

AN OVERVIEW OF ALASKA'S WORKERS' COMPENSATION SYSTEM

INTRODUCTION

This paper is intended to foster a discussion of the current status of the Alaska workers' compensation system, and the benefits and costs relating to that system.

BACKGROUND

The industrial revolution that took place in the United States during the 19th century was accompanied by a significant increase in workplace accidents. At that time, the only way injured workers could obtain compensation was to sue their employers for negligence. However, proving negligence was a time-consuming and costly effort, for both the injured worker and the employer. In response, by the 20th century, states began adopting legislation establishing a social contract between employees and employers that would compensate injured workers' while protecting employers from lawsuits.

Wisconsin passed the nation's first workers' compensation act in 1911, and by 1920 all but eight states had enacted similar laws. By 1949 all states had a workers' compensation system that provided compensation to workers hurt on the job, regardless of who was at fault. These no-fault social contracts made the employer liable for work-related injuries and disease regardless of fault.

However, compensation benefits varied greatly from state to state, and rules were far from uniform. In response, as part of the Occupational Safety and Health Act of 1970, Congress established the National Commission on State Workmen's Compensation Laws to "undertake a comprehensive study and evaluation of State workmen's compensation laws in order to determine if such laws provide an adequate, prompt, and equitable system of compensation" for injured workers and employers.

In July 1972, the Commission released its findings and recommendations to the President and Congress. The Commission made recommendations on which employees and employers should be covered; under what working conditions employees should be covered; which injuries and diseases should be compensated; and what type of benefits should be provided. The Commission made 84 recommendations, and described 19 of the recommendations as "essential". The full Commission report can be found online at www.workerscompresources.com.

In the four decades since the Commission's report, state legislatures have struggled to strike a balance between providing adequate and fair compensation to injured workers at an affordable cost to employers. These ongoing changes in public policy have impacted many areas of workers' compensation systems, including the adequacy of benefits, the efficiency of benefit delivery, timely dispute resolution, expeditious return to work of the injured worker, the affordability of workers' compensation insurance, and the prevention of workplace injuries and diseases.

Workers, employers, insurance carriers, medical providers, state officials, and other parties to workers' compensation want to know the correct balance to strike on these important issues. This briefing is an attempt to address that question, by identifying best practices used by various

jurisdictions. In doing so, studies, surveys, and other resource material from several organizations have been used, including the National Council on Compensation Insurance (NCCI), the International Association of Industrial Accident Boards and Commissions (IAIABC), the Workers' Compensation Research Institute (WCRI), and the National Academy of Social Insurance (NASI).

HOW THE SYSTEM WORKS

Excluding federal programs like the Federal Employer Liability Act and the Longshore and Harbor Workers' Act, which are administered by the U.S. Department of Labor, approximately nine out of 10 people in the nation's workforce are protected by state administered workers compensation insurance. Employers can purchase workers compensation coverage from private insurance companies or state-run agencies, known as state funds. Four states are monopolistic states, meaning workers' compensation coverage can only be purchased through a state administered fund, North Dakota, Ohio, Washington State, and Wyoming. The only state in which workers compensation coverage is optional is Texas, where about one-third of the state's employers are so-called nonsubscribers. In the event of a serious accident, those that opt out of the Texas system can be sued by employees for failure to provide a safe workplace. In Alaska, workers' compensation insurance is obtained from private insurance companies (voluntary market), or through a state administered pool (assigned risk market). Alaska does not have a state fund.

Some businesses finance their own workplace injury benefits through large deductible insurance policies or by becoming a self-insured employer. Businesses in these programs must prove that they have the financial ability to cover their workers' compensation losses. They usually protect their assets by purchasing insurance coverage for catastrophic losses or losses in excess of a specific threshold. Alaska does allow an employer to self-insure their workers' compensation liabilities. Currently there are 29 employers authorized to self-insure, covering approximately 20% of all Alaskan employees.

Workers' compensation covers an injured worker's medical care and provides disability benefits to compensate them for economic loss from the initial date of injury to the date they are able to return to work. In cases where the injury prevents the injured worker from returning to their pre-injury employment, the injured worker may receive reemployment retraining. In severe cases, the injured worker may be permanently disabled and receive lifetime benefits. In cases involving a fatality, the worker's dependents are provided disability benefits to compensate them for the loss of income.

The cost of workers' compensation insurance to employers is determined by insurance actuaries, who predict future losses based on the employer's prior loss history. Rates are determined by classification groups, such as office/clerical, construction, manufacturing, etc. Most states use contracted rating bureaus to perform this actuarial analysis. The National Council on Compensation Insurance (NCCI) is the largest rating bureau, used by over 900 insurance companies and 40 states, including Alaska. The rating bureaus make premium rate recommendations to state regulators, who make the final decision on whether or not to adopt the proposed rates. Premium rates can also be impacted by investment markets. When insurance companies are getting high returns in the investment markets, they can use those earnings to offset premium increases.

