require reform by California government -- education, health care and Workers' Compensation -- only Workers' Compensation can be reformed without the infusion of billions of dollars and has the potential of immediately affecting the State's economy. At a time when California's economy is scraping the bottom, businesses are being devastated by Workers' Compensation insurance premiums that have grown unchecked. If reform cannot be accomplished, Workers' Compensation may continue to burden California's economy, drive businesses from the State and fail to meet the needs of injured workers.

Introduction

Introduction

California spends more for Workers' Compensation than it does for welfare and the aged, blind and disabled programs combined, yet the system serves only 20 percent as many people. Although designed to support injured workers, much of the \$11 billion cost of the workers' compensation program goes into the pockets of attorneys, physicians and rehabilitation specialists.

While there has been acknowledgement for years that employers are paying exorbitant premiums and injured employees are not receiving adequate benefits, powerful interest groups have stood in the way of meaningful reform. When reform has been attempted, it often has been packaged so that immediate increases in benefits are supposedly balanced by steps that will cut costs and free resources to fund the benefit increases. Unfortunately, too often the savings fail to materialize and benefits to injured workers continue to lag behind the national average. As a result, costs continue to skyrocket, threatening California's economy, businesses and jobs, and injured workers find themselves living in poverty, unable to support themselves and their families.

In this study, the Little Hoover Commission focuses on the major cost-drivers in the Workers' Compensation system and examines how the program can be reformed to meaningfully benefit the employers and employees. The priority of the Commission is to

lower the cost of the system without adversely affecting workers the system was designed to protect.

The Commission initiated its study of Workers' Compensation in California in May 1992 and held a public hearing on August 26, 1992, in Sacramento. The hearing addressed the issues presented in this report and elicited testimony from a broad cross-section of interested parties. (Please see **Appendix A** for a list of witnesses providing testimony for the Commission's hearing.)

As part of the study, Commission staff conducted extensive fieldwork by reviewing literature, publications and statistics related to the Workers' Compensation system. The Commission and its staff also interviewed dozens of people representing organizations who are actively involved in the Workers' Compensation system.

In addition to the Executive Summary, this report is presented in six chapters; the first chapter includes the Introduction and a Background. The next four chapters contain the study's four major findings and their corresponding recommendations, and the sixth chapter presents the Commission's overall conclusions. The report also contains appendices detailing information related to the study, and the report's endnotes.

Background

Background

Many believe that California's Workers' Compensation system is more troubled today than when the Commission last looked at the issue in 1988. There is widespread agreement that employers are paying some of the nation's highest Workers' Compensation premiums while seriously injured workers are receiving some of the nation's lowest benefits. Yet the system was created to protect workers, limit costs to employers and stimulate safety in the workplace.

Beginnings

The shift to an industrial economy in the late 19th and early 20th centuries saw a significant increase in workplace injuries. Injured employees had very little opportunity for redress since an employer could escape liability if the employee was held liable for contributory negligence, the employee had assumed the risk of the employment or the injury was due to the negligence of another employee.¹ An injured employee could attempt to sue the employer, but this was a costly option with an uncertain outcome.

California established its basic Workers' Compensation laws between 1911 and 1917, the Progressive era in state government. The State's fundamental purposes in establishing Workers' Compensation laws were to ensure that injured workers would receive compensation for industrial injuries, including medical care as needed, and simultaneously limit employers' liability for employee injuries to a specified amount of compensation. The laws and system were

designed to ensure prompt, certain payment of benefits to employees.²

How the system works

Under California's system, all places of employment are required to provide benefits to workers injured on the job. Of the State's 600,000 employers, 75 percent buy private insurance or pay into the state's nonprofit insurance fund for insurance. The remaining 25 percent are self-insured. Employers who want to self-insure their compensation exposure must obtain the approval of the Director of the Department of Industrial Relations. Self-insurance, however, is a practical option only for public agencies and large private employers, expending a minimum of \$500,000 a year on Workers' Compensation and qualifying for bonding and self-administration services.³

The price for Workers' Compensation insurance is based on claims experience within the company's industry and the company's history of workplace injury. The rates employers pay are set by the Department of Insurance based upon recommendations of the Workers' Compensation Insurance Rating Bureau (WCIRB). The WCIRB, funded and operated by the Workers' Compensation carriers, is licensed by the State Insurance Commissioner to periodically develop and recommend rates for a wide range of employment classifications.

By law, insurers cannot set premium rates below the rates approved annually by the State Insurance Commissioner. California and Missouri are the only states that have a "minimum rate" law allowing rates to be set which include a built-in profit and overhead percentage. However, like California, many states have an administered pricing system with uniform rates recommended by a rating bureau and approved by a state insurance commissioner.

Approximately 13 million employees were covered by Workers' Compensation insurance in 1991. Employees may make a claim when they are injured and away from work for three days. The insurance company sends the employee to a physician it selects -- during the first 30 days and only if the employee had not previously designated a physician. The physician provides the employer an evaluation of the injury. The employee may seek additional evaluations and legal representation at any time. When the degree of disability cannot be agreed upon by the employer and the employee, litigation generally occurs.

Injured workers may receive medical treatment, weekly benefits and/or vocational rehabilitation. Employers may have disabled employees return to modified work. Once the disability is determined, vocational rehabilitation is an option, with the goal of returning the employee to the original job, an alternative job with the same company, or to a different profession.

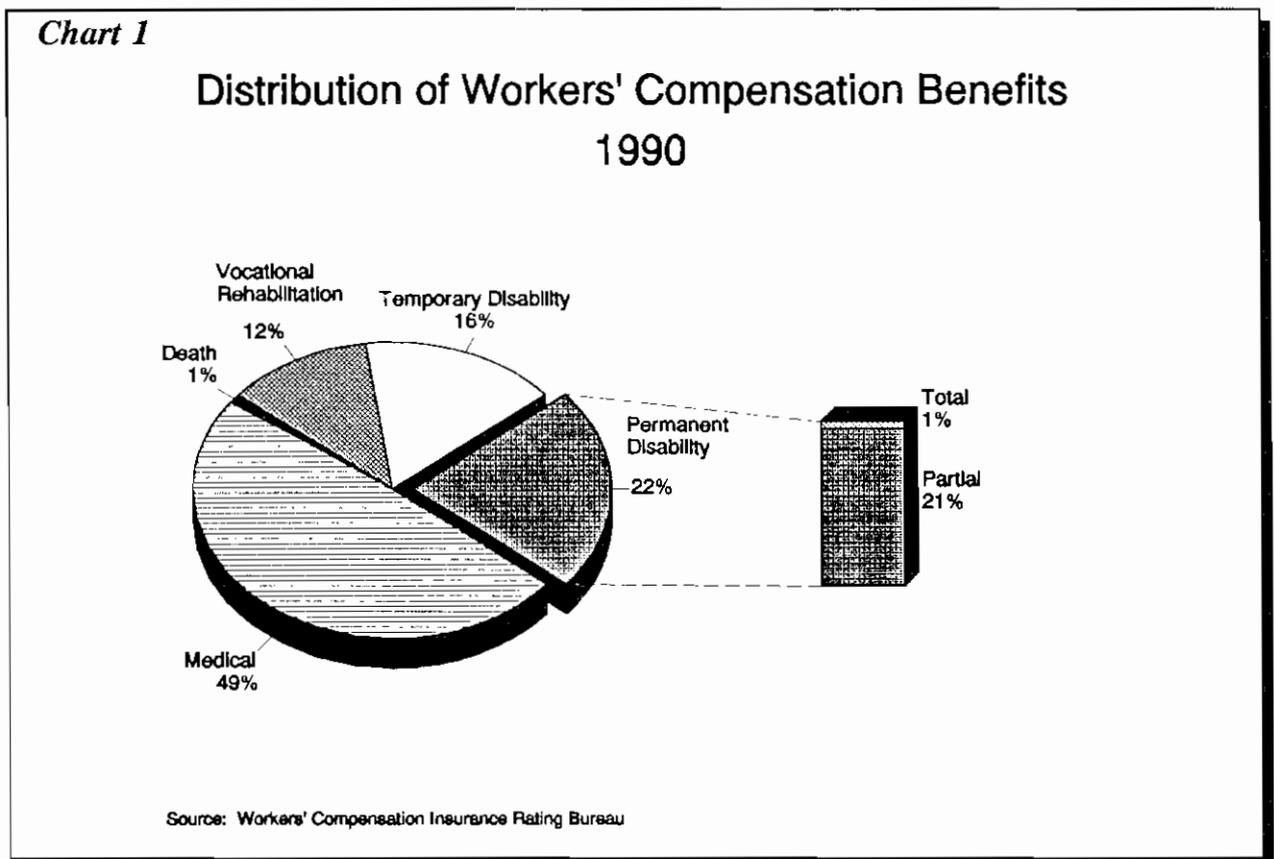
Types and levels of Benefits. There are five basic types of Workers' Compensation benefits:

- * **Medical Benefit:** Provides an injured worker with the medical and hospital treatment reasonably required to cure or relieve the effects of the injury.
- * **Temporary Disability:** Provides an injured worker with payments to replace two-thirds of his or her average weekly earnings during the time it takes to recover from the disability. Payments may not be less than \$126 nor more than \$336 per week. Payments are not made for the first three days of the disability unless the disability lasts for more than 14 days. Aggregate temporary disability payments for a single injury are limited to 240 weeks (almost 5 years) within a five year period.⁴
- * **Permanent Disability:** Provides a permanently injured worker with payments to replace two-thirds of his or her average weekly earnings. In 1991, if an injury leaves a worker less than 25 percent disabled, he or she is entitled to permanent partial disability payments from \$70 to \$140 per week. If an injury leaves a worker between 25 percent and 99.75 percent disabled, the employee may receive a maximum of \$148 per week. An employee who is 100 percent disabled as a result of a job-related injury, is entitled to receive two-thirds of his or her average weekly earnings at the time of the injury ranging between \$112 to \$336 per week. The length of time that an employee receives permanent partial disability ranges from three weeks for a 0.25 percent disability to 619.25 weeks (almost 12 years) for a 99.75 percent disability. An employee who is totally disabled receives benefits for life.⁵
- * **Vocational Rehabilitation:** Provides an injured worker with a variety of job services and allowances to facilitate returning to work. The worker is eligible for a maximum maintenance

allowance of \$246 per week while in a vocational rehabilitation program.⁶ The maintenance allowance is in addition to permanent disability payments described above.

- * **Death Benefit:** Entitles the dependents of a fatally injured worker to \$5,000 in burial expenses as well as a cash benefit ranging from \$95,000 to \$115,000 (based on number of dependents). The cash benefit is to be paid in weekly installments of no less than \$224 per week.⁷

Chart 1 below illustrates the proportion of total Workers' Compensation benefits paid to workers for each category described above.



As shown in Chart 1, the bulk of benefit costs is in medical care, with 49 percent of total benefits paid toward medical claims in 1990. Temporary disability benefits absorbed 16 percent of the total, permanent partial disability 21 percent, permanent total disability 1 percent, vocational rehabilitation 12 percent and death benefits 1 percent.⁸

*State Administration
of Workers'
Compensation*

Although Workers' Compensation benefits are largely privately administered, there are several state government agencies that have important roles in Workers' Compensation administration:

* **State Compensation Insurance Fund**

The State Compensation Insurance Fund (commonly known as the "State Fund") is an independent agency of the state created to write Workers' Compensation insurance coverage. It acts as a competitive insurer in the free marketplace and as the carrier of last resort. By law, the State Fund is required to offer Workers' Compensation coverage to any employer in the State who meets minimum, defined workplace safety standards. The State Fund is the largest Workers' Compensation insurer in California, covering approximately 21 percent of the State's policyholders in 1990.

* **Workers' Compensation Insurance Rating Bureau (WCIRB)**

The WCIRB is funded and operated by the Workers' Compensation carriers, and is licensed by the Insurance Commissioner to periodically develop and recommend rates for each of the more than 400 employment classifications. The bureau tabulates claims and expense data by each classification and considers other factors in developing recommended rates. For example, clerical work is charged about 1 percent of payroll, restaurants start at 8 percent, while the building industry, which is judged more dangerous, has a whopping average of about 30 percent.⁹ The recommended rates are then forwarded to the Department of Insurance for public review and approval.

* **Department of Insurance**

The department is responsible for the review of proposed rate changes developed by the WCIRB. The department reviews these rates in public hearings and then may adopt, modify, or reject the proposed rate schedules. The department licenses and regulates the business practices of the more than 400 insurance carriers. The department also

enforces anti-fraud laws related to insurance and prosecutes violators.

* **Department of Industrial Relations**

The department has a number of duties relating to Workers' Compensation, including compiling labor statistics and conducting audits of claims and insurers. The department also has a seven-member Workers' Compensation Appeals Board, appointed by the Governor, which adjudicates disputes on Workers' Compensation claims.

* **Department of Personnel Administration**

The department administers the provision of Workers' Compensation benefits to state employees and assists state agencies in reducing the number of work-related injuries and illnesses through training programs and compliance reviews.

***Where the
Money Goes***

Stability, then escalation. For many years, Workers' Compensation was a relatively minor cost of doing business in California. From the late 1940s to the early 1970s, Workers' Compensation was responsible for about 1 percent to 1.5 percent of employer payroll costs. However, costs climbed to about 3 percent by the end of the 1970s, and then to about 4.5 percent by the end of the 1980s.¹⁰

The escalation of costs apparently has not halted despite reforms in 1989 that were supposed to control costs. In late 1991, the WCIRB requested that the state Department of Insurance approve an 11.9 percent rate hike. In January 1992, the Insurance Commissioner would not agree and granted only a 1.2 percent increase.

Only months later, in May 1992, the WCIRB requested that the state Department of Insurance approve a 23 percent rate hike. The WCIRB cited an upsurge in state-mandated benefits and escalating costs. According to the Bureau, "it would be irresponsible not to recommend a rate increase at a time when the escalating cost of providing state mandated benefits to injured workers continues unabated." The insurance department eventually approved only a 6.7 percent hike, but even the scaled-back increase was seen as devastating by many business interests. There is substantial anecdotal evidence that the increase, coupled with worst recession

the state has seen in decades, has resulted in many companies folding or fleeing the State.

Despite two rate hikes in one year, Workers' Compensation insurers requested yet another rate hike in late 1992. This time they sought to raise premiums by 12.6 percent, complaining that rates were insufficient to cover the rapidly increasing costs of covering workers injured on the job. As this report is being written, the state Department of Insurance rejected the request.

Currently, under California law insurance companies may use 32.8 cents of every dollar they receive in premiums for operational expenses. According to the Insurance Commissioner, the justification for the latest rate increase is not convincing. "This request was based on wildly inconsistent expense ratios, and I will not approve it," State Insurance Commissioner John Garamendi said recently.¹¹ A decision was expected in January 1993, when the 1992 expense ratio expired.

History of Reform Efforts

The Workers' Compensation system has been the target of many reform efforts during the past 5 years. While some reforms have been enacted, none have proven wholly successful in addressing the system's many problems. Among those who have examined the system are the Little Hoover Commission, the Workers' Compensation Rate Study Commission, the Council on California Competitiveness and the Legislature itself.

Little Hoover Commission. The Little Hoover Commission first examined Workers' Compensation in 1988. In its report, the Commission found that:

- * California's Workers' Compensation costs were among the highest in the nation and were a burden for employers.
- * The State's efforts to combat fraud were inadequate.
- * Delays in the system had slowed payments to injured workers and increased administrative costs.
- * Employers who provided misleading information to insurance carriers in order to secure reduced rates forced other employers to bear increased rates.

- * The increase in subjective "stress" and wrongful termination claims had a negative impact on the Workers' Compensation system.
- * The effectiveness of vocational rehabilitation had not been evaluated, nor had costs been controlled.

The Little Hoover Commission supported the Workers' Compensation Reform Act of 1989 which established a rate study commission, increased worker benefits, established stricter standards for stress claims, required prompt payment of benefits, introduced incentives for low-cost vocational rehabilitation options and made other changes in line with the Commission's recommendations.

The **Workers' Compensation Rate Study Commission (WCRSC)**, created by the 1989 act, released a five-volume report in March 1992 that called for the repeal of the minimum rate law. The commission recommended that the law be replaced by open competition with floor rates approved by the Insurance Commissioner based on loss costs provided by the WCIRB. Under the recommendation, insurance companies would be able to price below the floor rate with the prior approval of the Insurance Commissioner.¹²

The rate study commission found that "experience in other states which have moved toward a more competitive market environment indicates that employer costs usually fall when regulatory constraints are eased."¹³ The commission noted, however, that "most of the cost containment opportunities lie outside the rate-making process" and that medical costs, mental stress claims, vocational rehabilitation, litigation and fraud are areas that also need reform.¹⁴ The commission did not investigate these latter issues because the commission's sole charge was to examine the rate-making process solely.

Because of the rate study commission's detailed work in the area of rates, and the complex and technical nature of the subject, this study will not re-examine the issue.

