California Workers’ Compensation
System Trends and Performance

Presented by:

WORKERS' COMPENSATION ACTION NETWORK

2012
Introduction

The Workers' Compensation Action Network is pleased to provide this overview of key trends in California’s workers’ compensation system. In analyzing the latest research on California’s system, the emerging trends should be of concern to policymakers and system stakeholders. Improvements in affordability, efficiency and injured worker outcomes stemming from major legislative reforms between 2002 and 2004 have given way to increasing costs and frictional issues. Because workers’ compensation represents a direct added cost on employment at a time of ongoing double-digit unemployment, California’s ability to address these trends will play either a favorable or unfavorable role in the state’s economic recovery, future competitiveness for jobs and ability to afford public services.

About Workers’ Compensation

Workers’ compensation was established as America’s first social insurance program a century ago. The first state to enact a complete workers’ compensation system did so in 1911, followed by numerous other states including California, which established its system in 1913.

Often referred to as the “grand bargain” between employers and labor, the purpose of workers’ compensation is to provide prompt medical care to workers injured on the job, as well as deliver cash benefits to compensate injured workers for a portion of lost wages on a temporary or permanent basis. Workers’ compensation is designed to function as a “no fault” system. There is no burden of proof for an injured worker to show employer negligence caused a workplace injury. It acts as the exclusive remedy for workers and employers to resolve workplace accidents without resorting to the court system.

Workers’ compensation is typically delivered through one of two mechanisms:

- Insurance — Employers may purchase workers’ compensation insurance from a private insurance company or the State Compensation Insurance Fund.
- Self-insurance — Employers, including very large employers and many public agencies, may choose to pay directly for their workers’ compensation costs. Smaller employers may also pool their resources to form self-insurance groups.

Regardless of the coverage mechanism, employers pay 100 percent of costs associated with the workers’ compensation system, inclusive of direct costs for medical treatment and cash benefits for injured workers, as well as costs associated with managing and litigating claims. In 2010, California employers paid $14.8 billion in costs for 530,000 occupational injuries and illnesses.¹

In California, employers also pay 100 percent of the costs for the state to administer the workers’ compensation program and pay partially or entirely for the state’s anti-fraud programs, workplace safety initiatives and compliance enforcement actions. The amount assessed on employers for these costs was $492 million in 2011.²
California in a National Context

As a mandatory program in which insurance costs are based on the number of employees and amount of wages paid, workers' compensation can increase an employer's payroll costs by more than 25 percent. The affordability and effectiveness of a state's workers' compensation system, therefore, is an important factor in a state's overall cost burden for employers. According to a 2011 survey of 2,500 California small businesses, for example, the cost of workers' compensation ranks among business owners' top five challenges.3

The global recession, high unemployment rates and large state budget deficits have put a spotlight on state competition for attracting and retaining jobs. Indices measuring the “business friendliness” of states frequently rank California as among the worst states in which to do business, as shown in Figure 1. Each of these indices includes either general labor costs or workers' compensation costs in its rankings.

![Figure 1: Rankings of California's Business Climate](image)

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<tr>
<th>Organization or Publication</th>
<th>Rating Measurement</th>
<th>California's Rank</th>
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<tr>
<td>Small Business and Entrepreneurship Council</td>
<td>Small Business Survival Index 2011: Ranking the Policy Environment for Entrepreneurship Across the Nation</td>
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<td>CNBC</td>
<td>America’s Top States for Business 2011: Cost of Doing Business</td>
<td>47</td>
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<td>Chief Executive Magazine</td>
<td>Best &amp; Worst States for Business 2011</td>
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State cost comparisons focused exclusively on workers’ compensation costs tell a similar story. California has historically been a high-cost state for workers' compensation when compared to other states. As Figure 2 shows, California has ranked in the top five most expensive states for workers' compensation for more than a decade, except for 2008, when it was ranked 13.