COST DRIVERS & BEST PRACTICE RESPONSES

Workers compensation costs are one of the many factors that influence businesses to expand or relocate in a state, generating jobs. When premiums rise, employers call for reforms. Statistical data indicates rising loss costs are attributable to changing market conditions, an uptick in claim frequency, rising indemnity benefit costs, escalating medical costs, legal costs, and reemployment benefit costs.

Changing Market Conditions

Insurance, particularly commercial insurance, is a cyclical industry marked by hard and soft markets. In 2000 as the economy expanded, premiums started rising, ushering in a hard market, when demand outstripped supply. Between January 2000 and December 2006, premium rates rose in Alaska by 61.8%. In 2007, with a generally softening market and a weakening economy, premiums began dropping again. Between January 2007 and December 2010, premium rates in Alaska fell 41.9%. Beginning in 2011, as the economy began to improve and markets began to harden, rates started to rise again.

In recent years, the workers compensation line has had the highest combined ratio of all of the major commercial lines. NCCI's preliminary analysis indicates that the workers compensation combined ratio for private carriers was 115 for 2011. A combined ratio of 100 or more means that workers' compensation insurers are not bringing in enough premium dollars to cover claim costs.

Best practices adopted by states to address changing market conditions include modifying experience modification formulas, implementing incentives to move employers out of residual markets, strengthening reserve requirements, and approving rate increases. Several states are considering adopting the Texas model, allowing employers to opt-out of mandatory coverage.

Claim Frequency & Indemnity Benefits

After almost 20 years of decline, in 2011 there was a slight increase in the frequency of workers' compensation claims and the average duration of indemnity benefits. NCCI attributed the increase to the recession, rising comorbidities (such as an aging workforce, obesity, and diabetes), and increased prescription of opioid pain medication.

Best practices to address rising frequency and indemnity benefit costs include focusing on stay-at-work and return-to-work programs, implementing medical reforms which return injured workers to work sooner, and increasing efforts on implementing and improving workplace safety programs.

Medical Costs

Two decades ago, indemnity costs made up the greater part of total losses. In 1986 indemnity costs represented 55 percent of the total. By 1996 indemnity and medical had changed places, with indemnity at 48 percent of losses and medical at 52 percent. By 2011, as medical care costs continued to rise, medical costs accounted for 59% of claim costs.

Growth in workers compensation medical costs has been much steeper than in the healthcare industry as a whole. The annual average rate of increase in workers compensation medical care costs

was 3.9 percent from 1991 to 1995. Since then, the rate of increase has more than doubled, and in most years, was more than twice the rate of increase in the medical Consumer Price Index (CPI).

Best practices to address rising medical costs include implementation of medical fee schedules based on Medicare's resource based relative value scale, implementing treatment guidelines to address over-utilization, modifying regulations permitting physician repackaging of prescription drugs, and implementing guidelines regulating the prescription of opiate drugs.

Legal Costs

Workers compensation programs were originally intended to be "no-fault" systems and therefore litigation free. However, over time, attorney involvement has increased, up to as much as 20 percent in systems where the number of disputes is high, and in roughly a third of claims where the worker was injured seriously. Attorney involvement boosts claim costs by 12 to 15 percent.

Best practices addressing rising legal costs include use of mediation in the dispute resolution process, establishing ombudsman positions to assist pro-se litigants, capping attorney fees, and undertaking steps to simplify workers' compensation systems to make them easier to understand and more "user friendly".

Reemployment Costs

The aim of the workers' compensation system is to help workers recover from work-related accidents and illnesses and to return to the workplace. A fast return to work is desirable for the employer, because it lowers claim costs, and for the employee, because studies show that long absences from work have a negative impact on the worker's future employment opportunities and socioeconomic well-being.

Best practices to address rising reemployment benefit costs include implementing stay-at-work and return-to-work programs, requiring treating physicians to take occupational medicine courses as part of their continuing education, and working with employers to develop modified workplace programs.

Other Cost Drivers

State processes have traditionally relied on manual, paper based systems, which are labor intensive for employers and insurers. In recent years, states have been shifting to electronic filing and reporting systems. Best practices have been to adopt electronic data interchange (EDI) systems, utilizing standards promoted by the International Association of Industrial Accident Boards and Commissions for proof of insurance filing, claims reporting, payment reporting, and medical bill payment.

