The Future of Workers Compensation: Is Opt-Out the Answer?

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According to several experts, opt-out programs are not viable for every employer, nor are they necessarily right for every state. As workers comp stakeholders increasingly look at opting out, there are a variety of issues to consider.

The Texas Experience
In its most recent biennial report, the Texas Department of Insurance reported that 113,000 companies—about a third of the state’s private sector employers—have opted out of the system. Companies that don’t subscribe generally fall into one of two categories. One is the pre-1910 reform system, “in which exclusive remedy is removed and the employer has [no] program, or a very casual program for injury management,” said Peter Rousmaniere, a long-time workers compensation consultant and columnist. “The modern program is the one that has been developed and refined, especially in the last 15 years.”

Rousmaniere was the primary researcher on the 2012 report, Workers’ Compensation Opt-Out: Can Privatization Work?, sponsored by Sedgwick Claims Management Services. He says that the modern opt-out program has increasingly appealed to larger companies, such as Walmart.

“It includes an ERISA structure for dispute resolution, plus a mandatory arbitration provision to manage liability suits,” Rousmaniere said. “In effect, what the employer is doing is creating a 24-hour program.”

The Employee Retirement Income Security Act (ERISA) was established by the federal government. It affects the administration of benefits, but not the benefit levels.

ERISA gives employers wide latitude to create a benefit plan, the experts say. But once the plan is written, employers must stick to it.

Advantages to Employers
Opting out “is a very good option for some employers,” said Greg Krohm, a research consultant and former executive director of the International Association of Industrial Boards and Commissions, and the coauthor, with Matthew Bryant, of the recent paper “Employer Opt-Out: Assessing the Impact on Workers’ Compensation Systems.”

Frustrations with workers compensation have led some stakeholders to take a serious look at leaving the system. While Texas is currently the only state that allows employers to choose whether to participate in the workers comp system, Oklahoma lawmakers have been considering an opt-out program. Observers in other states, notably Tennessee, have also kept a close eye on the issue.
“It cuts their risk and cost of compensation considerably. But this assumes a Texas-like system that gives employers maximum flexibility in designing benefits, administration of benefits, and adjudication of disputes.”

For employers that have that flexibility, the benefits can be impressive. “We saved roughly 50% a year in Texas,” said Becky Robinson, assistant vice president of Hobby Lobby, which adopted an opt-out plan in 2004. “We have more fees associated but are saving about $1 million a year.”

Dollar General went the opt-out route in 2009 in response to difficulties closing claims in Texas. During the first year of its opt-out program, Dollar General closed $700,000 in claims. But saving money is just one of the advantages to employers.

“They love it more for the simplification than for the demonstration that it reduces losses,” said Rousmaniere. “By closely listening to what employers were saying, what they like is that workers comp becomes much more like all the other benefit programs that the employer has.”

**Risks to Employers**

Employers that opt out of the state-based workers compensation system give up the exclusive remedy protection. “A danger to employers is getting sued and losing big—even punitive damages,” Krohm said. However, he also said that the risk of being sued—at least in Texas—is less than what one might expect.

“The Texas courts have tended to take a narrow view of the employer’s duties to provide a safe workplace,” he stated. “The Texas courts expect an employee—especially one who is seasoned in his job—to avoid risks that might cause injuries; for example, using a cutting knife carelessly or walking on a wet floor.”

Rousmaniere believes that mandatory arbitration, when included in an opt-out program, provides a viable alternative to exclusive remedy protection and can remove the threat of a runaway jury. “You have liability that is well understood by attorneys,” he said, “and it is insurable.”

**Medicare Set-Asides**

Employers that have opt-out programs and Medicare beneficiaries may face an additional risk. The Centers for Medicare and Medicaid Services (CMS) has, thus far, not developed a formal response on whether it will consider such cases as workers compensation or liability.

“The agency has indicated that the litigants’ responsibilities to Medicare are the same, but they are not giving the litigants the security you would get in workers comp because they won’t review the claim,” said James Pocius, a shareholder with Marshall, Dennehey, Warner, Coleman & Goggin and the author of many of the CMS guidances on Medicare for the workers comp system. “In workers comp, we have the guidances that allow us to send a case to Medicare for mandatory approval and extinguish their interests. If they don’t treat it as a workers comp case, you have a problem because you can’t close out Medicare’s interest, necessarily.”

**Impact on Workers**

Among the biggest controversies in the opt-out discussion is the effect on employees. Hobby Lobby’s Robinson says that the company went to great lengths to ensure that employees understood how the program is a benefit to them. The response from workers has been overwhelmingly positive.

“We prepared a study through our third-party administrator in Texas and sent out a questionnaire to those who filed claims,” she said. “The results illustrated that 90% were ‘satisfied’ or ‘very satisfied’ with the claims process.”

Dollar General also made sure its employees understood that the change was for their benefit as much as it was for the company’s. “We had computers in our stores, so we did videos,” said Rick Sumner, director of insurance and safety for Dollar General. “The CEO talked about the benefit plan, how it had changed, and what they needed to be aware of. We made a comparison. While there was ordinarily a seven-day waiting period in Texas [after an injury], they would collect from day one under the new plan. So we showed them the benefits versus what the workers comp system provided.”
But workers’ rights advocates believe that the system is inherently unfair to workers. “The reasons why employers are able to save money is because opting out gives them complete control,” said Rick Levy, legal director for the Texas AFL-CIO. “Once you cede complete control to the employer, the worker has no foothold to guarantee fair treatment. That’s why, even if you have an employer saying, ‘Look how great a job we do,’ that worker’s well-being is totally dependent on the goodwill of the employer. That’s not a situation that is either fair or advisable to put workers in.”

Krohm says that employees face a variety of risks. “Even the most pro-worker reforms will still leave some gaps in coverage for catastrophic claims, insecurity over employer bankruptcy—which would terminate the benefit plan—and a loss of procedural rights,” he said. “To the extent that you close off the risks and dangers to workers through robust benefit plans and guarantees of payment, you increase the cost of opting out so that it becomes a wash with staying within the workers comp insurance system.”

As the opt-out discussions intensify, the potential risk to workers may become more prominent. “We should expect that as other states seriously consider it, plaintiff attorneys will begin to launch a more thoughtful critique,” Rousmaniere said.

The Ideal Opt-Out System
Both Rousmaniere and Hobby Lobby’s Robinson agree that an effective opt-out plan is best done by an organization with a sophisticated background in human resources and risk management, something more likely seen in mid- to large-sized companies.

Says Rousmaniere, “A state entertaining an opt-out system is going to have to look long and hard at whether an opt-out system is appropriate for a small employer and an employer that does not have an ERISA plan, and that is able to sustain a negligence suit, which it can by having insurance.”

Robinson believes that appropriately designed opt-out programs can improve the system—not only for employers and employees in the affected companies, but for other employers as well. “I think that creating an alternative creates competition,” she said. “Workers comp reform becomes a higher priority, as we have seen in Texas.”

Dollar General’s Sumner says opt-out plans are not appropriate for every company. “There should be a qualifying process to opt out … a little structure to it. Not just bad companies that do what they want.”

Krohm says that “merely conditioning opt-out on some ERISA plan does not make it equivalent to state-based workers comp programs unless the ERISA medical and disability benefits are very robust—more than what even the better Texas non-subscribers offer. The benefits have to be somehow guaranteed against risk of default. Insolvency or financially related benefit cutbacks are a risk to injured workers that is not present in workers comp. And the events that qualify for disability are broadly interpreted to cover most injuries now compensable by workers comp law.”

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