![Figure 2: California Workers' Compensation Costs vs. Other States and the National Median](image)

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<tr>
<td>Rank by Most Expensive</td>
<td>3</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>13</td>
<td>5</td>
</tr>
<tr>
<td>% of National Median</td>
<td>148%</td>
<td>216%</td>
<td>236%</td>
<td>166%</td>
<td>121%</td>
<td>131%</td>
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The premium rates California employers pay for workers' compensation coverage are higher despite the fact that there is nothing inherently more dangerous about the state's workplaces. According to the U.S. Bureau of Labor Statistics, California's rate of occupational injury and illness per 100 workers is 3.7, very close to the national average of 3.5 per 100 workers.5
According to the National Academy of Social Insurance, California employers pay a disproportionate share of the national costs for workers’ compensation benefits, paying 16 percent of all benefit costs in the nation, despite employing just 12 percent of the national workforce.\(^6\)

The Massachusetts-based Workers’ Compensation Research Institute (WCRI) annually benchmarks workers’ compensation costs and performance in 16 large, geographically diverse states, including California. WCRI’s most recent research provides the following comparative measures for California’s system for claims with more than seven days of lost work time occurring between 2007 and 2010, after adjusting for each state’s injury and industry mix. When compared to the 16-state median, California’s:\(^7\)

- Average total costs per claim were 9 percent more expensive
- Incurred medical benefits per claim were 30 percent greater
- Indemnity (or cash) benefits paid on temporary disability claims were 28 percent greater, although overall cash benefits paid per claim were “typical”
- At 48 percent of claims, California had among the highest rates of workers’ compensation claims that result in permanent disability payments
- At an average of almost 23 weeks, temporary disability benefits were paid longer in California than in most other states and 48 percent longer than the median
- California’s “benefit delivery expense” – comprised of litigation and medical cost containment expenses – was 70 percent higher
- California had attorneys involved in more than 35 percent of all workers’ compensation claims, which is almost 10 percent higher than the 16-state median

Although a series of significant legislative reforms were effective at reducing California’s rank as the “most expensive state” in several categories, workers’ compensation claims in California remain generally more expensive, take longer to resolve and present more frictional costs than other states.

**Key Features of California’s System**

As a medical and cash benefit program for injured workers, the dominant features of each state’s workers’ compensation system are:

- The manner in which medical treatment is delivered
- The adequacy of temporary wage replacement benefits
- How permanent disability benefits are calculated for injured workers
- Strategies for getting injured workers back to work
California lawmakers significantly altered each of these key features within the past decade in an attempt to rein in spiraling costs and improve outcomes for injured workers. A detailed description of these legislative reforms can be found in Appendix A.

**Medical Treatment**
In California, all medical treatment must be in accordance with a Medical Treatment Utilization Schedule (MTUS), which is presumed correct for all medical treatment issues. State law requires that the MTUS be based on medical treatment guidelines that are evidence-based, peer reviewed and nationally recognized. Much of the current MTUS is based on guidelines published by the American College of Occupational and Environmental Medicine, though other guidelines are also used.

Employers and insurers may establish Medical Provider Networks (MPNs) to provide care to injured workers. Within these networks, injured workers have the ability to seek second and third opinions from other physicians within the network or appeal to the Division of Workers’ Compensation (DWC) for Independent Medical Review if they dispute the diagnosis or treatment. Injured workers may also “pre-designate” their personal physician as their physician for workers’ compensation claims. In 2009, 75 percent of medical treatment was delivered through MPNs. 8

According to a 2008 survey of approximately 1,000 injured workers conducted by the DWC, 80 percent were satisfied or very satisfied with their overall care and 79 percent rated their quality of care as good, very good or excellent. 9 According to the DWC, these results are consistent with surveys conducted prior to the adoption of evidence-based medicine and results found in surveys of group health patients.

California also now requires all employers to establish Utilization Review (UR) programs, which is the process by which qualified physicians review treatment requests to ensure they are supported by evidence-based guidelines. UR programs audited by the Division of Workers’ Compensation in 2011 performed at an average rating of 98 percent for their timeliness and accuracy of responses to medical treatment requests. 10

**Temporary Wage Replacement Benefits**
California pays temporary disability (TD) benefits to replace up to two-thirds of an injured worker’s lost wages, tax free, while he or she is out of work. These benefits may be collected up to a maximum of 104 weeks within a five-year period, subject to certain exemptions that extend the availability of these benefits. As a result of statutory benefit increases and indexing TD benefits to increases in the Statewide Average Weekly Wage, the maximum TD rate has increased by 106 percent since 2003 and is currently $1,010.50 per week. Consequently, two-thirds wage replacement level has been increased significantly and is currently reached for 97 percent of all injured workers. 11

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**Permanent Disability Benefits**

In 2004, lawmakers adopted a new method for rating permanent disability (PD). The pre-reform system relied on subjective factors and was generally described as “costly, inequitable, inconsistent and prone to disputes.” Under this system, PD cases in California accounted for 82 percent of all benefit payments, well above the national average of 59 percent. Permanent disability costs were three times the national average, and California’s rate of permanent disability claims per 100,000 workers was 1,221, compared to a national average of 434. 