Fraudulent activities drive up overall claim costs as well. Best practices have been to establish investigative units to aggressively prosecute fraudulent activity, seek restitution, and develop public awareness and reporting programs.

Finally, states are also evaluating historical programs traditionally administered by state agencies to determine whether such programs should be discontinued. Best practices have identified Second Injury Funds, and Executive Officer Waiver programs as likely candidates for discontinuance.

ALASKAN WORKERS' COMPENSATION STATISTICAL FACTS

Since 2006, Alaska has had one of the highest workers' compensation insurance premium rates in the nation. The recently released 2012 Oregon Workers' Compensation Premium Rate Ranking Summary rated Alaska's workers' compensation premiums as the highest in the nation, 160% higher than the median average of all other states.

Claim Frequency and Indemnity Benefits

- Claim frequency continues to decline in Alaska, down 32.6% from 28,665 reports of accident in 2001, to 19,321 reports of accident in 2010. Despite that decline, indemnity benefit payments have only declined 13.9% during that same period, from \$62.5 million in 2001 to \$53.8 million in 2010.
- The 2012 National Council on Compensation Insurance (NCCI) State Advisory Forum report shows Alaska's claim frequency rate of 4,821 per 100,000 workers is significantly higher than the national average of 3,633 per 100,000 workers. The percentage of temporary total disability claims in Alaska is 20.8%, compared to a countrywide rate of 15.1%.

Medical Costs

- The 2012 NCCI report indicates Alaska's loss cost rate is \$2.11 per \$100 payroll, compared to a countrywide loss cost rate of \$1.50.
- The NCCI report shows medical costs comprised 76% of total workers' compensation claim costs, up from 52% of total workers' compensation claim costs in 1988, and substantially higher than the national average of 59% of claim costs. Alaska's average medical claim cost is \$48,200 per case, compared to \$28,000 countrywide.
- The 2011 NCCI State Advisory Forum report disclosed prescription drug costs comprise as much as 19% of total medical costs. Over-prescription of expensive opioid narcotics and drug repackaging by physicians are the primary cost drivers of pharmaceutical costs.
- The November 2011 study of workers' compensation medical rates prepared by Milliman, Inc. for the Alaska Health Care Commission (AHCC) shows that workers' compensation physician rates in Alaska are 190% of regional physician rates, and inpatient/outpatient facility rates are 137% of regional facility rates.
- The Workers' Compensation Research Institute (WCRI) 2012 Survey of Workers' Compensation Medical Fee Schedules found that Alaska's allowable workers' compensation medical fees are the highest in the nation, exceeding 168% of allowable Medicare fees for Alaska. Broken down further, fees for radiology were 408% of Medicare and surgery was 440% of Medicare.
- The Workers' Compensation Division 2010 annual report indicates medical costs have increased 55.1% over the past 10 years, from \$95.6 million in 2001 to \$148.3 million in 2010.

Legal Costs

- The number of disputed claims has declined 18.1% in the past 10 years, from 3,876 cases controverted in 2001 to 3,174 cases controverted in 2010. During this period, the number of scheduled hearings has declined 8.3%, from 533 to 489, and the number of decisions and orders has declined 21.7%, from 263 to 206. Yet despite this decline in disputes, the Division's annual report illustrates legal costs have risen 68.6% over the past ten years, from \$9.4 million in 2001 to \$15.8 million in 2010.

Reemployment Benefit Costs

- The number of reemployment benefit evaluations has increased 6.5% over the past 10 years, from 728 in 2001 to 775 in 2010. Reemployment costs during this period have remained virtually unchanged at \$13.0 million per year. However the Division's 2010 report reflects reemployment plan completion rates remain extremely low, with only 8.4% of workers found eligible for retraining benefits successfully completing a retraining plan.

DISCUSSION

Workers' compensation premium costs in Alaska are the highest in the nation. Alaska's premium rates have steadily risen in state rankings, from 28th in the nation in 2000, to 1st in the nation in 2012. Premium cost increases are driven by the high cost of medical treatment, high frequency of compensable workers' compensation injuries, rising legal costs, and an ineffective reemployment benefits program.

Medical Costs

Statistical data clearly shows the cost for workers' compensation medical treatment in Alaska is substantially higher than regional and countrywide costs. To effectively lower workers' compensation medical costs it is recommended that Alaska consider best practices implemented by other jurisdictions. These best practices include

- Replacing medical fee schedules based on usual and customary billed charges by medical fee schedules based on state specific modifiers using the resource based relative value scale developed by Medicare.
- Implementing utilization and treatment guidelines derived from evidence based medicine.
- Allowing employers to enter into preferred provider networks, providing that employees would still be permitted to seek out-of-network care, but would be required to pay the difference out-of-pocket.
- Requiring treating physicians receive continuing professional education in occupational medicine.
- Implementing restrictions on prescription repackaging by physicians.
- Implementing restrictions and controls on the prescription of opioid narcotics.

