1987

REPORT TO

WILLIAM A. HODDER

VICE CHAIRMAN,

MINNESOTA BUSINESS PARTNERSHIP

CHAIRMAN,

MBP EMPLOYMENT LAW TASK FORCE

Submitted By:

EMPLOYER MEMBERS,

MINNESOTA WORKERS COMPENSATION ADVISORY COUNCIL

November 20, 1987

This is an update of the report you requested the employer members of the Minnesota Workers' Compensation Advisory Council to undertake in 1986. It encompasses a technical review of workers' compensation in Minnesota, focusing on overall effectiveness of the 1983 reforms, systemic goals, and how our WC system compares with those of other states.

The report is in four parts. The first part is a general overview of the history of Minnesota's WC system, detailing where we came from and why. The second part is an assessment of current systemic costs. And the third part contains a number of issues and proposed solutions, followed by a fourth part, a general conclusion.

The report is intended as a catalyst for discussion and further research, and not as a definitive document in its own right. Full analysis of the issues involved in the workers' compensation system depends on the availability of data not yet in existence. But the report might be of assistance in evaluation of that data.

I. General Overview

Background: Workers' Compensation is a system invented by Chancellor Otto Von Bismarck in Germany over 100 years ago to provide prompt, uncontested (presumably) but limited (also presumably) coverage for injuries suffered at the workplace. It was adopted in one form or another in most of the industrialized world by the early 20th century.

Theory: Rather than require an injured worker to demonstrate fault or negligence on the part of an employer in order to collect damages, workers' compensation systems generally adhere to a "no-fault" concept. Two things must be demonstrated:

1. The worker is hurt, or impaired to a specific degree; and

2. This disability has a substantial relationship to the workplace.

Having established these points, the inquiry is theoretically at an end. The injured worker becomes entitled to one or more of a variety of benefits. Typically, these include:

1. Full health care cost coverage;

2. Loss of wage benefits during periods of inability to work (commonly called "temporary total" or "permanent total" benefits);

3. Additional benefits based on permanent disabilities (commonly called "permanent partial" or benefits);

4. Partial benefits to bridge the gap between former salary levels and new levels at a lesser job, if necessary (commonly called "temporary partial" benefits);

5. Death benefits, rehabilitation and retraining costs, etc.

Recent Minnesota History:

Our state's benefits were essentially static for a considerable period lasting until the early '70's. Reforms instituted during that period were probably overdue, but their sweep extended further than even their authors envisioned.

The concept of "supplemental benefits" was one of the first major changes, introduced in 1972. It provided for augmentation of income replacement percentages for low-income workers and long-term disabled people. The increases were initially "capped" at a specific (and low) dollar level, but later were annually increased and ultimately allowed to float in accordance with a specified "index" figure. The amount is now over 400% larger than the original supplemental amount.

Major structural changes were made in addition to benefit level increases, specifically with the adoption of statewide weekly average wage as a maximum benefit and all the other various benefit components being tied to this annual float upwards, including an escalator clause incorporating cost of living increases for long-term injuries.

The old system (similar to the ones most commonly found in other states) had provided for weekly "wage-loss" benefits of finite duration ("temporary total"). At the end of that time, benefits could be continued for a specified period in the event of permanent disability. A detailed schedule for the number of additional weeks was provided (e.g. "X" weeks for an arm, "Y" weeks for a back, etc.). The mid-70's reforms changed this system in several ways:

1. The temporary total benefits were made potentially infinite in duration, thus exceeding the previous combination of temporary and permanent benefits;

2. The "temporary" benefits were "indexed";

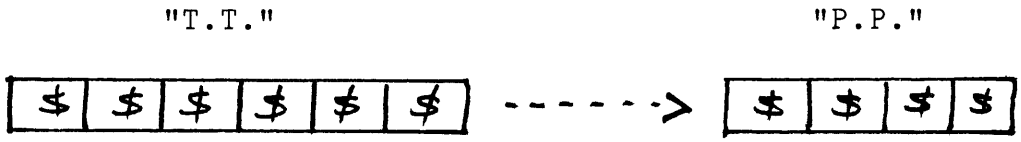
3. Because the permanency benefits were now superseded, they took a new form, being made available to injured workers in lump sum upon proof of disability.

4. Benefit levels were increased.

Note: The "structural" changes were more significant in the long term than the "benefit" changes.