For the purpose of calculating permanent disability (PD) benefits, California now utilizes guides published by the American Medical Association (AMA) for measuring permanent impairment. Significantly, these guides, which are used in some manner by 36 other states, provide a tool for physicians to objectively measure and rate the level of an injured worker’s impairment. This rating is then multiplied by factors for age, occupation and diminished future earning capacity to arrive at the percentage of permanent disability.

California’s PD system now also requires physicians who evaluate workers to identify any percentage of permanent disability that is not caused by the specific workplace injury. This process, known as “apportionment to causation,” mandates that permanent disability caused by previous workplace injuries or preexisting medical conditions that contribute to the permanent disability are not compensable.

Since 2003, the frequency of PD claims in California has declined by 20 percent. Although California’s PD claim frequency is still higher than average, it is no longer the highest of any state. The vast majority of these cases – 78 percent – result in PD ratings of less than 25 percent.

**Return to Work**

According to the RAND Center for Health and Safety in the Workplace, effective return-to-work outcomes achieve the dual benefit of improving benefit adequacy for injured workers and reducing benefits costs for employers.

California’s system includes several mechanisms for facilitating improved return-to-work rates for injured workers. These measures include the adoption of evidence-based medicine to enhance the quality of medical treatment and speed up recovery, grants to small businesses to finance workplace modifications to accommodate workers’ disabilities, and financial incentives to encourage employers to bring injured workers back to work. This latter mechanism, generally referred to as “bump up, bump down,” allows PD benefits to be decreased if there is an offer for alternative or modified work or increased if there is no such offer.

Since 2002, the “return to work” rate for injured workers has increased by as much as 11 percent. According to RAND, “the biggest gains were experienced by workers with the most severe injuries.” The long-term wage loss of permanently disabled workers between 2004 and 2006 was 20 percent lower than it would have otherwise been as a result of the return to work improvements.
Current Trends Impacting California’s System

Claims Costs Rising Rapidly
After a post-reform reduction, the average cost per workers’ compensation claim increased by 41 percent between 2005 and 2010. As shown in Figure 3 below, the total cost per claim in 2010 was more than $65,000, 14 percent more expensive than California’s previous all-time high reached in 2002, a period generally acknowledged as a “crisis” in the state’s workers’ compensation system.\(^\text{17}\)

Figure 3: California Workers’ Compensation Costs Per Indemnity Claim

The vast majority (two-thirds) of the increase in claims costs are due to higher costs for medical treatment. Cumulatively, workers’ compensation medical costs increased by $1.7 billion between 2006 and 2010.\(^\text{18}\)

According to WCRI, medical cost drivers include an increase in the “fee schedule” amounts that physicians are reimbursed for treatment that took effect in February 2007. According to the California Workers’ Compensation Institute (CWCI), cost increases for specific medical services between 2005 and 2009 include:

- 90 percent increase for physician medical-legal reports
- 64 percent increase in first-year medical payments on indemnity claims
- 128 percent increase in medical cost containment (utilization review, bill review, MPN) per claim
- 52 percent increase in payments to medical care providers per claim
- 95 percent increase for pharmaceuticals and durable medical equipment
The 95 percent increase in the pharmaceuticals category stems, in part, from a dramatic increase in the prescribing of “schedule II opioids” – narcotics such as oxycodone – and “compound drugs” as well as medical foods. Between 2005 and 2009, according to CWCI research, reimbursements for Schedule II drugs increased from 3.8 percent to 23.6 percent of total prescription drug payments in the California workers’ compensation system – an increase of more than 500 percent. Recent research has found that more than half of these drugs are prescribed by less than three percent of medical providers in California. In 2011, the California Legislature passed legislation to cap reimbursement for pharmacy goods, including compound drugs.

In 2009, the DWC launched a 12-point plan for regulations to “monitor and help control medical costs in California’s workers’ compensation system.” Among these measures were regulations to end double payments for hardware used during spinal surgeries – which currently adds $55 million in annual costs for these procedures – and bring payments to ambulatory surgery centers more in line with the rates Medicare pays such facilities.

Cash benefit payments are also driving the increase in costs per claim. TD benefits paid per claim increased by 6 percent between 2008 and 2009, driven by a one-week increase in the average length of TD claims. According to the RAND Institute for Civil Justice, average permanent disability ratings have increased by eight to 10 percent each year between 2007 and 2009. The increase in ratings has been driven primarily by three court decisions – Almaraz, Guzman and Ogilvie – that allow claimants to challenge their AMA-based impairment ratings and dispute the application of the modifier for their Diminished Future Earning Capacity. In total, these cases were estimated to increase employer costs by $800 million.