Claim Frequency and Indemnity Costs

The number of workplace injuries occurring each year continues to decline. However, Alaska's frequency rate (number of injuries per 100,000 employees) continues to exceed regional and countrywide rates. To effectively lower Alaska's workers' compensation frequency and indemnity

costs, it is recommended that Alaska consider best practices implemented by other jurisdictions, including

- A reduction in weekly indemnity benefits if the injured worker was found to be in violation of company safety policies and requirements.
- Increasing the waiting period to receive indemnity benefits from 3 days to 5 days.
- Lowering the maximum weekly indemnity benefit rate.
- Implementing duration limits on temporary total disability benefits.
- Implementing utilization and treatment guidelines derived from evidence based medicine.
- Providing exemptions from coverage for family members in family owned businesses.
- Providing exemptions from coverage for small employers (those with 3 or fewer employees).

Legal Costs

As the number of reported injuries decline, so too does the number of disputed claims. However, despite the reduced number of disputes, legal costs have risen dramatically, almost 70% in the past 10 years. Industry bears the entire burden of paying legal costs, both plaintiff and defense attorney fees if the injured worker prevails at hearing. While attorney fees must be approved by the Alaska Workers' Compensation Board, it is rare for an attorney to have their attorney fees declined or reduced. Consequently, there are several workers' compensation attorneys currently charging and receiving in excess of \$400/hour. To effectively lower legal costs many jurisdictions have implemented legislative changes that have

- Mandated mediation talks before disputed claims can be adjudicated.
- Streamlined legal proceedings to expedite resolution of disputed claims.
- Discontinued allowing non-attorneys to represent parties.
- Established advocate positions to assist pro-se litigants (30% of disputes involve proceedings where one or both parties are not represented).
- Placed caps on attorney fees based on statutory formula or benefits awarded.

Reemployment Benefits

There were substantial legislative changes to the reemployment benefits program made in 2005. The goal was to improve the efficiency and effectiveness of the reemployment benefits program, and increase successful plan outcomes. Evaluation referrals became mandatory after the 90th day an injured worker was off work. Unfortunately, these changes have not improved outcomes, and in fact have led to additional delays in evaluations and plan development. To effectively lower reemployment costs many jurisdictions have implemented legislative changes that have

- Focused on reforming medical care, with emphasis on the role of occupational medicine in determining an injured workers' ability to stay-at-work and return-to-work.
- Created economic incentives to employers to offer modified jobs through special state funds.
- Focused on promotion of workplace accommodations by employers.

Other

Many jurisdictions have implemented additional reforms to help lower workers' compensation costs, including

- Strengthening laws defining fraudulent and misleading acts to better enable an agency's ability to prosecute fraud and recover overpayments.
- Amending laws and regulations to facilitate transition from paper based environments to electronic systems for benefit payments, medical payments, claims reporting, proof of insurance reporting, and data reporting .
- Sun setting Second Injury Funds (SIF). With the implementation of the American with Disabilities Act in 1990, these state funds no longer serve the purpose for which they were originally created.

CONCLUSION

2011 was the 100th anniversary of the first workers' compensation act in the United States. As the 1972 National Commission on State Workmen's Compensation Laws noted, "We began with a common and profound conviction that American workers should receive adequate and fair protection if they suffer a work-related injury, disease, or death." There is no debate that this remains the guiding principle in workers' compensation law today.

In 2005, the Alaska Legislature memorialized this guiding principle when it added section .001 to the Alaska Workers' Compensation Act, which reads

It is the intent of the legislature that this chapter be interpreted so as to ensure the quick, efficient, fair, and predictable delivery of indemnity and medical benefits to injured workers at a reasonable cost to the employers who are subject to the provisions of this chapter.

A notable inclusion to the legislative intent is that workers' compensation benefits must be "reasonable" for employers who bear the burden of paying these costs. A system that delivers benefits at an unreasonable cost to employers is one that holds back employment and economic growth, promotes relocation of employment to jurisdictions with a more favorable climate, and fosters discussions of a return to a 20th century tort solution, as is currently being considered by the State of Oklahoma which is considering allowing employers to "opt out" of workers' compensation.

This paper is not intended to make specific recommendations, but is rather intended to identify best practices and promote discussion between workers, employers, insurance carriers, medical providers, state officials, and other parties striving to strike the correct balance between workers' compensation benefits and the cost of those benefits.