The Council on California Competitiveness. The Council on California Competitiveness was formed in late 1991 to find ways to remove barriers to creating jobs and increasing state revenues. In its report "California's Jobs

and Future," released in April 1992, the Council found the cost of the state's Workers' Compensation more than doubled between 1981 and 1991. During this same period, however, the work force increased by only 25 percent and the incidence of disabling work injury per 1,000 workers actually decreased. The Council concluded that Workers' Compensation had "become a national embarrassment" and offered the following remedies to the Governor and legislative leaders:

- * Force insurance companies to compete -- giving them the incentive to keep insurance costs down.
- * Disallow "cumulative trauma" stress claims, requiring 51 percent work causation and excluding good-faith personnel actions.
- * Allow employers to use Health Maintenance Organizations (HMOs) and Preferred Provider Organizations (PPOs) to stop runaway costs.
- * Reduce litigation by eliminating adversarial medical testimony.
- * Allow less-costly alternatives to vocational rehabilitation.

*The Governor and
the Legislature*

California passed the Workers' Compensation Reform Act in 1989. Among its provisions, the act increased worker benefits and established that stress injuries are compensable, if work is responsible for as little as 10 percent of the stress. The act did not:

- * Eliminate the duplication of vocational rehabilitation services with benefits from permanent partial disability benefits.
- * Eliminate costly litigation.
- * Establish an adequate medical review process.

Despite the reforms established by the 1989 act, there is still widespread dissatisfaction with California's Workers' Compensation system. Many employers complain that their premiums have doubled within the

span of one or two years -- even after the reform measures. Labor unions are unhappy that employee benefits continue to be among the lowest in the nation. Others point out that no steps have been taken to discourage or mitigate frivolous lawsuits.

During 1992, the Legislature and the Governor pursued various reforms but reached no agreement. As the new legislative session begins in January, both the Governor and legislative leaders have pledged to focus on Workers' Compensation reform as a key to addressing the State's economic doldrums.

California Not Alone

Other states have wrestled with Workers' Compensation reform -- increasing costs of Workers' Compensation is not unique to California -- and many have enacted cost-containment legislation. As a result, Oregon, for example, has experienced a double-digit drop in Workers' Compensation premium rates for the third consecutive year. Most states, though, have yet to determine the effectiveness of their reforms. Where pertinent, information from other states is cited in later sections of this report.

Cost Drivers

California's Workers' Compensation problems remain, despite general agreement that the State's economy is suffering because of the lack of reform. Costs continue to increase, primarily for the following reasons:

- * An increase in the cost of medical treatment and vocational rehabilitation.
- * Few incentives in the system to control costs.
- * Rampant fraud.
- * Excessive profiteering by those who are supposed to deliver services.
- * The inherent subjectivity of some types of claims.
- * The increasing number of stress claims and resulting litigation.

Reform of the system has been stymied by powerful interest groups. Insurance companies are

guaranteed a profit; attorneys and physicians benefit from escalating legal and medical costs; and labor unions do not want employees' access to or eligibility for benefits to be limited.

The Little Hoover Commission has examined the interplay of factors that drive the costs in the Workers' Compensation system. The following sections identify specific problems within the system and recommend options for addressing those problems.

**High Costs,
Low Benefits**

High Costs, Low Benefits

Finding #1: High Workers' Compensation costs are choking business but at the same time are producing little in the way of benefits for injured workers.

Escalating Workers' Compensation costs significantly affect business owners and their employees. Consider:

- * A 46-year-old home appliance and consumer electronics retail chain shut down on January 30, 1992 after the owner learned that his Workers' Compensation premiums would increase by more 40 percent. The premiums increased despite a reduction of almost two-thirds of the company's workforce.
- * It started with pains in the knees, swelling, and then she could hardly walk. Finally,

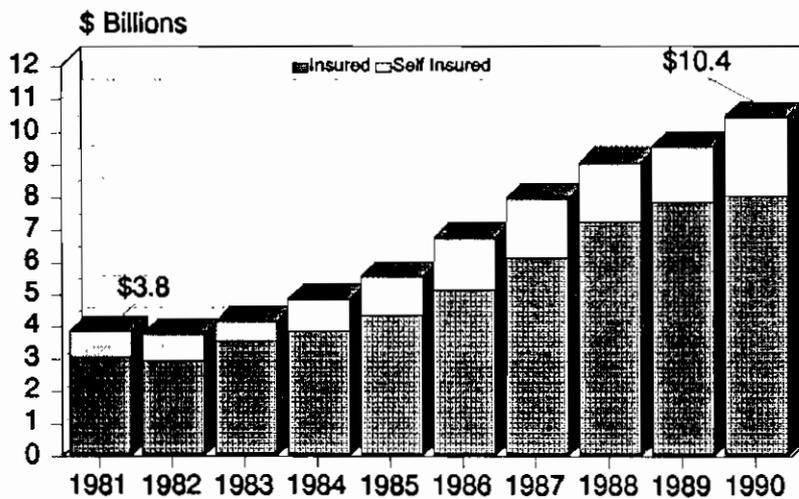
the delivery truck driver, a 40-year old mother of twins, had to have therapy and surgery. Not wanting to quit, she worked at the same company washing trucks for five months. But the swelling persisted. She went through a job retraining program, mountains of paperwork, medical evaluations and delays. "You get caught between the doctors and the physical therapists. They keep bouncing you back and forth. The whole thing just drags on and on. Always another form. Always new questions and exams." For three months she received no benefits at all, then only \$224 per week, not nearly enough to cover her living expenses. Eventually, she had to file a bankruptcy action.¹⁵

Impact on Business

The cost of the Workers' Compensation system to business has increased dramatically in the past decade. Chart 2 shows the growth in employers' costs from 1981 to 1990.

Chart 2

Workers' Compensation Costs Paid by Employers



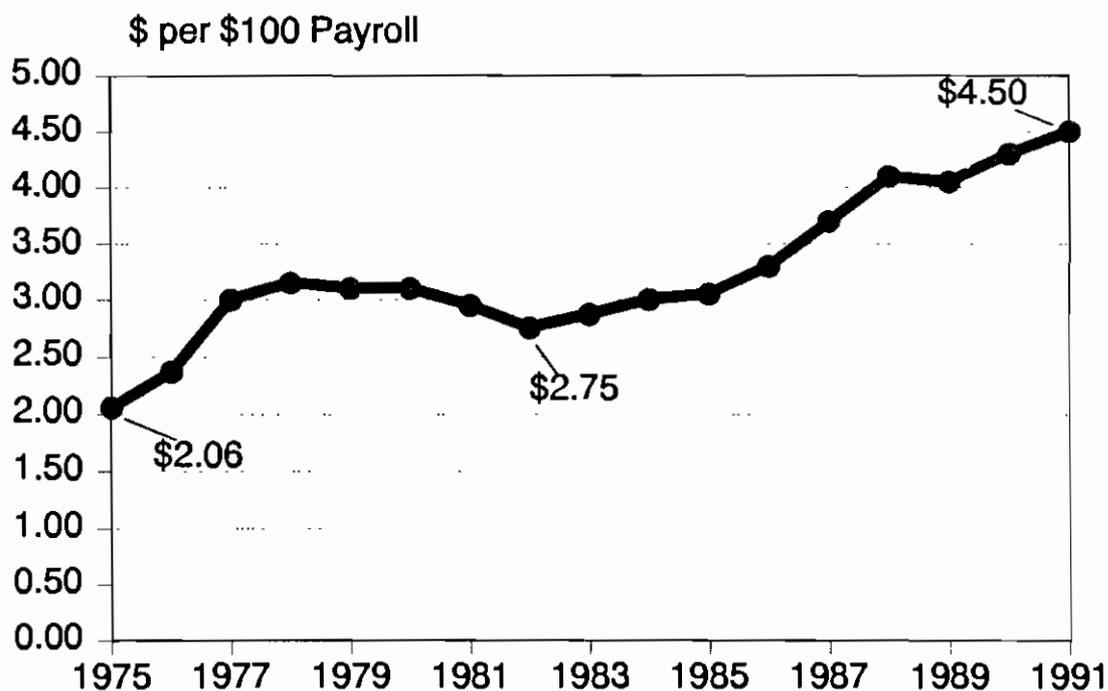
Source: WCIRB

As Chart 2 indicates on the previous page, businesses in 1990 spent more than \$10 billion on Workers' Compensation. Since \$3 billion was paid in benefits and almost another \$3 billion was consumed in medical care costs, that left approximately \$4 billion for the "middle men" of the system: insurers, consulting doctors and lawyers.

Chart 3 below indicates how Workers' Compensation premium rates have changed between 1948 and 1990.¹⁶

Chart 3

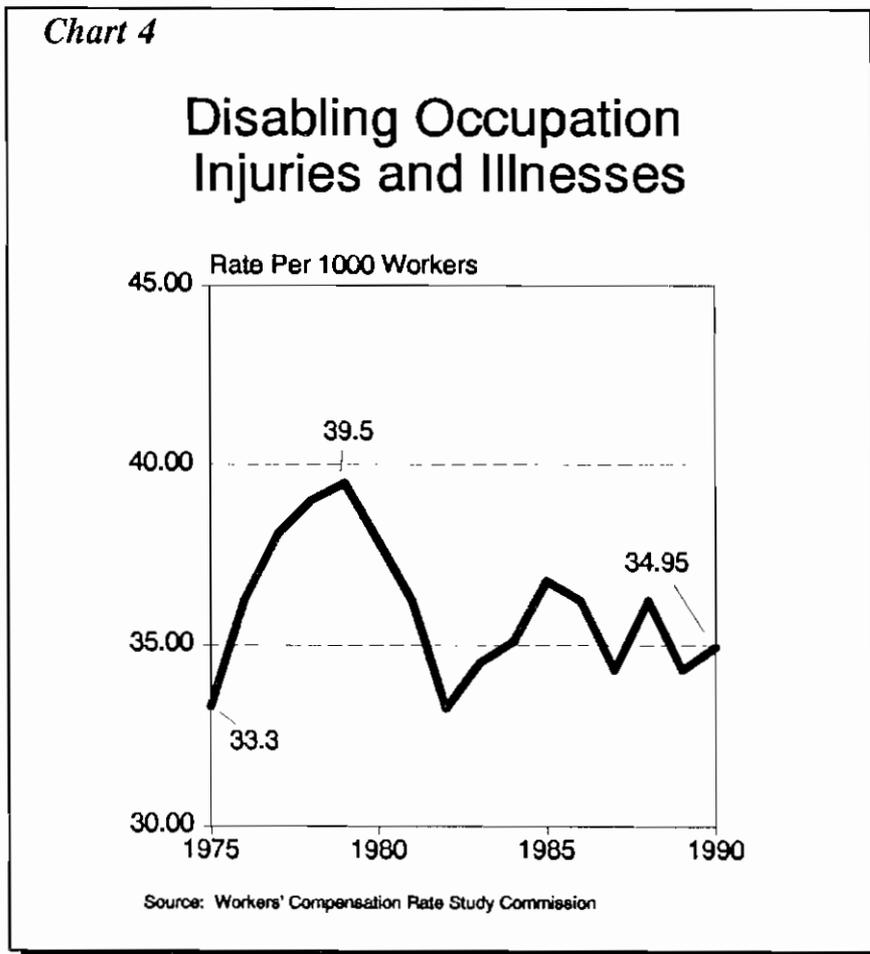
Average Workers' Compensation Premium Rate (Manual Rate - California)



Source: Workers' Compensation Rate Study Commission

As shown in Chart 3, the average Workers' Compensation premium rates more than doubled between 1975 (almost \$2.06 per \$100 payroll) and 1991 (\$4.50 per \$100 payroll). The increase particularly was dramatic between 1982 and 1991 when rates climbed by almost 64 percent.

Perversely, these increases come at a time when work place safety is holding steady or improving. Chart 4 below shows the rate of disabling injuries for 1975 to 1990.



As Chart 4 indicates, the rate of disabling incidents has dropped from 39.5 per thousand workers in the late 1970s to less than 35 in 1990. The increased costs of Workers' Compensation cannot be attributed to increasing rates of injuries.

High Workers' Compensation costs prevent businesses from expanding, drive some employers out of business entirely, and encourage other California businesses to relocate out of state. Anecdotal evidence of these effects is abundant.

* An industrial relations manager of a frozen foods company says that California's

manual rate for workers' engaged in processing frozen vegetables and fruits is more than double the rate of Oregon and Arizona. "Meaningful reform of the Workers' Compensation system or the lack of it will influence our decision regarding any future shift of our production outside of California."¹⁷

- * Blue Diamond, which operates the world's largest almond factory in downtown Sacramento and has a \$45 million annual payroll, is considering leaving California because of high Workers' Compensation costs.¹⁸
- * The president of the California Chamber of Commerce cited numerous instances of workers compensation costs that had increased to a point that businesses were considering moving out of state. For example, a furniture manufacturing company in Los Angeles that employs 125 people and pays \$400,000 in Workers' Compensation costs has a nearly identical factory in North Carolina and pays only \$4,000 per year.
- * In February 1992, a 68-year-old, family-owned bakery in Stockton shut its doors upon learning that its Workers' Compensation premiums would increase by 200 percent.
- * A popular restaurant in Newhall shut down on May 12, 1992. The owner of the 27-year-old restaurant said that rising Workers' Compensation costs were responsible for the closure of this and 14 other restaurants in the chain since 1989.

Even employers that are doing a brisk business have indicated that they have not been able to afford to hire additional workers because of high Workers' Compensation premiums. The California Business Roundtable has found that 84 percent of the companies responding to a 1991 survey believe that Workers' Compensation is harmful to business operations in California. The survey also found that 23 percent of companies surveyed planned to relocate outside of

California. Of these companies, 17 percent cited Workers' Compensation as the reason.¹⁹

Although some critics have challenged the validity of the Business Roundtable survey, an abundance of anecdotal research indicates that California's Workers' Compensation system is harmful to business.²⁰

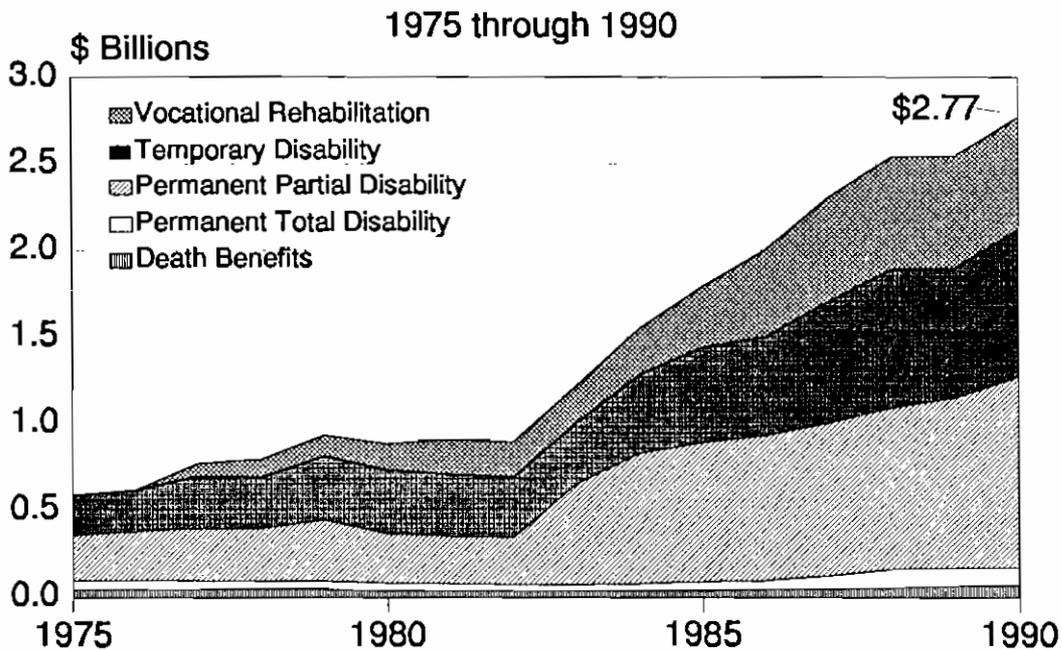
The chairman of the California State Chamber of Commerce stated that from a study done by five California utilities, 669 manufacturing plants left the state in the past five years taking 100,000 jobs with them. In addition, one-third of the senior executives surveyed said they are considering moving out of state. He identified the chief culprit as the state's Workers' Compensation system.²¹

***Impact on
Injured Workers***

While the cost of the system to business has increased significantly since 1981, the cost for benefits has also increased dramatically. On the following page, Chart 5 shows the distribution of Workers' Compensation benefits.

Chart 5

Workers' Compensation Benefits Distribution To Workers



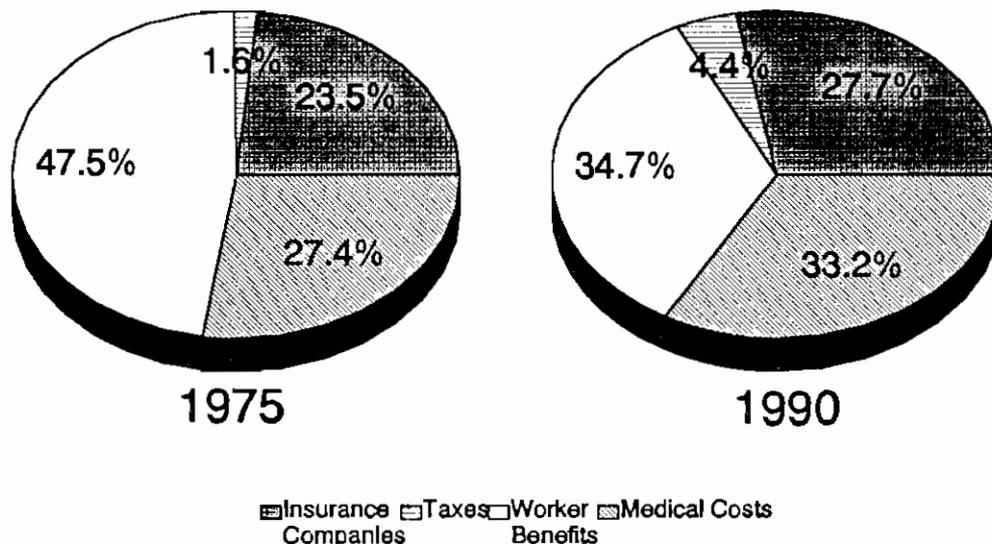
Source: WCIRB

As Chart 5 indicates, the distribution of Workers' Compensation benefits to injured employees totalled slightly more than half a billion dollars in 1975. By 1990, almost \$3 billion went to workers, with the greatest increase occurring in vocational rehabilitation. Despite the dramatic increase in the cost of benefits, injured workers increasingly have fallen behind even as the costs of the system have risen.