In response to escalating costs, the average workers’ compensation insurance rates charged to California employers increased 10 percent between 2008 and 2011. Despite the increase in rates, premiums were insufficient to pay for the cost of claims as insurers paid out on average $1.30 in losses and expenses for each $1.00 of premium earned in 2010.

Rising claims costs have directly impacted employers who self-insure for workers’ compensation. Between 2005 and 2010, for example, private companies that self-insure saw their costs increase by $11 million, despite the fact that the number of claims decreased by 26 percent. Between 2006 and 2011, public agencies – such as schools, cities and special districts – that self-insure saw their costs increase by $83 million, a 32 percent overall increase despite the fact that the number of claims remained essentially unchanged. Increased workers’ compensation costs for these employers – which are struggling to maintain services with declining financial resources – have a direct impact on funding available for education, public safety, maintenance and other services provided to the public.

Claims cost increases have also hit the State of California as it struggles to close significant budget gaps. Between fiscal years 2008-09 and 2010-11, workers’ compensation costs increased by $92 million to $552 million even though state payroll stayed the same.
**Adjudication of Claims Slowing, Litigation Increasing**

After gains made in lowering the litigation rate and increasing the speed at which workers’ compensation claims are resolved, California’s system has become less efficient in recent years by both measures. The percentage of PD claims that were settled at the 18-month interval decreased by 13 percent between 2005 and 2009, indicating that PD claims are taking longer to resolve.\(^{27}\)

Additionally, the number of litigated claims – those filed for adjudication by the Workers’ Compensation Appeals Board (WCAB) – increased by 22 percent between 2008 and 2010. This increase marks the first time the number of cases filed with the WCAB has increased since 2003.\(^{28}\)

The speed at which hearings are held on litigated claims has also worsened, with the number of days from a trial request to the actual trial growing by 50 percent. On average, none of the three types of hearings conducted by the WCAB were completed within statutory deadlines. Reasons cited for the increase in litigation include additional litigation on PD cases arising out of the Almaraz, Guzman and Ogilvie decisions and time spent at the WCAB adjudicating lien claims.

Liens arise mostly due to disputes between medical providers and employers or their insurance company over whether and how much they should get paid for medical treatment. These disputes include instances when physicians who are outside of an employer’s MPN provide unauthorized treatment or when service providers seek reimbursement greater than the amounts in the state’s fee schedules. According to a study performed by the Commission on Health and Safety and Workers’ Compensation, there was a 46 percent increase in the number of liens filed from 2009 to 2010. According to the report, these liens are costing California employers an estimated $200 million per year and creating significant backlogs in the adjudication of workers’ compensation claims. In the Los Angeles WCAB office, for example, liens account for 35 percent of the court’s workload. The office currently is adding 2,000 liens per month to its current backlog of 800,000 pending liens.\(^{29}\)

**Opportunities and Challenges for Policymakers**

An affordable, efficient workers’ compensation system is vital to a healthy jobs environment and the ability of public agencies to provide critical services. The track record shows that the reform of California’s system between 2002 and 2004 successfully reduced costs for employers and taxpayers, improved outcomes for injured workers and brought California’s system more in line with systems in other states. During a period of significant economic challenges, these outcomes helped to reduce the overall cost of doing business in California and make the state’s economy more competitive.

The current state of California’s workers’ compensation system, however, demonstrates that the reforms have been substantially eroded in recent years: costs are spiraling upward, conflict is increasing and loopholes are being exploited to the detriment of employers and injured workers. The system requires renewed attention from policymakers so that jobs and vital public services are not lost to inefficiencies and unnecessary workers’ compensation costs.
About WCAN

WCAN is a statewide, broad-based grassroots coalition of employer and insurer trade groups, businesses, non-profit organizations and public entities working together to ensure predictability and stability in California’s workers’ compensation system, reduce costs for employers and improve services to injured workers. WCAN works to inform employers, policymakers and the media about California’s system and advocate for policies that ensure injured employees are given necessary medical care promptly and receive benefits timely, fraud is eliminated, legitimate disputes are resolved fairly and quickly, and system costs are reduced where inefficiencies and inequities exist.