Chart 6 on the following page demonstrates that over time, the portion of Workers' Compensation money actually going to cover direct benefits to disabled workers has diminished.

Chart 6

Workers' Compensation Premium Dollar Distribution - 1975 Compared with 1990



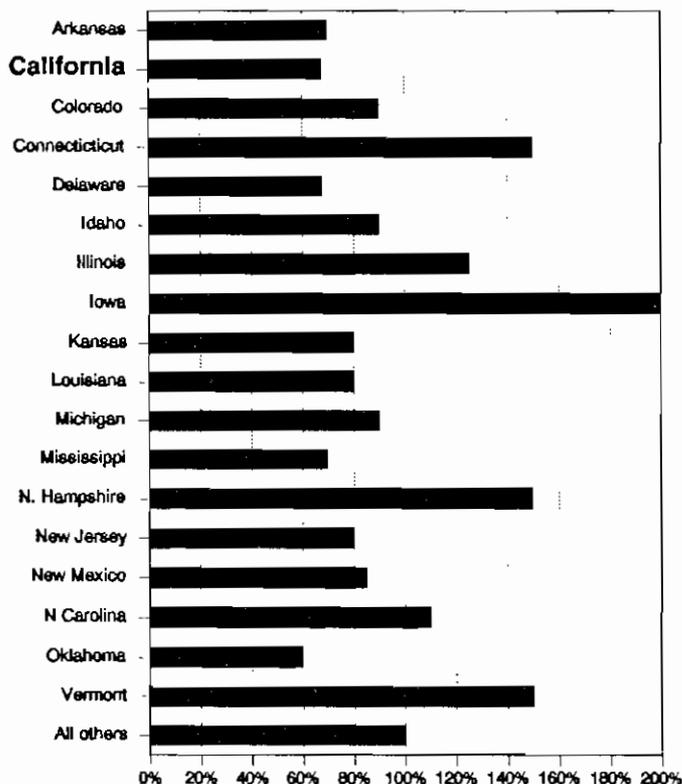
Source: Workers' Compensation Insurance Rating Bureau

As seen in Chart 6, workers benefits in 1975 were more than 47 percent of the premium dollar. But in 1990, workers received far less -- in fact, less than 35 percent.

Besides receiving a low percentage of California's Workers' Compensation dollars, employees are also impacted by the way California sets its benefits. Other states calculate a state-wide average weekly wage and provide a percentage of the average wage as maximum benefits. However, California provides only two-thirds of the injured worker's average weekly wage, to a maximum of \$336 per week. Chart 7 on the following page shows how states vary in the amount of Workers' Compensation they pay injured workers.

Chart 7

Maximum Temporary Disability Benefit as % of State Average Weekly Wage 1991



Source: AFL-CIO, reported in Commission Report, "Workers' Compensation Rate Study Commission"

Chart 7 shows that 32 states pay 100 percent of the state's average weekly wage. Only 12 states pay less than 100 percent, six pay more and only one state pays injured workers less than California's 67 percent.

California's overall benefits are low compared to other states. On the following page, Chart 8 shows how California's average benefits compared to other states in 1989.

Chart 8

**Average Benefits Provided by Statute
for All Types of Cases, 1989**

	Dollar Amount	State's Benefit as a % of U.S. Average	Rank Among 50 Jurisdictions
Arizona	\$ 8,165	72.0%	30
Arkansas	6,612	58.3	39
California	5,058	44.6	47
Connecticut	33,105	291.8	1
Florida	11,444	100.9	17
Georgia	6,731	59.3	37
Illinois	22,719	200.2	5
Indiana	4,358	38.4	48
Iowa	12,554	110.6	14
Kentucky	11,254	99.2	19
Louisiana	12,560	110.7	13
Massachusetts	27,034	238.2	3
Michigan	31,851	280.7	2
Minnesota	16,849	148.5	10
New Jersey	6,890	60.7	36
New York	8,714	76.8	25
North Carolina	7,427	65.5	33
Ohio	8,961	79.0	24
Oklahoma	7,131	62.8	35
Oregon	5,435	47.9	45
Pennsylvania	9,704	85.5	22
Tennessee	6,112	53.9	43
Texas	7,539	66.4	32
West Virginia	8,492	74.8	27
Wisconsin	8,479	74.7	28
25-State Average	11,308	99.7	
National Average	11,347	100.0	

Source: Grant Thornton, *Grant Thornton, Manufacturing Climates Study*, August 1990.

As shown by Chart 8 on the previous page, California provided an average \$5,058 for all types of Workers' Compensation cases in 1989. This figure was 44.6 percent of the national average, with California ranking 47 out of 50 states in the level of benefits.

While employers have borne the brunt of the rising cost, employees have failed to see comparable increases in their benefits.

- * In 1989, an orchard worker fell off a ladder and landed on a pair of pruning shears, severing a vein in his arm. He said the hospital's delay in providing medical treatment cost him the use of his arm and now he can't work. For nine months, he received \$187 per week in temporary disability benefits. A rehabilitation therapist told him that he should learn a new trade, but he is finding it difficult because he has never done anything else.²²
- * Another farm worker, who worked for the same employer for 22 years, was fired and the worker says he doesn't know why. He does know he was injured in the fields many times. He claims he has never been able to obtain full Workers' Compensation benefits, although he admits he received a small settlement from the grower's insurance company after one injury. He says, however, he received no compensation for his lost wages and his wife had to work in the fields to support the family until she, too, was injured.²³
- * After falling down stairs at work more than three years ago, constant wrist, arm and back pain has kept a drugstore employee from earning a paycheck. After the accident, the pain across her back caused her to see a doctor, which led to weeks of physical therapy, followed by a visit to an orthopedic surgeon who concluded that she had a ruptured disk. She had surgery on her neck and five months later, a back operation. Suffering from persistent pain, she is critical of the insurance company that has delayed her treatment. "You go see a doctor," she says, "and he tells you

you're injured, but then you can't get treated. I still have this problem." Even after vocational rehabilitation, she cannot do any work because of the pain.²⁴

***Reform
Needed***

The Workers' Compensation system is failing to meet the original goals set forth when the program was created. The cost to companies -- which was meant to be limited and finite -- is spiraling. The benefits for injured workers -- which were supposed to be enough to compensate them for their impairment -- are too low and slow in coming.

While the problems of Workers' Compensation are widely recognized, reform of the system has been stymied by conflicting interest groups. Reform packages that have been implemented in the past often have purported to "balance" immediate, real-dollar increases in benefits with system savings that turn out to be illusory. Meaningful reform that would return the program to its original intent is greatly needed.

Recommendation #1: The Governor and the Legislature should convene a special session to focus on the Workers' Compensation system and facilitate the rapid implementation of reforms.

Such a special session would allow the waiver of deadlines and rules that often lengthen the legislative process. It also would raise the public visibility of the issue, providing pressure for action as a counterpoint to the gridlock created by competing interests. Recommendations for reforms that could be considered in special session are contained in the following sections of this report.

Medical Costs

Medical Costs

Finding #2: Medical costs have increased because of inefficiency, price-gouging and unnecessary treatments.

Employers are responsible for providing the necessary medical care for workers injured on the job. From the beginning, Workers' Compensation was designed as a means of providing comprehensive coverage to injured workers. It is not likely, however, that the designers of the system imagined the costs brought about by the variety and the number of work-related injuries seen today.

Controlling medical costs, however, is difficult for a number of reasons. There are few existing controls to contain costs. Moreover, when it is difficult to determine whether an injury is work-related, which is frequently the case, the Workers' Compensation system bears the cost of medical treatment more often than not.

Many believe the cost to employers for medical treatment is increasing so rapidly that it threatens to cripple the entire Workers' Compensation system. At the core of the problem is the conviction most people hold that choosing a physician is a right. The special relationship one feels with one's doctor is crucial to care

and cure. If the Workers' Compensation program is to function efficiently, the current system of selecting personal physicians without incentives for cost containment must be modified.

***Employers Must
Pay for
Workplace Injuries***

State law requires employers to pay for "reasonably required" medical care for injured employees. According to the Labor Code, "Medical, surgical, chiropractic, and hospital treatment, including nursing, medicines, medical and surgical supplies, crutches, and apparatus, including artificial members, which is *reasonably required* to cure or relieve from the effects of the injury shall be provided by the employer."²⁵ Some critics of the current Workers' Compensation system believe that this provision of state law provides a blank check for medical claims, causing medical costs to soar.

These critics contend that an employer should not have to pay excessively for medical care, but should pay for the care "reasonably required" to provide relief to an injured worker, as required by law. Under today's system, however, the employer often pays costs that have little to do with the care provided directly to the injured worker. These "hidden" costs include unnecessary treatment due to physician conflicts of interest, inefficiency in medical administration or duplication between Workers' Compensation plans and other medical plans. Ultimately, consumers pay the price for these added costs, because employers build all their expenses for employee medical treatment into the final cost of their goods and services.

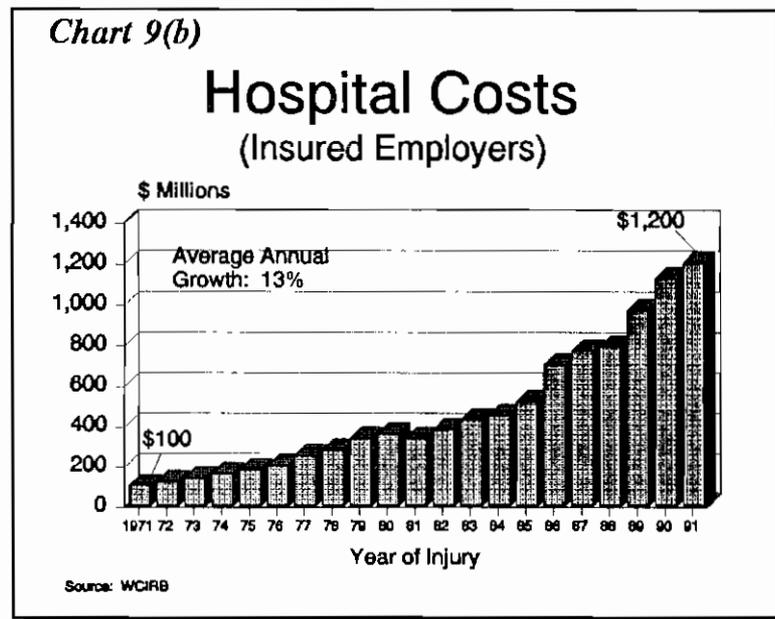
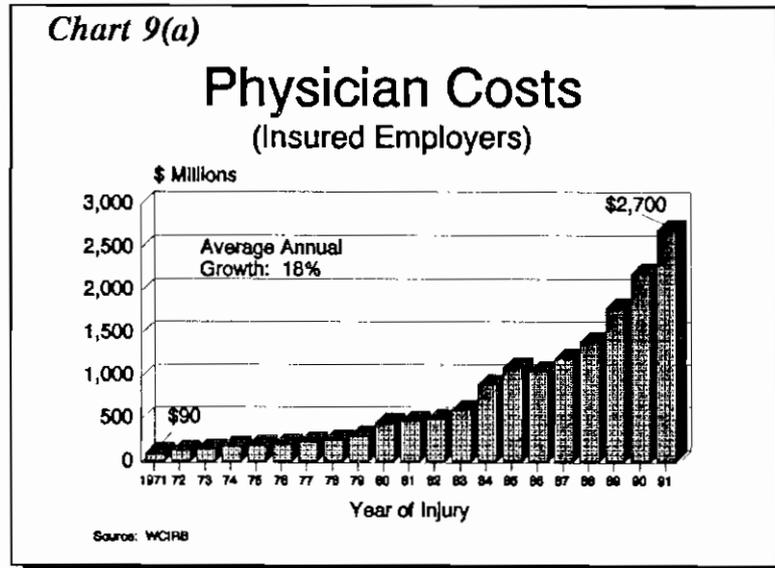
What is lacking is within government's responsibility: reasonable policies to control runaway expenses.

The Costs

The growth of health care costs generally, and Workers' Compensation in particular, is a national problem. Medical costs have risen at rates far greater than the rate of inflation and Workers' Compensation medical costs have grown at a rate exceeding even that of other health care costs.²⁶

Nationally, Workers' Compensation medical costs grew by 75 percent between 1983 and 1987. In California, Workers' Compensation medical costs nearly doubled for the same period. In fact, between 1970 and 1987 California's Workers' Compensation medical costs increased one and one half times the national average.

Based in part on mounting physician and hospital costs, the WCIRB recommended insurance premium increases twice during 1992. Charts 9(a) and 9(b) respectively show how physician and hospital costs have grown for insured employers.



As can be seen on Chart 9(a) on the previous page, over the past two decades physician costs have increased from \$90 million in 1971 to \$2.7 billion in 1991. During the same period, Chart 9(b) shows hospital costs increased from \$100 million to \$1.2 billion.²⁷ Medical treatment costs have grown at annual rates of 13 and 18 percent for physicians and hospitals, respectively. The growth has accelerated greatly in recent years. From 1986 through 1991, the annual growth was 31.4 and 14.3 percent, respectively. The WCIRB reports that "Clearly, this (medical costs) is the most significant cost driver (in the Workers' Compensation program)."²⁸

In California, claims frequency for medical benefits is 11th highest of the 45 states that have private insurance coverage.²⁹ As a result, according to the WCIRB, medical treatment amounted to an estimated 29.3 percent of total insured employer costs for 1990. On the benefits side, as discussed in the Background section, medical treatment costs make up nearly half the total benefits dollar.

The Causes of Escalating Costs

Several factors make up the mix of escalating costs. First, the Workers' Compensation system is "liberally constructed" with regard to medical benefits, that is, it literally leans on the side of the injured worker. Second, there are insufficient incentives to hold cost down. Physicians are charging for more intensive and more costly procedures. Follow-up visits have become more common and physical therapy is prescribed more often.³⁰ Medical fees (but not hospital fees) are regulated by a periodically adjusted, state fee schedule, but many expensive procedures are not covered by the schedule. Also, costs have shifted from other medical programs to Workers' Compensation. There is a lack of coordination between Workers' Compensation and other health programs. Finally, in too many cases, there is abuse and overutilization of medical services. As a result of all these factors, the state's medical treatment costs under Workers' Compensation continue to skyrocket.

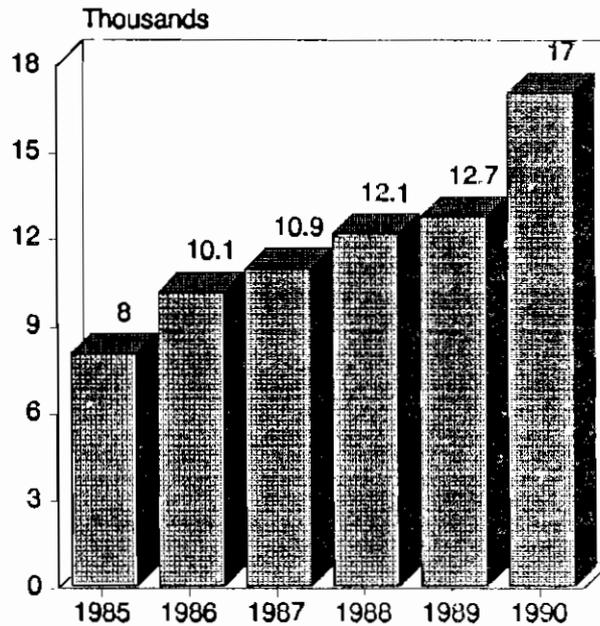
A Liberally Constructed System

The law provides that the Workers' Compensation system "shall be liberally construed by the courts with the purpose of extending (its) benefits for the protection of persons injured in the course of their employment."³¹ As a result, the kinds and numbers of work-related injuries covered by the Workers' Compensation system has increased.

One effect of "liberal construction" is that when employees' pre-existing medical conditions are aggravated by their employment, employers assume Workers' Compensation liability for the injuries. As a result, cumulative trauma is a valid cause for a Workers' Compensation claim. Cumulative trauma injuries include stress, joint inflammation, circulatory conditions, carpal tunnel syndrome and ulcers. On the following page, Chart 10 shows that between 1985 and 1990 cumulative injury reports have more than doubled.³²

Chart 10

Cumulative Trauma Claims Statewide



Source: "California Work Injuries and Illnesses," DIR

Of particular note in Chart 10 above is the significant jump in cumulative trauma cases reported in 1990, an increase of 34 percent

*Incentives for
cost control
are lacking*

The lack of incentives for the participants to hold costs down is the primary reason for escalating costs. The Council on California Competitiveness recently declared that the Workers' Compensation system "is one of the few remaining health care systems that includes virtually no mechanism for cost containment."³³ Consider two examples regarding fees physicians charge. First, when an employee has not designated a personal physician in advance of an injury, the employer retains control of medical care for only 30 days. The employer gets to approve the physician during that period. But, thereafter, the employee can select any physician. When that happens, any incentive to obtain cost-effective treatment is not available. An employer who attempts to interfere with an employee's "right" to

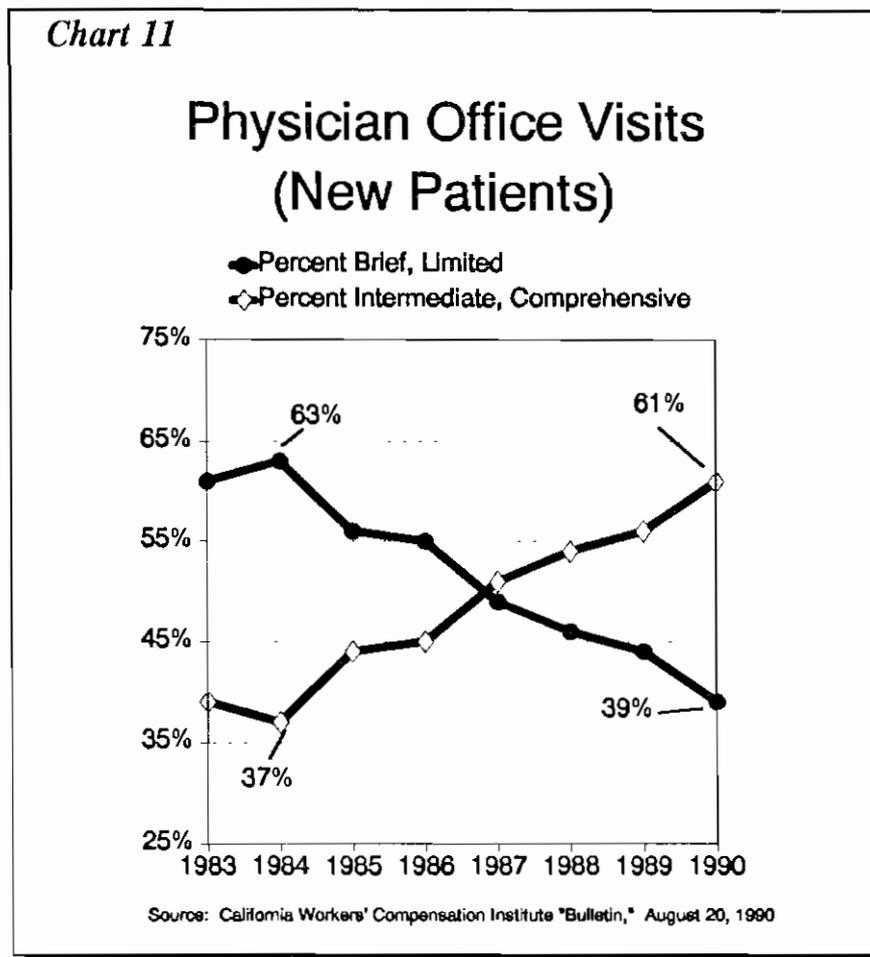
choose a physician, may not only face a hostile employee, but costly litigation as well.

The second example relates to the medical fee schedule. Required by state law, the medical fee schedule lists over 5,000 medical procedures, each with a precise description of the service and a relative value or "unit". Procedures are grouped into five sections: Medicine, Surgery, Radiology, Pathology and Anesthesia. Using a conversion factor, the state determines the "usual fee" for that type of service. Because treatment costs do change with time, the conversion factors are reviewed, usually every other year.

Physician reimbursement is calculated by multiplying the conversion factor by the relative unit. For example, an office visit involving limited examination, treatment and evaluation of an established patient, has a relative value of 5.2 units in the Medicine section of the schedule. The 1989 conversion factor for procedures in the Medicine section is \$6.15 per unit. Thus, the schedule charge for this procedure is 5.2 times \$6.15, or \$31.98.

A physician requesting reimbursement based on the above procedure is, by definition, charging a reasonable fee. The physician may claim a greater amount, but will have to accompany the billing with an itemization and explanation. For example, some expensive medical procedures aren't regulated under the current fee schedule, such as magnetic resonance imaging tests. Even so, the charge cannot exceed the physician's usual fee.³⁴

While physician reimbursement may be "reasonable," physicians are billing more intensive and more costly procedures. This trend, called "procedure creep," is one of the factors that explain the rising cost of medical treatment in the Workers' Compensation system in recent years. As shown in Chart 11, intermediate and comprehensive doctor appointments now occur more frequently than brief, limited visits.



As Chart 11 shows, "brief" or "limited" doctor visits in 1984 constituted 63 percent of the new patient office visits; by 1990 these examinations constituted only 39 percent of initial office visits. The greater number of intermediate and comprehensive visits can be attributed to physicians using more followup visits and prescribing more physical therapy.³⁵

Frustrated with the present Workers' Compensation system, a risk manager for the Oxnard school district said during his testimony to the Commission that the average school district claim takes three years to close, and one reason it takes so long is that there are few controls on doctors. "The system allows people to overtreat," he said.³⁶

Costs Are Shifted to Workers' Compensation

Costs are shifted from other health programs to Workers' Compensation because it is easy and attractive to employees to do so. Workers'

Compensation does not have the characteristics of group health insurance such as deductibles, co-payments, payment restrictions and waiting periods.³⁷

When health care costs escalated in the 1980s, insurers and the federal government implemented restrictive cost containment measures for many private insurance programs and Medicare and Medicaid. The Workers' Compensation system, with relatively insignificant health care costs for so many years, became a target for cost shifting as hospitals, doctors and rehabilitation therapists looked for payers without cost restrictions.³⁸

In addition, the absence of health coverage for many workers encourages employees to attribute an injury or illness to work even when the injury or illness occurs off-the-job. This allows the employee not covered by health insurance to receive medical treatment under the Workers' Compensation insurance.

Lack of Coordination

As long as there is duplication of coverage for many workers, coordination of treatment and services will remain a problem. For example, lack of coordination:

- * Between Workers' Compensation and other health care plans leads to higher costs because of duplicative administration and record keeping requirements.
- * Prevents insurers from knowing of pre-existing conditions with the injured worker. This knowledge is useful for determining whether a claim is compensable under the current job situation.
- * May lead to duplicate payments by Workers' Compensation and health care insurers.
- * May lead to improper classification, so that the wrong insurance pays for a claim.

Coordination is hampered by a variety of factors. One is that data used for Workers' Compensation insurance is different from those used in health care insurance, making coordination between the two difficult. Another is that Workers' Compensation and health care insurers are interested in different things: Workers'

Compensation insurers are interested in the training and experience of the claimant and the time and place where the accident occurred; while health care insurers are interested in a precise diagnostic classification or a precise statement of medical procedures, information necessary for controlling costs.³⁹

Cost Control Proposals

The proposals to control costs in the Workers' Compensation system are as varied as the factors behind those cost increases. They include:

- * Managed care (one effect of which is to limit "doctor shopping").
- * Elimination of self-referrals by physicians.
- * 24-hour integration of medical coverage.
- * Adoption of practice guidelines.

Managed Care

Managed Care Organizations (MCOs) assist employers in handling health care benefits, while Health Maintenance Organizations (HMOs) and Preferred Provider Organizations (PPOs) provide medical treatment. Although there are many variations, the primary goal of managed care is to reduce unnecessary and ineffective utilization of medical services and thereby lower expenses without sacrificing quality of care.⁴⁰ MCOs generally provide risk assessment and control, managed medical services, claims management, fraud control, legal services management, medical and vocational rehabilitation and worker education.

Employer groups favor the use of managed care. The Council on California Competitiveness advocates allowing employers to use state-certified MCOs, with established fee schedules and strict case management for each injured worker. According to a recent survey, 87 percent of business leaders and 66 percent of voters favor setting fee schedules for medical treatment payments.⁴¹

Some opponents of managed care express their concern over quality of care and the right to choose. Some critics oppose managed care programs because they feel that employees would lose their right to select their own physicians.⁴² There is concern that not all HMOs and PPOs, especially small ones, would be able to guarantee that the necessary specialists are available to

treat injuries. California labor representatives oppose the "company doctor" approach and believes that the employee should be allowed to change physicians if the treatment is unsatisfactory. The representatives have expressed little confidence in the ability of the state to monitor the providers.⁴³

Initially, similar arguments were made against managed care in the delivery of health care in general. However, careful monitoring of care and effective dispute resolution mechanisms have provided safeguards for those receiving medical services under managed care options. As a result, the Medi-Cal program and private and public employee health insurance programs have employed managed care concepts successfully.

Proponents of managed care say that costs for treating difficult-to-pin-down injuries like back injuries and stress-type claims are skyrocketing. They say employers and insurers alone cannot control medical treatment costs. Managed care, proponents argue, would help limit costs without reducing the quality of necessary medical care by reviewing and pre-certifying treatment schedules.

24-Hour Coverage

Many who have looked at the problem of containing medical costs believe integration of the various medical systems is essential and that 24-hour coverage is inevitable. The health insurance industry generally is in a state of flux, in California and throughout the nation. Only recently, the Health Insurance Association of America changed its long-held opposition to health care reform, indicating its willingness to accept reforms.⁴⁴

Generally, 24-hour medical coverage refers to the integrated management of an employee's Workers' Compensation and group health insurance benefits. It would make no difference where workers were injured -- on the job or at home, day or night. Several states are moving in this direction. Florida allowed employees to obtain 24-hour health coverage when it enacted Workers' Compensation reforms in 1990. The Minnesota Department of Labor and Industry studied 24-hour coverage as part of its solution to reforming Workers' Compensation in that state. Alaska and Oregon, as well, have moved in the direction of 24-hour coverage. Each of these innovations, although still too early to evaluate, will be closely watched.

Among supporters of a 24-hour program are the California Chamber of Commerce, the California Medical Association, and the State Insurance Commissioner. Benefits of merging health insurance systems include:

- * A more coordinated management of claims which will curtail duplicate payments and fraud.
- * Eliminating conflict among the systems, the liens and counter-claims that are the costly administrative side of health care.
- * From the worker's perspective, stability and continuity of medical treatment.

One drawback of 24-hour proposals is that it may be difficult to coordinate benefits because of the co-pay requirement of the health plan and the absence of co-pay within the Workers' Compensation benefit.

Another problem is the uncertainty of what actual level of cost savings can be achieved by integrating Workers' Compensation into a 24-hour health benefit system.

Public approval of the 24-hour concept was sought in November 1992, but how valid the results were in terms of accurately reflecting public opinion is difficult to say. Proposition 166, called the Affordable Basic Care program, addressed two driving concerns about health care -- the more than 6 million Californians that have no health coverage and the increase in Workers' Compensation program costs. Among other things, the proposition would have consolidated Workers' Compensation and other health insurance programs. But the package came at a price and most voters apparently felt it was too high. Opponents convinced voters that small businesses would go under, large businesses would leave the state and workers would pay through the nose.

Although the initiative was defeated by California voters in November, it is likely that the high cost associated with this plan for 24-hour coverage was the key to its rejection.

The Americans With Disabilities Act (ADA), implemented in part on July 26, 1992, affects Workers' Compensation. It may help business and reduce the cost to the Workers' Compensation system. Under the ADA, when a person applies for a job for which he or she is

qualified, that person cannot be denied employment on the basis of the disability. Current laws regarding Workers' Compensation permit a doctor to decide whether a person who is injured on the job will be allowed to return to work, or whether the person might be allowed to remain off the job and collect disability.

Under the ADA, an employer will have the right to tailor a job to the abilities of an injured employee and thus put that person back to work. That is much better than having the employer forced to contribute to Workers' Compensation payments and leave a potentially productive worker as a non-productive recipient of Workers' Compensation funds.⁴⁵

As business experience with ADA broadens, it is likely that the greatest potential source of claims against the ADA will come from employees who became disabled through injuries on the job or after hours. Those workers will have to be accommodated or employers will face both Workers' Compensation claims and lawsuits under ADA.⁴⁶

Practice Guidelines

Another reform the State could adopt is the use of "practice guidelines" similar to those used in Medicare. These practice guidelines include medical fee schedules, auditing procedures, case management and utilization review.

The guidelines have a similar effect to managed care programs by focusing on limiting costs and eliminating unnecessary procedures while providing a standardized level of medical care. The adoption of such guidelines has been supported by the Governor and the Council on California Competitiveness, among others.

Self-Referral

Many critics believe that some medical providers inflate medical treatment costs by ordering unnecessary tests and prescribing unnecessary treatment.

Some physicians refer their patients to medical facilities, such as clinics and laboratories, that they have a financial interest in. Such self-referral is not illegal. At the Commission's public hearing, an organization that represents injured workers believes that the State could reduce medical costs by prohibiting doctors from referring patients to labs in which the doctor has a financial interest. The group claims that this recommendation, also

endorsed by the Council for California Competitiveness, would save an estimated \$350 million per year.

There is evidence that self-referrals lead to higher costs and unnecessary procedures. In a recent study published in the *New England Journal of Medicine*, California doctors who own an interest in testing and treatment facilities were more likely than independent doctors to refer patients for physical therapy and order unnecessary MRI body scans. Another study has found that nine out of 10 MRI and computer-assisted tomography (CAT) scan centers in California, outside of hospitals, are owned by physicians who refer their patients to them.⁴⁷

Numerous studies in California and elsewhere find that physician ownership of medical facilities increased patient services at those facilities by 50 percent or more over services provided at non-owned facilities. Total charges were up, too. For example, three studies of physician-owned clinical laboratories in Michigan during the 1980s found charges in self-owned laboratories were from 71 percent to 84 percent higher than in non-owned laboratories. As evidence of over-use of self-owned facilities mounts, so does the concern that something be done to stop the abuse.

Various groups have proposed barring physicians from referring injured workers to facilities owned by those physicians. Although this measure alone would not prevent physicians from encouraging colleagues to refer their patients, it would reduce present misuse of the system. At least one corporation has gone a step further by recommending that whenever the employee selects a physician, the physician would be required to attach a list of his or her medical affiliations to the employer.

The Mercer Corporation released a study in January 1992 that concluded that \$356 million or 3 percent of the total Workers' Compensation cost could be saved by prohibiting medical providers from referring workers for medical services when the referring provider potentially could receive a financial reward.⁴⁸

While the majority of physicians who are invested in medical facilities and testing laboratories are ethical, there are those who are not. There are insufficient controls to curb abuse by self-referring physicians and hold the line on costs.

***One Corporation's
Proposal***

As frustration mounts over the lack of progress in reforming the current Workers' Compensation system to deal with the factors identified above, it is not surprising that corporations have made their own recommendations. For example, one company, well known for its innovations in the entertainment industry, set up an internal task force to draft model Workers' Compensation legislation. The resulting proposals include:⁴⁹

- * Encouraging employers and carriers to use HMOs and PPOs in conjunction with Workers' Compensation programs.
- * Creating the following system whenever the employee has not designated in advance a "personal physician" for treatment in work-related injury:
- * The employer retains control of medical care for 90 days. Within the first 90 days, the employee may change physicians, but only to one approved by the employer.
- * After 90 days the employee may change physicians once. If the employer uses an MCO, then the employee may select a physician from the MCO. If the employer doesn't use an MCO, then the employee may select any physician.
- * For any further change in physicians, the employee must prove exceptional circumstances that jeopardize the course of care before the change is made.

***Track Record
in Other States***

California is not alone in the struggle to cope with Workers' Compensation costs. Other states, too, have strategies to reduce Workers' Compensation health care costs. For example, in its 1991 survey, the Workers' Compensation Research Institute found:⁵⁰

- * Primary treating providers were designated in 41 states and no other medical services could be provided except as ordered by the primary treating provider.
- * Fee schedules that list maximum reimbursement levels were used in 26 states, including California, and five other

states were in the process of establishing fee schedules. Bill review procedures were used or were planned to be used to enforce the schedules in 13 states.

- * The employee's choice of a physician was limited in 21 states; 39 states limited the employee's right to change providers.
- * Hospital charges were regulated in 18 states and regulations affecting hospital charges were under development in five other states.

One state that enacted comprehensive reforms targeted particularly at medical costs is Oregon. Examining those reforms and their outcome may help shape the direction California should take.

Oregon was faced with the second highest medical claim costs in the nation, second only to Alaska, when it adopted its Workers' Compensation reforms in 1990.⁵¹ Workers' Compensation was the only insurance system in Oregon still paying for all services without any control or ability to question the necessity of care. As in California, there was a fee schedule for physicians, but none for hospitals. Also, as in this state, there was a substantial cost shift from other forms of payment to Workers' Compensation. In 1989, the Workers' Compensation portion of care in hospitals was 4.2 percent, but it accounted for 25.2 percent of their operating income.

Oregon had some success with the managed care concept in the private sector and believed it could be applied to Workers' Compensation. As discussed earlier, the primary goal of managed care is to reduce unnecessary and ineffective utilization of medical services and thereby lower expenses without sacrificing quality of care. In Workers' Compensation, there could be additional savings from reduced indemnity, specifically time loss and disability awards. The state had also, as early as 1988, experimented successfully on a limited basis with managed care for injured workers. And so, when Oregon adopted managed care for Workers' Compensation, it was with high expectations that the concept would bring down costs.