Contact WCAN at (916) 554-3467 or contactus@fixworkerscompnow.org or visit our website: www.fixworkerscompnow.org.
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<th>Legislation</th>
<th>Medical Treatment and Utilization</th>
<th>Temporary Disability</th>
<th>Permanent Disability</th>
<th>Other Reforms</th>
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<tr>
<td><strong>Assembly Bill 749</strong>&lt;br&gt;(Calderon)&lt;br&gt;Year: 2002</td>
<td>• Eliminates the treating physician’s presumption of correctness, except for a predesignated, personal physician or chiropractor&lt;br&gt;• Requires Administrative Director to develop fee schedules for pharmaceuticals and outpatient surgery centers</td>
<td>• Annual benefit increases 1/03, 1/04 and 1/05&lt;br&gt;• Future benefit increases tied to increases in Statewide Average Weekly Wage</td>
<td>• Annual benefit increases for Permanent Total Disability 1/03, 1/04 and 1/05&lt;br&gt;• Future benefit increases for Permanent Total Disability tied to increases in Statewide Average Weekly Wage&lt;br&gt;• Annual benefit increases to maximum PD benefits for certain rating intervals 1/03 - 1/06&lt;br&gt;• Increase in scheduled number of weeks for PD benefits 1/04</td>
<td>• Increase aggregate life pension and death benefits in '06&lt;br&gt;• Weekly life pension and death benefits subject to COLA adjustments after 1/03&lt;br&gt;• Allows for lump-sum settlement payment for vocational rehabilitation</td>
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<td><strong>Assembly Bill 227</strong>&lt;br&gt;(Vargas)&lt;br&gt;<strong>&amp; Senate Bill 228</strong>&lt;br&gt;(Alarcon)&lt;br&gt;Year: 2003</td>
<td>• Requires Administrative Director to adopt a new medical treatment utilization schedule, which will be presumptively correct with regard to extent and scope of medical treatment&lt;br&gt;• Requires that ACOEM guidelines be used until the new schedule is developed&lt;br&gt;• Requires that for injuries not covered by ACOEM, treatment be based on other evidence-based treatment guidelines generally recognized by the medical community&lt;br&gt;• Requires development of new fee schedules for physician services, inpatient hospital services, pharmaceuticals and outpatient facility services&lt;br&gt;• Generally limits chiropractic and physical therapy to 24 visits NOTE: AB 1073 (Nava) 2007 prohibits limitation on physical medicine from applying to postsurgical treatment if provided according to postsurgical treatment guidelines&lt;br&gt;• Requires employers to develop a utilization review process</td>
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<td>• Repeals vocational rehabilitation&lt;br&gt;• Requires that an injured worker receive a supplemental job displacement voucher if he/she does not return to work within 60 days of termination of TD payments&lt;br&gt;• Requires employers to pay any bill for medical treatment within 45 days</td>
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<td><strong>Senate Bill 899</strong>&lt;br&gt;(Poochigian)&lt;br&gt;Year: 2004</td>
<td>• Repeals primary treating physician’s presumption of correctness for all issues and all dates of injuries&lt;br&gt;• Requires that the presumption given to the treatment utilization schedule/ACOEM may only be contested by a preponderance of scientific medical evidence&lt;br&gt;• Requires that employers pay for up to $10,000 worth of medical treatment while determining whether to accept or deny a claim&lt;br&gt;• Allows employers to establish Medical Provider Networks (MPN) for the treatment of injured workers&lt;br&gt;• Provides injured workers in MPNs the right to 2nd and 3rd medical opinions and Independent Medical Review for disputed diagnosis and treatment&lt;br&gt;• Generally limits occupational therapy to 24 visits</td>
<td>• Caps TD payments at 104 weeks within 2 years of first TD payment, with some exceptions NOTE: AB 338 (Coto) 2007 extends timeframe from 2 years from first TD payment to 5 years from date of injury</td>
<td>• Repeals use of work restrictions for determining PD awards&lt;br&gt;• Requires the use of AMA guides for determining physical impairment&lt;br&gt;• Requires Administrative Director to create a new Permanent Disability Rating System by 1/1/05, which must include modifiers for age, occupation and loss of future earning capacity&lt;br&gt;• Increases scheduled number of weeks from 9 to 16 for PD ratings above 70%: reduces scheduled number of weeks by 1 for PD ratings below 15%&lt;br&gt;• Increases PD award by 15% if there is no offer to return to modified work; decreases PD award by 15% if there is an offer to return to modified work&lt;br&gt;• Requires that employer is only liable for the permanent disability caused by work-related injury</td>
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Sources: WCIRB; CHSWC; CWCI
Endnotes

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