A Faulty Program?

To date, the anticipated savings have not materialized; but it may be wrong to fault

managed care. The Oregon Workers' Compensation reforms may have been flawed from the start. At the heart of the issue is the relationship of incentive-based legislation to actual reform. In the private health care sector, any one qualified can provide medical health or insurance services. Open competition, although not perfect, provides the incentives to help keep costs low.

However, the Workers' Compensation reform legislation limited competition by excluding Workers' Compensation insurers from forming, owning or operating a certified managed health care organization. It effectively gave the job of managed care in Oregon to health care providers only, thereby reducing incentives for cost containment. It could be argued that although health care providers have the most experience providing health care, they have the least to gain from reducing medical costs. In addition, the exclusion so tightened the managed care market that two years after the bill was passed, there are only six certified companies. Almost all are hospital-based.

Other problems Oregon has experienced with its managed care model include:

- * Hospital fees have remained the same or increased. As part of the reform legislation, hospitals were made subject to a cost/charge ratio reduction. Whatever a hospital charged for its medical services, its bill would be reduced by an amount specific to that particular hospital. That is, the reduction would be individualized for that hospital. Since the reforms, the cost/charge ratios have been altered to provide hospitals a higher percentage of their bills. In addition, hospitals that are currently contracting to provide services for a certified managed care organization are doing so at high negotiated fees. As a result, hospital costs have not been reduced.
- * Physicians generally continue to receive payment at the 75th percentile as dictated by the fee schedule. The reforms did not intend to change that provision. However, managed care was to reduce costs by instituting new efficiencies and controls on physicians. For example, the injured worker would be directed to a panel of

physicians that ideally would determine the appropriate and cost-effective treatment protocol. This procedure has not been effective. Panels are either too large, not in place, or physicians are reluctant to change procedures with which they feel comfortable.

- * Because managed care organizations are certified to provide care in specific geographical areas, many injured workers fall outside their jurisdiction and cannot be directed into a managed care program. There is an additional problem concerning payment for treatment when injured workers are treated outside the areas of their private health care networks and their claims are denied by Workers' Compensation.
- * There are administrative problems not easily overcome. For example, the current structure of the MCO has led to a duplication of tracking services and case management. Mirroring the administration the insurer provides on its claims, there are now two groups of the same data, adding to and not reducing costs.

It is too early to tell if Oregon's managed care reforms will be successful in lowering Workers' Compensation costs. The state's experience is useful, however, in pinpointing pitfalls to avoid.

Managing Medical Costs

An examination of Workers' Compensation data clearly shows that medical care is a major cost driver in the system. Outstripping the increases in general health care costs nationwide and in California, the medical costs associated with Workers' Compensation are not tied to any incentives that would ensure efficient and effective use of resources while not diminishing the quality of care.

Moving the management of medical care provided through the Workers' Compensation program so that it is more in line with the systems for health care used in other arenas -- government programs such as Medi-Cal and Medicare and privately supplied health insurance plans -- would accomplish cost containment. Since the majority of people who have some type of health care

coverage are already in such cost-contained systems, injured workers would be receiving no different, or lesser, level of care.

California needs to take steps to bring medical care under control, balancing the need for cost containment with the need to provide injured workers with adequate medical care.

Recommendation #2 The Governor and the Legislature should enact legislation to establish managed care as the mode for delivery of medical services under the Workers' Compensation system.

The legislation should be designed to eliminate the struggle for control of medical care between employers, insurers and the employee. A variety of approaches could be used, including:

- * Allowing companies to merge their Workers' Compensation medical care plans with the other health plans that they offer employees. Employees would then be required to use the same medical providers for on-the-job injuries that they have selected for their more routine medical needs.
- * Allowing companies to use a Managed Care Organization to operate their Workers' Compensation health benefits and requiring injured workers to be treated within that system. This concept could be combined with allowing employees to demand a change of doctors for any reason a limited number of times, after which the employee could only change doctors by proving some level of gross mismanagement of treatment.

Recommendation # 3 The Governor and the Legislature should enact legislation that would establish system-wide limits for medical care under the Workers' Compensation system.

Without altering the "liberal construction" philosophy -- which is a clear statement of California's intent that every effort be made to redress damages to injured workers -- limits can and should be put into effect. These limits would be designed to cap profit-driven excess medical treatment but not deprive injured workers of necessary and desirable medical treatment. Examples include:

- * Instituting practice guidelines, similar to those used in Medicare, that include medical fee schedules, auditing procedures and case management utilization review.
- * Creating fee schedules for hospital services.
- * Eliminating the practice of self-referral, where physicians send patients to facilities for testing or training when the doctor has a financial interest in the facility.

Vocational Rehabilitation

Vocational Rehabilitation

Finding #4: The Vocational Rehabilitation Program lacks sufficient incentives to return employees to work quickly and to control cost.

Vocational rehabilitation is designed to help injured employees with a disability get back to productive employment.⁵² Combined with other traditional forms of benefits for disabled workers such as medical care, physical restoration, and indemnity payments for lost wages and permanent impairments, vocational rehabilitation is crucial for many individuals in their effort to achieve a productive career placement.

The benefit is important because it serves the social goals of promoting personal dignity, family stability and taxpaying capacity through returning the injured employee to work. Lengthy periods of unemployment may have the opposite effect, resulting in personal bitterness, family disruption and dependence on unemployment insurance.

Of California's 12 million workers, more than 56,000 are identified each year as potential candidates for vocational rehabilitation. Records show that 60 percent will be determined as eligible to receive vocational

rehabilitation, and eight out of ten will complete a vocational rehabilitation program.⁵³

Eligibility

Two criteria decide a disabled worker's eligibility for vocational rehabilitation. The first relies upon a physician's medical judgement: whether the permanent impairment resulting from the injury permanently prevents the worker from returning to his or her usual occupation, or to the job or position occupied at the time of the injury. The second criterion is vocational feasibility. This is an even less precise test that attempts to decide, before the fact, if the employee can benefit from rehabilitation services, taking into consideration the employee's age, injury, work experience, vocational interests and other factors.⁵⁴

Benefits

Vocational rehabilitation offers a three-fold benefit to the qualified injured worker. However, not all rehabilitation candidates receive all three benefits. For instance, some individuals will decline the benefit or drop out of a specific program while others will not meet the qualifying standards.

- * The worker is eligible for a maintenance allowance to help replace lost wages while the worker receives rehabilitation services. The maintenance allowance is paid at a rate determined by the date of the injury. Workers injured after January 1, 1990, receive a maximum of \$246 per week while in a vocational rehabilitation program. The maintenance allowance accounts for about one-half of total vocational rehabilitation costs.
- * The worker is also eligible for coverage of the cost of evaluations, testing, development and implementation of a specific return-to-work plan, job placement assistance and other rehabilitation counseling services. About one-third of vocational rehabilitation costs are paid for services provided by private rehabilitation counselors and other service providers.
- * The qualified injured worker also may receive reimbursement for out-of-pocket expenses related to the return to work plan such as tuition, books, transportation,

tools, uniforms, food and lodging while the worker is away from home. Child care is included in some cases.

The Process

Vocational rehabilitation applicants go through a specific state mandated process.⁵⁵

- * When aggregate total disability continues for 90 days, the employer immediately shall assign a qualified rehabilitation representative who shall meet with the employee and explain the employee's rights and obligations pertaining to vocational rehabilitation.
- * Once an employee is determined to be eligible for vocational rehabilitation benefits, the employer must submit a vocational rehabilitation plan agreed to by the employee to the Department of Industrial Relations' Office of Benefit Determination within 90 days for review and approval or request the Office of Benefit Determination to resolve any dispute concerning the provision of vocational rehabilitation services.

Vocational Rehabilitation Plans

Vocational rehabilitation plans can take several forms. Options include:

- * Modified job. Re-employment by the same employer in the same job, but with changes to the work process or work function to fit the employee's physical limitations.
- * Alternative work. Re-employment by the same employer in a different job within the employee's physical limitations.
- * Direct placement. Re-employment with a new employer in a new job that uses the employee's existing skills gained through previous employment, education, military training, hobbies, etc.
- * On-the-job training. Re-employment by a new employer willing to train the employee in a new job, with the cost usually shared with the at-injury employer.

- * Formal schooling. Vocational or academic instruction in a classroom setting directed at re-employment in a new occupation.
- * Self-employment. Assistance and consultation in establishing an independent, self-sustaining enterprise, excluding expenditures for capital investments.

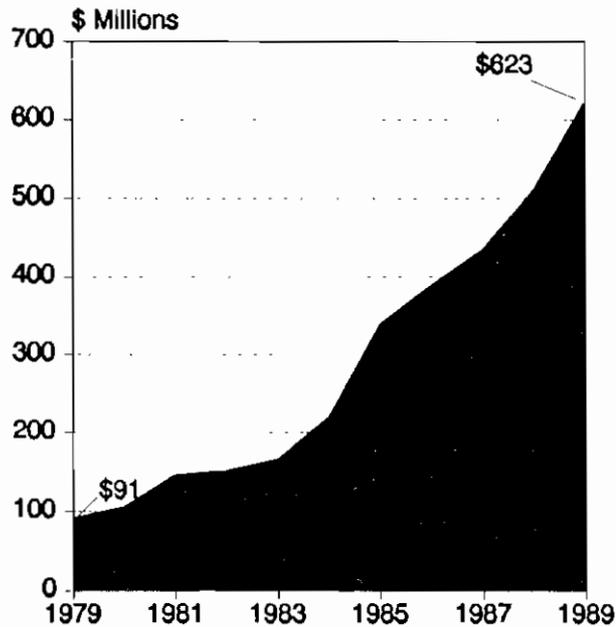
The Costs

In 1975, vocational rehabilitation was added to the worker compensation system as a mandatory benefit.⁵⁶ The implementation of a mandatory vocational rehabilitation benefit has required the development of complex regulations and an extensive network of rehabilitation counselors and providers to design and implement rehabilitation plans. The important goal of a speedy return to work for injured employees has receded as the vocational rehabilitation bureaucracy has grown and lengthy, expensive rehabilitation plans have proliferated. Prior to 1975, vocational rehabilitation, though provided voluntarily in cases of severe injury, was not a significant cost in the Workers' Compensation system. After the mandatory law took effect, the number of qualified injured workers grew rapidly, and the cost of providing rehabilitation grew even faster.

Initially, the new benefit was projected to cost 2.7 cents for every dollar in total benefit costs (cash benefits and medical payments). Today, it represents nearly 13 cents for each dollar in total benefit costs.⁵⁷ On the following page, Chart 12 shows how costs have increased for vocational rehabilitation services between 1979 and 1989.

Chart 12

Vocational Rehabilitation Insured Employer Costs

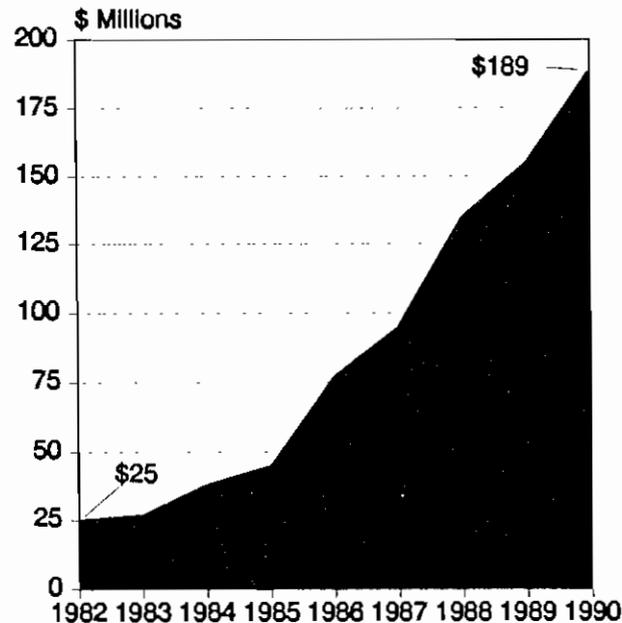


Source: WCIRB

As seen in Chart 12, the costs of vocational rehabilitation have climbed almost 600 percent between 1979 and 1989, from \$91 million to \$623 million. The State Fund too, has had tremendous growth in its Workers' Compensation costs. On the following page, Chart 13 indicates the rapid rise in vocational rehabilitation costs to the State Fund.

Chart 13

Vocational Rehabilitation State Fund Costs



Source: State Compensation Insurance Fund

As can be seen in Chart 13, the State Fund's figures show that its vocational rehabilitation costs grew 656 percent in the eight year period, from \$25 million in 1982 to \$189 million in 1990, making it the fastest growing benefit delivered by the fund.⁵⁸ In 1991, the vocational rehabilitation benefit is estimated by the WCIRB to have cost insured and self-insured employers more than \$1 billion.⁵⁹

A bulletin published by California Workers' Compensation Institute (CWCI) in 1987 stated that "the vocational rehabilitation benefit gets the blame for a major portion of the recent rise in employers' premium rates. During the (1980-84) period, rehabilitation expenses grew at an annual rate of 41 percent, three times faster than the increase in total costs. The vocational rehabilitation benefit now accounts for 13 percent of claims costs."⁶⁰ The CWCI contended that the frequent use of formal schooling is one reason why the costs for vocational rehabilitation have soared in recent years.

The cost of plan cases that were closed in 1989, whether completed or not, averaged nearly \$19,000 each, 350 percent higher than the average in 1978, when the first cost measurements were made.⁶¹ It appears that the major factors contributing to the cost escalation of the rehabilitation plans was a lengthening in the duration of the plans.

For example, in 1978 plans took an average of 5.6 months to complete. In 1989, plans took an average of 8 months. There was a shift to longer and more expensive plans. The longer the duration of the plan the longer there is a need for maintenance payments and the services of rehabilitation counselors.

In an October 1991 report entitled "Vocational Rehabilitation: The California Experience, 1975-89," the CWCI explains the significant increases in Workers' Compensation costs as follows:

The rapid acceleration in the number of vocational rehabilitation claims after 1982 may have been triggered by a major benefit increase that gave higher visibility to the Workers' Compensation program. Additionally, the California economy was emerging from recession; some observers speculate that with fewer job openings, some injured workers may have decided to continue Workers' Compensation payments by applying for vocational rehabilitation benefits rather than receive lower payments from the state unemployment compensation program. A third explanation argues that the increase in vocational rehabilitation claims followed a policy change by the state administrative agency that, for the first time, allowed the claimant's attorney a separate, additional fee paid from the injured worker's maintenance allowance. This may have had an impact on the selection of the more expensive schooling plan in that if the worker is represented, a schooling plan is more than twice as likely to be developed and implemented as other types of vocational rehabilitation.⁶²

The California Association of Rehabilitation Professionals (CARP) contends that employers take too long to inform employees that the vocational rehabilitation

benefit is available to them. Furthermore, the association maintains that this results in longer rehabilitation periods because the longer the employee is away from work the more difficult it is to rehabilitate the employee. As a result, more maintenance payments must be given to the employee.

In its April 1989 study entitled "A Review of the Workers' Compensation System" the Auditor General found, "Employers in our sample notified the bureau as early as 62 days and as late as over 6 years after their employees' injuries; the average length of time between injury and notification was 550 days."⁶³

Effectiveness in Question

The effectiveness of vocational rehabilitation as a useful tool for dealing with work injuries has been questioned. The actual success rate of entry into new fields of employment is far lower than the benefits escalating costs would suggest. The State Fund indicated that "only 48 percent of the injured workers completing rehabilitation plans have seen the plans produce long-term employment in new occupations. While 65 percent of those completing plans are still employed three years later, only 17 percent of all participants have returned to their pre-injury occupation. Results that place less than half of plan participants in new long-term employment as a result of retraining do not justify the \$695 million cost of the program."⁶⁴

However, the California Workers' Compensation Institute disagrees, maintaining the program is a success. According to the Institute, in the first 15 years of the program, from 1975 to 1990, nearly 100,000 seriously disabled workers have completed programs to restore their employability. A substantial majority of them return to the work force in modified or new occupations. Despite their disability, says the Institute, rehabilitated workers on average earn about 90 percent of their pre-injury wages. Forty percent return to work at wages greater than before their injury.⁶⁵ CARP maintains that, of those workers completing a plan, 84 percent will return to work as productive taxpaying citizens.⁶⁶

In her testimony presented to the Commission on August 26, 1992, the Chief of the Benefits and Training Division of the Department of Personnel Administration said:

*It appears that the more extensive
the vocational rehabilitation program in*

time or funding, the less likely the employee is to return to work. All of the players in the states workers' comp system bear part of the responsibility for this phenomenon. Employers are not diligent in their efforts to bring the employee back to work. Employees often see vocational rehabilitation as an avenue to a better career rather than a method of quickly returning to gainful employment, especially if they did not like their former job. Attorneys and private rehabilitation vendors have no financial incentive to get the employee back quickly into the labor market, because the longer the process takes the greater their respective incomes.⁶⁷

Defenders of vocational rehabilitation argue that the purpose of the system is not to guarantee a job, but to guarantee employability or the ability to compete in the market place. An article in the Workers' Compensation Enquirer sides with that theory, concluding that "judging the value of vocational rehabilitation in the California Workers' Compensation system by measuring statistics of injured employees having returned to work within the strict time line of mandated service-providing is invalid."⁶⁸ Yet, there is no dispute that California created the rehabilitation benefit with the intent of getting employees back to work with a comparable wage as soon as possible.

CARP acknowledges the high cost of vocational rehabilitation and cites several factors besides delays in getting workers into programs because the employers are late in notifying them about their options. CARP says that one of the costs drivers is excessively lengthy plans. with the average time of rehabilitation exposure was two and one-half years, based on 1989 data.⁶⁹ They indicate that there often is no easy way for an understaffed Rehabilitation Unit in the Division of Workers' Compensation to expedite vocational rehabilitation in a heavily litigated Workers' Compensation system.⁷⁰

Rehabilitation professionals also cite time wasted in waiting for meetings, documenting turnaround, and not promptly fulfilling certain obligations as a reason for spiralling costs. These delays increase the amount of temporary disability payments that must be made during the rehabilitation process.

***Comparison of
Different Approaches***

Authorities generally agree that modified and alternative work plans are the quickest, least costly and most successful rehabilitation programs. Rehabilitation professionals indicate that the rehabilitated worker, on average, returns the full cost of rehabilitation to society in approximately four years through his or her renewed tax-paying capacity. They also claim that rehabilitated workers are more than twice as likely to return to work as non-rehabilitated workers.

The CWIC, the insurance industry's research group, completed a report in 1991 in which they found that modified work is the least expensive and most cost-effective form of rehabilitation. They also found that it accounted for only 13 percent of all plans while schooling, which is the most expensive and least successful of return-to-work options, accounted for 53 percent of rehabilitation plans. Costs average \$5,389 for modified or alternative work options, compared to \$24,201 for formal schooling. The median length for modified or alternative work was 2.2 months in 1989. By contrast, classroom instruction lasted 8.6 months.

Moreover, workers completing modified job and alternative work plans fare best financially in wages after returning to work, averaging a gain of \$32 weekly. Least fortunate are workers who finished programs combining schooling and on-the-job training. They lost an average of \$105 weekly. Graduates of other types of plans netted weekly losses in the \$40-\$50 range.⁷¹ The CWIC contends that the frequent use of formal schooling is one reason why the costs for vocational rehabilitation have soared in recent years.

From the employer's perspective, there are advantages to modified or alternative work plans over schooling in a new occupation. The State Fund found that:

Most injured employees are best served by a return to their former employment, where the seniority and expertise gained through years of prior employment contributes to relatively high earnings. While there may be an initial interest in pursuing retraining at the employer's cost, very few employees are willing to accept the reduction in earnings that a change in careers often involves. By far the most successful rehabilitation plans are those that return the injured worker to

the same employer in the same or a modified job.⁷²

Modified or alternative work plans have returned 75 percent of their participants to the labor force, but they account for only 13 percent of all the rehabilitation plans. Thus, although other plans are less successful and far more costly, they are used more frequently.

The State Fund and the CWIC are not alone in their conclusions. In a 1989 report entitled, "A Review of the Workers' Compensation System," the Auditor General commented that although the number of employees who completed vocational rehabilitation plans increased substantially, the relative success of these employees finding jobs after completing their plans increased only slightly. The report concluded that this resulted from employees most frequently choosing the rehabilitation plans that were the least successful in returning them to work -- schooling plans. Further, the report stated that the two vocational rehabilitation programs that were the most successful involved either a modified job or an alternative job with the same employer. These plans are among the least expensive and result in better earning capacity at the end of the rehabilitation.

The conclusion, then, of those who have examined vocational rehabilitation programs closely is that the least expensive, most expeditious methods are the most effective in returning workers to jobs -- but are also the least used options.

Reform Act of 1989

Improving the effectiveness and lowering the cost of vocational rehabilitation was one of the goals of the reform legislation enacted in 1989. The Workers' Compensation Reform Act incorporated several new elements to reward performance and discourage delays.

For example, an employer who modifies a job or finds alternative employment for a qualified worker will receive a "rehabilitation dividend" equal to the first year's Workers' Compensation premium on that employee from the insurer. Also, a worker who begins the rehabilitation process during the temporary disability period will continue to receive the full disability payment instead of the lower maintenance allowance paid after the employee's medical condition stabilizes, thus encouraging early participation and shorter, more successful plans. In addition, to avoid delays, an eligible worker must agree to accept vocational rehabilitation within 90 days. If the

employee does not agree, the employer's liability for the benefits terminates.

The 1989 reform act also provided additional vocational rehabilitation services at the employer's expense, if the employee is unable to complete one year of employment in modified or alternative work and demonstrates an inability to obtain suitable gainful employment because of a lack of existing skills.⁷³

According to CARP, the 1989 reforms have helped put more people into modified and alternative work plans, more than doubling those forms of vocational rehabilitation from 13.5 percent in 1989 to 34.5 percent in 1991.⁷⁴ The reforms also have reduced the time it takes to get an eligible worker into a vocational rehabilitation program. For example, as stated earlier, in 1989 it took an average of 550 days until the employee was informed by the employer of vocational rehabilitation services. Now, according to CARP, the average time is approximately 200 days.⁷⁵

In a research project assessing the effectiveness of vocational rehabilitation services under the Workers' Compensation reform legislation of 1989, the Rehabilitation Presidents Council of California agreed that the reforms have been beneficial. The Council reported that the interval between injury and initial evaluation had decreased by 8 percent and between the evaluation and the beginning of the plan, by 27 percent.

Recent Proposals

Various critics of the Workers' Compensation system have offered plans to further reform the vocational rehabilitation component. The Governor has proposed that vocational rehabilitation be eliminated as a Workers' Compensation benefit; instead, workers who are unable to return to their jobs after an injury would be referred to the Division of Workers' Compensation Rehabilitation Unit. The unit would be appropriated one-third of the funds now spent on vocational rehabilitation, paid for by a tax on employers. The unit would contract for services that would be provided to injured workers. The Governor also called for increasing worker benefits with the money saved by this proposal. Opponents doubt that the state could provide the benefit efficiently enough to provide the two-thirds savings.

Another proposal would have capped vocational rehabilitation at \$25,000 per injury and reduce the fee

schedule by 10 percent. However, this proposal, says an attorneys association, among others, has the potential to provide too much to employees that do not really require much rehabilitation and not enough to employees that are seriously injured.⁷⁶ According to the WCIRB, the proposed cap would eliminate services to 50 percent of those whose disability rating is 75 percent or more. Also, the WCIRB states that 23 percent of vocational rehabilitation cases involve costs in excess of \$25,000.

The State Fund recommends that vocational rehabilitation services should be offered only where they represent a realistic, cost-effective alternative for injured workers.

The California Association of Rehabilitation Professionals (CARP) offered the following package of cost saving measures.⁷⁷

- * ***Limit an employee to one plan.*** According to the CWCI, there is an average of 1.2 plans per injured employee. If the employee knew that he or she would be able to have just one plan, it would increase the employee's commitment to the plan, as well as make it easier for the Rehabilitation Unit in the Division of Workers' Compensation to close the case. The net effect would be to minimize lengthy plans. Although this proposal does not provide an incentive for the employee to choose the most cost-effective plan, the recommendation may save money.
- * ***Integrate vocational rehabilitation with the federal Americans With Disabilities Act.*** Under this proposal, employers would not be liable for any other form of vocational rehabilitation if the employer offers the injured worker a reasonable accommodation of alternative or modified employment that meets the definition of suitable, gainful employment under state law.
- * ***Cap the period of entitlement.*** For example, all services could be capped at 18 months from the date of notice of eligibility and would include mandated time frames for determination of whether an employee can reasonably be expected to return to

suitable gainful employment through the provision of vocational rehabilitation services; for the plan development; and for the actual plan, placement services, and to coordinate with the beginning of training programs.

- * ***Prohibit vocational rehabilitation services for injured workers who relocate out of state.*** Existing law allows for workers who relocate or who are only eligible for placement services out of state to receive vocational rehabilitation services. These services are generally provided by out-of-state counselors who are not familiar with California regulations. These cases are difficult for the insurer, attorney and Rehabilitation Unit to control. There is a motivation for some workers to relocate to where their temporary disability dollar can be stretched due to lower cost of living standards.

- * Make the system more efficient through auditing, fines for noncompliance, and eliminating unnecessary requirements.

In its 1992 report, the Council on California Competitiveness cited vocational rehabilitation as "the fastest growing cost factor" in the California Workers' Compensation system. The Council pointed to other states, such as Washington, Oregon, Alaska, Florida and Colorado that have reduced or eliminated vocational rehabilitation as a benefit entitlement. In an attempt to control costs, the Council made the following recommendations:

- * Institute limits on scope, duration, and cost of rehabilitation programs.

- * Allow employers to reasonably accommodate (i.e. re-employ) a disabled worker (per the federal Americans With Disabilities Act and state Fair Employment and Housing Act) in lieu of vocational rehabilitation.

- * Allow employer and employee to negotiate rehabilitation claims.

- * Require that vocational rehabilitation, if pursued, be completed before final settlement of permanent disability benefits; amount of disability to be determined on the basis of the "new" occupation acquired through rehabilitation.

The Americans With Disabilities Act may play a role in how Workers' Compensation operates in the future. Under the ADA, when a person applies for a job for which he or she is qualified, that person may not be denied employment based on a disability. Instead, employers must take all reasonable steps to accommodate the person's disability.

Using the parameters of the ADA, an employer should be able to offer an injured employee accommodations that would allow a return to work despite any disability. Companies that pursue this strategy would gain a productive worker and avoid the cost of vocational rehabilitation and long-term disability payments.

Oregon's Reforms

Like California, other states have seen vocational rehabilitation costs in their Workers' Compensation programs soar. Unlike California, some states have acted decisively to contain their costs. Oregon's reforms of 1989 took control from those who had been profiting from the system. As a result, the state has seen a continuous reduction in the cost of vocational rehabilitation services, as the table on the next page indicates.

Average Costs for Vocational Rehabilitation in Oregon

Type of Cost	1989-90	1990-91
Direct Worker Plan	\$3,484	\$1,155
Professional Rehabilitation Organization Fees (Average)	\$5,332	\$2,485

Oregon achieved the cost reductions through several steps:

- * A contact regarding vocational services is made with all workers within five days of the knowledge of the need for vocational rehabilitation or the worker being declared medically stationary without returning to suitable employment.
- * All workers must be notified of their reinstatement or re-employment rights within five days of a release to return to work.
- * All workers contacted for vocational services must have their eligibility for these services determined within 30 days of the contact.

In addition, Oregon has tightened its eligibility review process. In order to be eligible for services, the worker must have a substantial handicap to suitable employment. Suitable employment means the worker has the skills, knowledge, abilities and physical capacities to perform the job. In addition, it must pay at least 80 percent of the wage currently being paid for the worker's regular employment.

As a result of the new process, approximately 67 percent of all reviewed cases were determined eligible for services in 1991. Prior to 1988, all workers who did not return to work were eligible. This reduced costs to the system while continuing to ensure that employees who will benefit from vocational rehabilitation services receive them.

***Improving the
Effectiveness of
Vocational
Rehabilitation***

The underlying intent of vocational rehabilitation as a component of Workers' Compensation is to return injured workers to the labor force as productive, tax-paying members of society. Despite a growth in dollars spent on vocational rehabilitation, these services have been only partially effective in returning workers to jobs.

Lacking in the operation of vocational rehabilitation services are controls that would result in employees receiving only the most effective and suitable form of retraining. To achieve the most benefit for the injured

worker and the least cost for businesses, California should institute controls to direct rehabilitation efforts.

Recommendation #4: The Governor and the Legislature should enact legislation that focuses vocational rehabilitation services on effectiveness for returning injured workers to the labor force.

California already has instituted reforms that encourage companies to provide alternative or modified jobs to injured workers. Other steps that could be taken include:

- * Requiring the Rehabilitation Unit of the Workers' Compensation Division to evaluate schooling plans based on their success in finding long-term employment for graduates, with the eventual aim of setting standards for what types of vocational rehabilitation services the employee can seek.
- * Setting up eligibility standards that restrict vocational rehabilitation services only to those employees who have a demonstrable chance of finding meaningful new employment opportunities.
- * Requiring injured workers to accept modified or alternative jobs that offer a similar pre-injury wage or forfeit the right to vocational rehabilitation.

Recommendation #5: The Governor and the Legislature should enact legislation that would limit employer liability for vocational rehabilitation.

To encourage employers to assist in the goal of returning injured workers to the labor force, companies should be allowed to have no responsibility for vocational rehabilitation costs if they

offer suitable modified or alternative work for the employee. They also only should be required to pay for one vocational rehabilitation plan, rather than being responsible for multiple plans that the worker may wish to pursue. Finally, there should be a clear legislative statement that an employer who meets the standards and tests prescribed by the Americans With Disabilities Act will be deemed to have offered suitable replacement employment to the injured worker.

Fraud, Evaluations and Stress

Fraud, Evaluations and Stress

Finding #4: The high incidence of fraud, the multiplicity of expensive medical/legal reports and the subjectivity involved with stress claims all place an overwhelming burden on the Workers' Compensation system without benefitting the injured workers the program was designed to protect.

Some components of the Workers' Compensation system involve services provided directly to injured workers, such as medical care and vocational rehabilitation. In those areas, the State has an interest in balancing carefully any cost containment efforts against the goal of adequately and fairly redressing workers for injuries. Other aspects, however, that have become part of the Workers' Compensation system over time add tremendous costs to the system without directly benefitting the on-the-job injured employees who Workers' Compensation was designed to protect. Chief among those factors are:

- * **Fraud.** Some critics of the system contend that up to 30 percent of the cost of Workers' Compensation -- a potential \$3 billion -- is wasted through fraud. This provides no benefit to deserving workers and, in fact, deprives them of the higher benefits and employers of the lower premiums that could be possible if money were not siphoned away from the system illegally.

- * **Multiple medical/legal reports.** Both the employee and the employer may fall into the "dueling doctor" syndrome, with each side obtaining multiple medical opinions to bolster their viewpoint of the degree of injury and its job-relatedness. Such reports cost the system \$700 million in 1990 -- almost half the total cost of litigation. Once again, these are costs that deprive the system of resources that could otherwise be spent on increased benefits.

- * **Subjectivity of stress claims.** While these claims represent only a fraction of all Workers' Compensation claims, they are a difficult-to-prove and highly contentious type of claim that serves to undermine the credibility and viability of the system. With the State requiring very little of the cause of stress to come from a job and with the rapid growth in stress claims, this area of Workers' Compensation threatens to divert more and more dollars away from the benefits for workers with more traditional or directly job-linked types of injuries.

Fraud

Despite reforms, fraud continues to be a significant cost-driver in California's Workers' Compensation system. According to some estimates, fraud accounts for as much as 30 percent of the dollars paid out in California's Workers' Compensation system. Corrupt doctors and lawyers exploit the system, false and misleading advertising is rampant and, while employee fraud receives most of the media attention, there is evidence that employer fraud may be as serious.

According to a report by the Council on California Competitiveness, as much as 20 percent to 30 percent of

employee claims are fraudulent, totaling \$2 billion to \$3 billion in 1991. Major insurers estimate 20 percent of all claims are fraudulent.

One major avenue of fraud are so-called "comp mills," groups of doctors and/or lawyers who try to entice employees into filing Workers' Compensation claims for non-existent injuries. Typically, the mills specialize in poorly defined, subjective ailments. The firms hire recruiters, known as "cappers," to convince unemployed persons -- who they may find standing in line waiting to file for unemployment benefits -- that it is more profitable to file a Workers' Compensation claim against a former employer than to collect unemployment benefits.

According to exposés that have appeared on *60 Minutes* and a Los Angeles news program, the "capper" gets a fee of up to \$450 for every claimant recruited. The comp mill interviews the claimant, diagnoses non-existent ailments and leads the claimant through an assortment of medical tests and treatments. "Soft tissue" damage claims, usually in the form of back injuries or mental stress, are the stock in trade of unscrupulous doctor/lawyer teams. When skillfully presented, these claims are difficult to refute.

Another contributor to fraudulent cases is the disparity between Workers' Compensation benefits and unemployment benefits. When companies lay off workers, some learn that they receive more money if they claim to be injured.

Anecdotal evidence is plentiful:

- * One insurance company said it was billed more than \$100,000 for medical evaluations for seven fired employees. The workers were fired because they were not U.S. citizens. Not long after they were discharged, they were contacted by a lawyer and urged to file Workers' Compensation claims. Each was sent to five different health clinics, examined by nine different doctors, including a dentist, a neurologist, a radiologist and a chiropractor. The company is contesting the claims.⁷⁸
- * The director of insurance and employee relations for the California Chamber of Commerce said that many firms are hit

with 15 to 20 stress claims at a time -- and all the paperwork is filed by the same doctor and attorney.⁷⁹

- * A large, nationally known insurance company related its experience with the California Workers' Compensation system. "When a Southern California plant earlier this year put 119 employees out of work, all but four of them filed mental and other Workers' Compensation claims for hard-to-verify injuries. The (plant's Workers' Compensation insurer), has now received 211 separate claims from the employees since the plant's closing. Coincidence? Probably not. One law firm is handling 154 of those claims."⁸⁰

- * The president of a furniture-making company in Orange said over a period of time he fired five employees for reasons ranging from drug use to theft. All five ended up filing Workers' Compensation claims against the firm, alleging job-related stress or other ailments. As a result, direct and indirect costs to the company totalled \$120,000.⁸¹

Employer Fraud

Workers are not the only source of fraud. In its 1988 report, the Little Hoover Commission found that employer fraud was a significant problem. The Commission found that "employers who do not report accurate wages to insurance carriers effectively raise premiums rates for other employers."⁸² Employer fraud can include an employer's intentional misclassification of a business to obtain lower rates, an employer not reporting employees on the payroll, and an employer forgery of the required certificate of insurance.

One indicator of the prevalence of employer fraud is the increase in the amount of claims paid by the California Uninsured Employers Fund. A worker files a claim with this fund when the employer has failed to comply with the law that requires Workers' Compensation insurance. The fund is run through the Division of Workers' Compensation in the Department of Industrial Relations. The fund provides benefits to injured workers and then attempts to recover costs from the employer. The amount of claims paid through this fund has increased from \$4.8 million in fiscal year 1981/82 to

\$19.1 million in fiscal year 1990/91, an increase of more than 300 percent.⁸³

Other indicators of employer fraud can be seen in lawsuits that highlight the practice of trying to hide the true extent of a payroll (upon which premium costs are based) or trying to qualify as a different classification of business. Some examples include:

- * In July 1992, the State Fund filed a complaint in the United States District Court in Los Angeles against a group of formerly insured individuals and corporations for violations of the Racketeer Influenced and Corrupt Organization Act (RICO). The complaint alleged that the defendants conspired to defraud the Workers' Compensation insurer of millions of dollars. The \$6 million lawsuit alleged that the defendants executed a scheme to defraud the State Fund by providing false information to the insurance carrier in order to obtain Workers' Compensation insurance policies far below their actual costs.

According to the State Fund, the defendants acted through a series of temporary employment agencies that provided employees at a reduced rate. They could achieve the lower premium rate because they misrepresented the number of workers they employed, the amount of annual payroll earned by the workers, the nature and type of work performed, prior Workers' Compensation premiums and employee claims for work-related injuries.

- * Earlier, the State Fund won a judgement totalling more than \$2.3 million in a suit against Workers' Compensation fraud.⁸⁴

Other states also face problems with fraud in their Workers' Compensation systems. The Colorado Compensation Insurance Authority (CCIA) found that businesses are twice as likely to commit fraud than are injured workers. The CCIA cites the following examples:⁸⁵

- * An employer took out an insurance policy after an accident.

- * To make its payroll appear smaller, a roofing company paid its employees in cash, thereby lowering its premiums.
- * Some businesses with high compensation rates, such as roofers, will pass themselves off as home improvement businesses. The insurance premiums are lower and, with lower costs, they have an edge on their competition.
- * Of 173 instances of fraud found by the authority, businesses were responsible for 111 cases, employees for 55 cases, and insurers or medical providers for 6 cases.

Weeding Out Fraud

Until recently, the Workers' Compensation system had no built-in incentives for insurance companies to weed out fraud and very little resources were devoted to tracking down and punishing fraud. In its 1988 report, the Little Hoover Commission found that only 160 suspected cases of fraud were reported to the Department of Insurance's Bureau of Fraudulent Claims between 1979 and 1986. The Fraud Bureau investigated only 17 of those cases and only one of the cases had been prosecuted as the 1988 report was being written.⁸⁶ However, since the reforms of 1989, there has been a substantial increase in fraud reporting, investigations and arrests. In 1992 alone, 5,662 suspected cases of fraud were reported to the Bureau, 397 cases were assigned for investigation resulting in 24 arrests.⁸⁷

While insurance companies are vigilant about sniffing out fraud in homeowners' and automobile insurance, where their economic interests are affected, there has been less stimulus to do so in the Workers' Compensation system. Claims that are paid out one year become the basis for higher premium rates the next year. In addition, insurance companies are allowed to keep almost 33 percent of the premium dollars for administration, overhead and profit. Ever-spiralling premium rates give insurance companies a larger and larger pie to cut their 33 percent from.

New laws that took effect on January 1, 1992, have significantly altered the State's approach to fraud, however. The laws make it unlawful for any person to:

- * Make or cause to be made any knowingly false or fraudulent material statement or

material representation for the purpose of obtaining or denying any compensation,⁸⁸

- * Assist or conspire with any person for the purpose of obtaining Workers' Compensation benefits or denying a claim for benefits illegally.
- * Make any false or fraudulent statement for purposes of obtaining Workers' Compensation insurance at less than the proper rate.

Violations are punishable by imprisonment in the county jail for up to five years and a fine of up to \$50,000 or double the amount of the fraud, whichever is greater. Prosecution of violators is funded by a fee assessment paid by employers. The funds are divided between the Bureau of Fraudulent Claims in the Department of Insurance and local district attorneys.

The legislation also requires insurance companies to report suspected cases of fraud to either the bureau or local district attorneys. A claims data bureau also has been established so that insurers can provide information on claims to a central database. Information of this type helps track patterns of abuse by businesses and employees.⁸⁹

Finally, the new laws also established a Fraud Assessment Commission, composed of five members appointed by the Governor, two representatives of self-insured employers, one representative of insured employers, one representative of Workers' Compensation insurers and the president of the State Compensation Insurance Fund.⁹⁰

The anti-fraud campaign had a mixed record for its early months. On the one hand, in the first three months insurance companies reported 977 cases of suspected fraud, which is more than was reported in the previous 12 years combined.⁹¹ This number grew to almost 4,000 by the middle of 1992. On the other hand, state investigators and local prosecutors complained from the beginning that the anti-fraud program was poorly conceived, badly underfunded and "almost totally ineffective."⁹² The State Insurance Commissioner said a recent survey of statewide insurance carriers indicates fraud has been reduced by only about 2 percent since the laws went into effect.

A regional supervisor for the Insurance Department's fraud bureau commented that "employers had expected the fraud bureau's investigators to sweep all of the unemployment offices and major clinics within weeks of the law's enactment on January 1, 1992. Instead, the department has been so inundated by fraud reports -- averaging 100 calls a day (by last June) -- that it has become a 'paperwork nightmare.'"⁹³

The Fraud Assessment Commission held a hearing in June to examine problems with the law and came to the conclusion that the program needed an additional \$10 million.⁹⁴ Only \$3 million was appropriated originally, but the Legislature added an additional \$7 million as the 1992 legislative session ended. As one Los Angeles District Attorney's official put it, "It's like trying to melt an iceberg with a can of Sterno."

More Aggressive Steps

With the assistance of the new laws -- and perhaps stimulated by the State Insurance Commissioners refusal in recent years to grant the full premium increases requested by insurers -- some insurance companies are beginning to take aggressive steps to combat fraud. Many have believed it is easier -- and less costly -- to settle. But, others are finding that fighting back is more cost-effective. One study puts the savings at \$10,000 per case -- \$7,000 to fight it out, \$17,000 to settle.

One insurance company has created a fraud unit that saved it \$3 million in 1991 year and was saving about \$1 million a month by mid-1992. The company had found that 10 medical clinics using 120 different names had accounted for 40 percent of the company's total Workers' Compensation medical payments in 1991.⁹⁵

Another company has found that simply subpoenaing the records involved in cases sometimes cause fraudulent medical clinics to back down from claims. In one of the cases where the company used this tactic, the clinic dropped \$56,000 in claims.⁹⁶

Tracking Results

On beyond the dramatic increase in reports of fraud, Workers' Compensation observers have yet to see signs that the new laws are having a meaningful effect. But with the significant lead time required to investigate and prosecute cases, it is possible that statistics will not reflect much reduction in fraud for several years.

Medical-Legal Evaluations

In litigated cases, each side often "shops" for a doctor willing to provide a favorable medical/legal evaluation. The employer pays for each evaluation. According to the Council on California Competitiveness, "dueling doctors" render extreme positions at the behest of "dueling lawyers" on either side of a litigated case. The doctors provide "expert" testimony on the extent of the alleged injury and disability. The lawyers and doctors that engage in the litigation process are "middlemen" who profit from friction in the system and thus have an incentive to create and prolong the friction.⁹⁷

The 1989 reform act established new requirements and cost limits for medical/legal reports. The act established panels of independent medical evaluators (Qualified Medical Examiners), limited the information that could be submitted to medical evaluators, established caps on report fees, limited the reports to one evaluator per specialty and allowed only those reports that are "reasonable and necessary."⁹⁸ Many believe, however, that these reforms have barely dented medical/legal report costs.

Abuse in a No-Fault System

Workers and employers are dissatisfied with the Workers' Compensation system as demonstrated by the vast number of cases that wind up in the hands of lawyers. This is particularly ironic, since the Workers' Compensation system was designed to be no-fault.

Some injured workers may find their physical or mental problems compounded by the need to fight for the level of treatment they believe is appropriate. Many injured workers sent to managed care physicians by their employers for medical evaluations feel that they and their medical problems are not taken seriously. They may have legitimate concerns that an evaluation rendered by a physician chosen by their employer could be unfair.

Employers, too, are increasingly frustrated with a system over which they have no control, that provides little benefit to them and that eats away at their firm's financial resources. They feel frustrated, too, when they try to deal fairly with employees who may or may not have legitimate injuries. Employers know that Workers'

Compensation medical and legal mills operate blatantly at their doorsteps.

In far too many cases, employers and employees abuse the system. Employees seek a second, third or more medical evaluations for the advantage it may bring in litigation. No matter how many medical evaluations an employee obtains, the employer is stuck with the bill. Some employers may advise their injured employees to see physicians who will provide an evaluation more favorable to the employer. Also, some employers question the seriousness of the injury or whether it is, in fact, job-related. Thus, the extent of injury and whether it is job-related is often not quickly or inexpensively resolved.

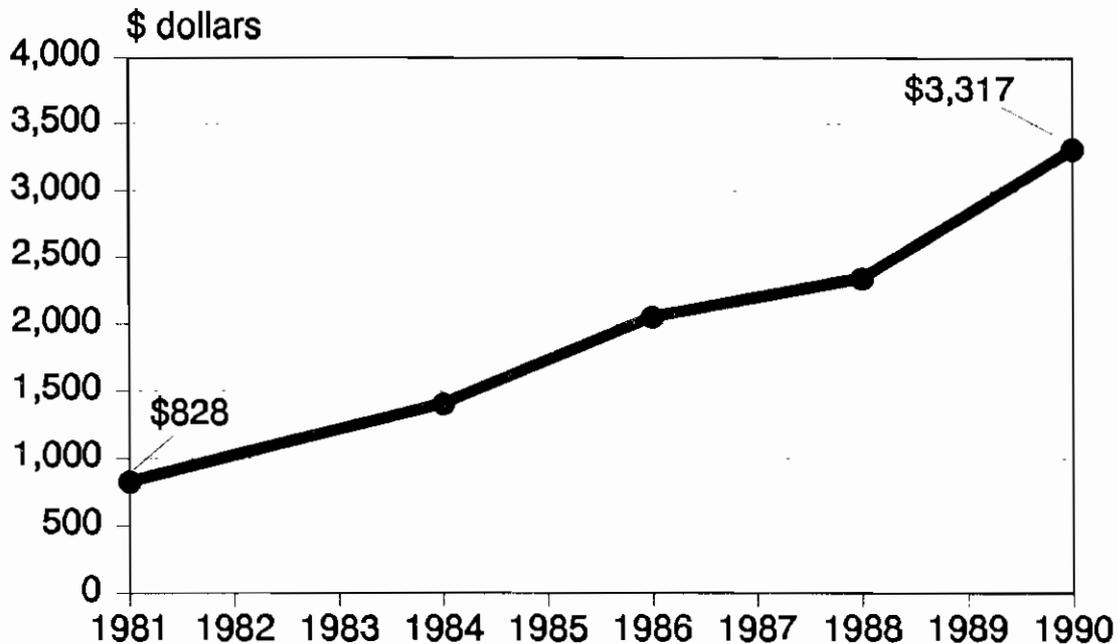
The Costs

Medical/legal evaluations alone cost almost half the total amount spent on litigating Workers' Compensation cases. According to the California Workers' Compensation Institute (CWCI), evaluations cost the Workers' Compensation system approximately \$700 million in 1990; litigation cost \$1.5 billion during the same period.

The CWCI has found that the number of reports per litigated case increased from an average of 2.8 in 1984 to 3.6 in 1990. Chart 14 on the following page shows the average costs for medical/legal reports between 1981 and 1990.

Chart 14

Average Costs Per Case for Medical-Legal Reports



Source: California Workers' Compensation Institute

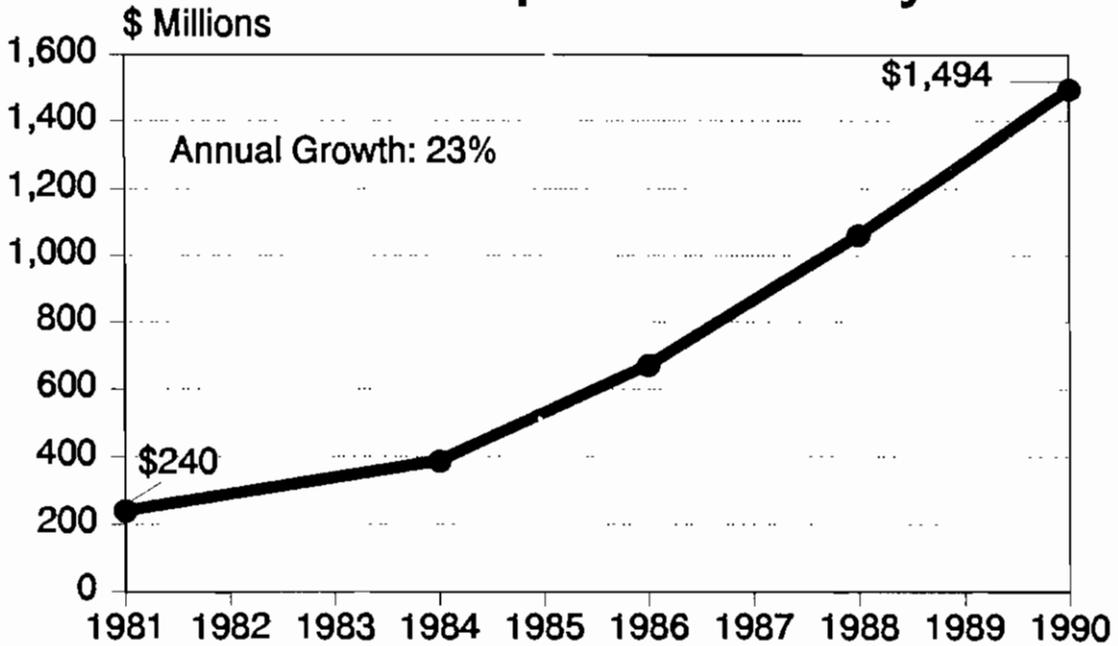
As Chart 14 indicates, the average cost of these reports per case increased from \$828 to \$3,317 between 1981 and 1990.⁹⁹

Perhaps most significant is that the cost of the average evaluation increased 17 percent between 1989 and 1990. There are allegations that the costs are much higher for medical/legal evaluations than the costs of medical evaluations performed outside of the Workers' Compensation system.¹⁰⁰ The Workers' Compensation Institute, of Cambridge, Massachusetts, said recently that doctors in California charge more than \$1,000 for a medical evaluation that would cost from \$200 to \$300 in other states.

It is estimated that when employees lose more than three days of work because of injury, they hire lawyers 41 percent of the time to press their claims. Chart 15, on the following page, shows how rapidly litigation costs have increased, going from \$240 billion in 1981 to almost \$1.5 billion in 1990.

Chart 15

Litigation Costs Workers' Compensation System

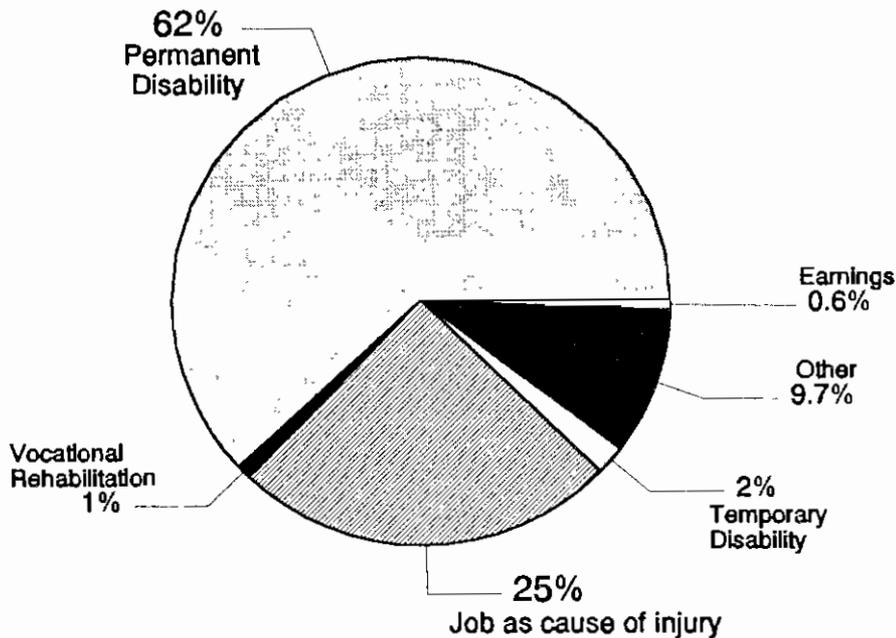


Source: California Workers' Compensation Institute

As seen in Chart 15, litigation costs increased at a staggering annual rate of 23 percent. The breakdown of litigation by category is displayed in Chart 16 on the following page.

Chart 16

Breakdown of Litigation by Category Workers' Compensation - 1990



Source: California Workers' Compensation Institute

Chart 16 shows that, in 1990, 62 percent of litigated claims concerned the amount of permanent disability. Another 25 percent disputed the issue of whether the illness or injury was job-related.

Employer groups argue that litigation costs are not only out of control, but that they provide little direct benefit to employees.

Options for Containing Medical-Legal Costs

One cost-saving measure that has been proposed is to have employers liable for just one medical/legal evaluation per injury. However, an attorney's association opposes that proposal arguing that it would give employers and insurers almost complete control over medical evaluations because workers would often be evaluated first by doctors selected by the employer who may be biased in favor of insurers and employers.

Other recommendations include:¹⁰¹

- * Prohibit medical/legal evaluations within the first 15 days after a claim is filed.
- * Require approval of the Workers' Compensation Appeals Board for more than one medical/legal evaluation.
- * Reduce medical/legal fees by a set amount for a specific length of time.
- * Establish arbitration procedures to settle disputes between employers and medical providers over the costs of medical/legal evaluations.

Under the current system, there are few incentives to keep costs low. Attorneys who specialize in Workers' Compensation cases are encouraged to generate high legal fees because they receive a percentage of the benefits awarded to injured workers. High legal fees are dependent to a large degree on maximizing medical expenses. As a result, workers are encouraged to seek additional medical evaluations and prolong medical care.

Stress

California is only one of six states that allows claims for stress, a difficult to disprove and hard to investigate medical malady. California law requires that employers pay for employees disabled due to stress even when the job contributed only 10 percent to the condition. The subject represents the most easily abused and fastest growing category of all claims in the Workers' Compensation program. And of all Workers' Compensation issues, probably none generates more controversy than stress claims.

Job-Related Stress

California law recognizes that work-related stress can contribute to employee illness or injury. To receive benefits, employees must prove that only 10 percent of the disabling stress was caused by the job. The law allows for compensation of stress claims that are either cumulative or sudden. For example, a case where a supervisor harassed a subordinate employee over a period of years would represent cumulative stress. Sudden stress could result when a police officer witnesses a partner getting killed. However, the line

between cumulative and sudden stress is not always clear. The police officer may have been suffering from years of stress when the latest incident described above put him over the edge.

The 1989 reform act requires an injured employee to "demonstrate by a preponderance of evidence that actual events of employment are responsible for at least 10 percent of the total causation from all sources contributing to the psychiatric injury."¹⁰²

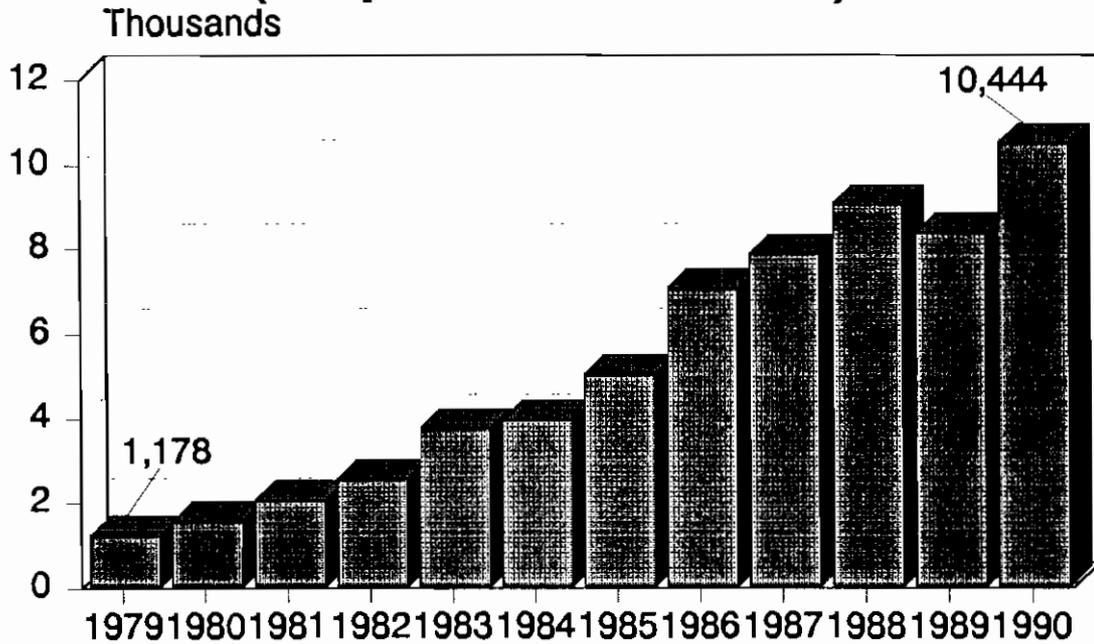
The California Workers' Compensation Institute (CWCI) had found that about 13 percent of stress claims occur within the first six months of employment.¹⁰³ In an effort to reduce the number of stress claims, California recently established a law that makes psychiatric injuries occurring during the first six months of employment noncompensable unless the injury is related to a physical injury or caused by a "sudden and extraordinary employment condition as distinguished from a regular or routine event."¹⁰⁴

Stress Claims on the Rise

Although stress cases make up a small percentage of Workers' Compensation claims, the proportion is growing. Stress claims amount to 7 percent of all claims costs, or over \$450 million per year.¹⁰⁵ Chart 17 on the following page shows the rate of growth in these claims from 1979 to 1990.

Chart 17

Mental Stress Claims (Reported to State)



Source: DIR, Division of Labor Statistics and Research

As shown by Chart 17, the number of stress claims has increased from 1,178 in 1979 to 10,444 in 1990, an 800 percent increase.

However, the CWCI, a group funded by insurance companies, believes that the department understates the true incidence of these claims. The CWCI believes there are perhaps four times as many stress claims than are reported to the DIR.¹⁰⁶ According to CWCI, 73 percent of mental stress claims filed under 1985 policies were not reported to DIR, either because the employer had no knowledge of the injury or did not recognize it was work-related, or because litigation had already commenced so a report was considered unnecessary. The state figures do not include self-insured employers. CWCI contends that many stress claims originate with law enforcement personnel, firefighters, teachers and other employees of self-insured state and local governments. CWCI says that if the injury-reporting experience of self-insurers is similar

to insured employers, the number of mental stress claims may be four times higher than reported to DIR.¹⁰⁷

According to the California Business Roundtable Survey of 1992, 98 percent of business leaders and 74 percent of voters believe claimants should be required to prove that mental stress was pre-dominantly work related. However, although 90 percent of the same business leaders support changing the law to eliminate claims of mental stress arising from job termination, only 49 percent of the voters favor such action.¹⁰⁸

Prevalence of Job Stress

How prevalent is stress in the workplace? A study by Northwestern National Life reported in the California AFL/CIO News concludes that job stress is a national problem and has reached critical proportions, afflicting millions of employees, burdening employers with reduced productivity, costly turnover, and rising health care bills and disability claims. The study's key findings include:

- * Job stress is widespread, with 46 percent of private sector workers perceiving their work as "stressful" or "very stressful."
- * Stress is costly. One worker in two is able to show how his or her productivity has been impaired by stress and 33 percent experience frequent stress-related physical or mental conditions.
- * A long list of conditions, including ulcers, asthma, anger, diarrhea, fatigue, migraines, and depression, are more common among workers in high-stress jobs.
- * Stress-related "burnout," which the researchers termed "America's newest epidemic," is highest among single women with children and low-paid workers with comparatively little control over their own jobs.

The study also noted a sharp rise in the incidence of disabling stress. For example, in 1985, the U.S. Department of Health and Human Services found that 20 percent of the working population was highly stressed and 13 percent experienced stress-related illnesses.¹⁰⁹

***Stress is Difficult
to Disprove and
Investigate***

The subjectivity of stress claims make these claims hard to disprove. Stress claimants receive Workers' Compensation benefits in nine out of ten claims. A 10 percent threshold as called for by the 1989 reform act is not difficult to prove. Thus, a person whose stress is caused predominantly, and up to 90 percent, by any cause off the job, such as a divorce or an auto accident, will be able to have an employer foot the bill.

One indicator of the subjectivity of stress claims is that in 1985 the CWCI found that 98 percent of the claims were litigated, more than twice the rate for other indemnity claims. Claimants received benefits in 90 percent of the claims and 86 percent of stress claims were resolved before going to trial. According to the CWCI, the prospect of expensive litigation and an uncertain outcome encourages most insurers to settle.¹¹⁰

Some examples of "horror" stories:

- * This past summer, a Fresno law firm sent letters to members of the California Teachers Association openly suggesting that teachers file for Workers' Compensation benefits. The form letters, headlined "Money Talks," advised the teachers that "many of you are passing up thousands of dollars to which you may be entitled," adding that, "teaching, in addition to being a stressful profession, is a physically demanding profession, as well."¹¹¹ Just call us, the ad says.
- * One company's investigation unit described 10 similar "comp mill" clinics in the Los Angeles area alone, operating under 100 different names, that specialized in stress claims.¹¹²
- * Particularly rampant in Los Angeles, doctors and lawyers run ads on billboards and in newspapers, often in Spanish, urging workers and former workers to claim the benefits they deserve.

***Options for
Reform***

Various options have been suggested to more clearly define job-related stress and avoid the cost of litigation in a claim area that is so difficult to prove. The proposals have included:

- * Limiting stress claims by requiring employees to show by clear and convincing evidence that the injury was caused by a sudden and extraordinary employment event, regardless of duration of employment.
- * Prohibiting stress claims for "good faith" personnel actions, such as termination for cause.
- * Requiring that actual events of employment be a more significant contributing factor of the psychiatric-stress injury and that the cause of the injury be a sudden employment event.

Conclusion

The Workers' Compensation system was designed to give immediate, direct aid to injured workers and to cap the employers' costs at a fair and appropriate limit. Instead, what has developed is a contentious, litigious system that has left employees dissatisfied and employers overburdened, while providing too liberal opportunities for deceit. The high cost of this system comes not so much from providing services to the injured but from other factors, such as fraud, a multiplicity of evaluations, and a lack of clear-cut direction on stress claims.

Recommendation #6: The Fraud Assessment Commission should report to the Governor and the Legislature on the effectiveness of the 1992 anti-fraud laws by July 1, 1993.

While investigations and prosecutions typically are lengthy processes, the problem of fraud in the Workers' Compensation is so overwhelming that the State needs an early assessment of how effective its new anti-fraud program is. The Commission should prepare a statistical analysis of the results from the first 15 months of the program and make recommendations for further improvements. These may range from providing the program with increased resources to increasing penalties against those who engage in fraud and rescinding licenses for professionals found guilty of conspiring to commit fraud.

Recommendation #7: The Governor and the Legislature should enact legislation that would require employers to pay for only one medical/legal evaluation, which would be performed by a professional chosen by the injured worker.

The problem of "dueling doctors," with multiple medical/legal evaluations purchased by each side (all eventually paid for by the employer), provides no direct benefit to the injured employee and serves only to drive up the cost of the Workers' Compensation system. Yet there is a legitimate interest on the part of the State in protecting the injured worker from being railroaded by a biased medical assessment. Allowing the injured worker to choose the evaluating physician provides that protection. At the same time, nothing in the law would preclude the injured worker from obtaining other evaluations at his or her own expense.

Recommendation #8: The Governor and the Legislature should enact legislation to restrict stress claims to on-the-job sudden or extraordinary events.

The subjectivity involved with determining the existence of stress-induced injury and its source places an intolerable burden on the Workers' Compensation system, increasing the rate of litigation, undermining the credibility of the system and increasing opportunities for fraud. In a day and age in which almost half of the workers in the nation believe their jobs are stressful, it can well be argued that no Workers' Compensation system can afford to address cumulative stress. Instead, the State should limit benefits to those who have been injured by stress stemming from an on-the-job event of a definable nature.

Recommendation #9: The Governor and the Legislature should enact legislation to prohibit stress claims for "good faith" personnel actions.

Employers who terminate workers for good cause or who lay off workers because of economic developments should not be penalized by being required to pay for stress claims arising from those actions.

Conclusion

Conclusion

Of the three major issues that require reform by California government -- education, health care and Workers' Compensation -- only Workers' Compensation can be reformed without the infusion of billions of dollars and has the potential of immediately affecting the State's economy. At a time when California's economy is scraping the bottom, businesses are being devastated by Workers' Compensation insurance premiums that have grown unchecked from \$3.8 billion in 1981 to more than \$10 billion by 1990. Even after the Workers' Compensation reforms were enacted in 1989, many employers saw their premiums double in one or two years. As a result, many companies are cutting rather than creating jobs, while others are closing or moving to more favorable business climates in other states.

As the cost to employers for Workers' Compensation coverage has soared, injured workers receive far less of the insurance premium dollar in benefits than in the past -- down from 47 percent in 1975 to less than 35 percent in 1990.

While employers and employees complain about high costs and low benefits, profiteers in the Workers' Compensation system are more than content with the status quo. Reform of the system has been stymied by insurance companies who are guaranteed a profit, attorneys and physicians who benefit from escalating legal and medical costs and rehabilitation specialists who

profit from excessive treatment and unnecessary education programs.

The Little Hoover Commission has examined the Workers' Compensation process and the factors that drive the costs in a system that California can no longer afford. Throughout the study, the Commission found evidence of the lack of controls and incentives to contain costs. The Commission has, therefore, concluded that:

- * Reform of the Workers' Compensation system is urgently needed.
- * Reforms must address controlling the costs that are choking business and producing inadequate benefits for injured workers.

To correct the deficiencies in the current system, the Commission is encouraging the State to convene a special session of the Legislature to focus on repairing the Workers' Compensation program. The Commission is recommending that the following steps be considered:

- * The State should establish managed care as the mode for delivering worker's compensation medical services to replace the present inefficient system fraught with abuse and over-treatment. Limiting profit-driven medical treatment throughout the system by establishing practice guidelines and effective fee schedules can be accomplished without limiting appropriate treatment for injured workers.
- * Vocational rehabilitation, the fastest growing segment of Workers' Compensation, needs to be focused on programs that quickly and efficiently return employees to work. Schooling plans, for example, should be evaluated based on their ability to place workers in long-term employment. Employers should have new incentives to provide alternate or modified work for their employees, such as limiting their responsibility for vocational rehabilitation costs if they provide such work.
- * The State is encouraged to control the broad areas of the Workers' Compensation system that offer little benefit to injured

workers. Rampant fraud, a multiplicity of medical/legal reports and the subjectivity of determining the cause and effect of stress have arguably resulted in more compensation paid to physicians and attorneys than benefits received by deserving workers. The Commission encourages the State to limit employers to paying for one medical/legal evaluation, performed by a professional chosen by the injured worker. To control stress claims, benefits should be limited to those who have been injured by an on-the-job event of a definable nature. Finally, to assess the adequacy of recent anti-fraud efforts, the Fraud Assessment Commission should report to the Governor and the Legislature by July 1993.

If reform cannot be accomplished in these areas, the Commission fears that the Workers' Compensation system will continue to burden California's economy, drive businesses from the State and fail to meet the needs of injured workers.

Appendices

APPENDIX A

Witnesses Appearing at
Little Hoover Commission
Workers' Compensation Public Hearing

August 26, 1992, Sacramento

Robert Lee
Injured Worker

Dennis Scharf
Injured Worker

J. Andrew McKenna, President
California Applicants Attorneys Association

Kirk West, President
California Chamber of Commerce

Paul Fanelli, Industrial Relations Manager
Patterson Frozen Foods

Michael Barrett, Director of Risk Management
Raley's Superstores

Ray Allen, Assistant Director, Department of Personnel
City of Los Angeles

Stanley Zax, Chairman and President
Zenith Insurance

John Garamendi, Insurance Commissioner
State of California

Pat Pavone, Chief, Benefits and Training Division
Department of Personnel Administration

Endnotes

Endnotes

1. *Beth A. Van Voorhis, "The Treatment of Mental Stress by Workers' Compensation: A Comparison of the Approaches by Different States," November 1991, p. 1.*
2. *"A Review of Current Problems in California's Worker's Compensation System," Little Hoover Commission, March 1988, p. 3.*
3. *Ibid.*
4. *Senate Committee on Industrial Relations Taskforce on Workers' Compensation Benefits, Background Paper, June 1992, p. 1.*
5. *Ibid., p. 2.*
6. *Labor Code, Section 139.5.*
7. *Ibid., Section 4702.*
8. *Provided by Dave Bellusci, Chief Actuary, Workers' Compensation Insurance Rating Bureau (WCIRB), July 31, 1992.*
9. *"No Rest for Restaurateurs," The Business Journal, November 9, 1992.*
10. *"Commission Report," Workers' Compensation Rate Study Commission, p.II-5.0-10.*
11. *"Garamendi says 'no' to 12.6% hike," Sacramento Bee, December 1, 1992.*
12. *"Commission Report," Workers' Compensation Rate Study Commission, March 1992, p. I-1.0-8.*
13. *Ibid., p. I-1.0-6*
14. *Ibid., p. I-ii.*
15. *"Injuries just start of pain, paper work, exams, frustration follow," Sacramento Bee, February 9, 1992.*

16. *Op. cit.*, p.II-5.0-10.
17. *Paul Fanelli, Patterson Frozen Foods, testimony to the Little Hoover Commission, August 26, 1992.*
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