Conceptual Chart

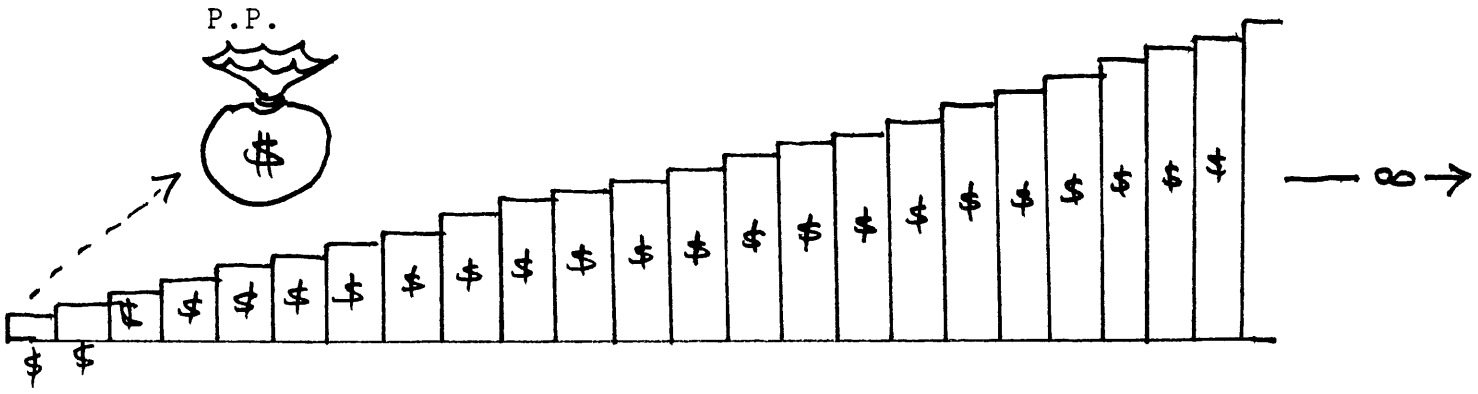
Old System:



Temporary weekly benefit received, subject to maximum duration. No "escalator" for COLA

"Permanency" award, specific amount of additional weekly benefits after "temporary" benefits expire.

Revised System:



T.T. indexed to increase with COLA; made potentially infinite.

P.P. payable as lump sum, up front, upon diagnosis.

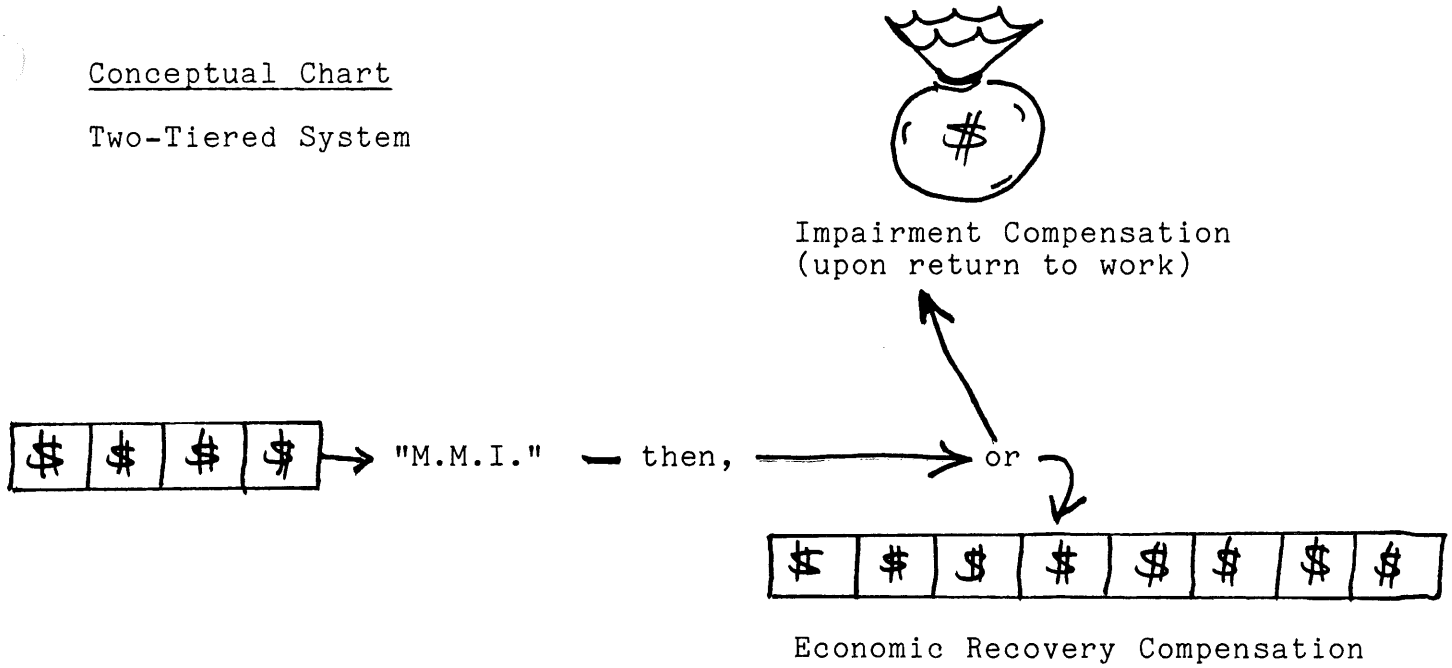
The result was a much more costly system, not just because of dollar amounts in schedules, but because of structure itself. Some parties with limited expertise in the area commonly expressed amazement that Minnesota could be so much more expensive than Wisconsin, for example, despite the fact that the statutory benefit amounts seemed to be closely comparable. Structure, not benefit amount, was the main reason, although there are substantial differences in certain benefit areas.

Reforms of the '80's:

Rising workers' compensation costs led to reform movements in a number of states in recent years. Florida adopted a "wage-loss" system which compensates only for loss of earnings (Professor Arthur Larsen at Duke University is the best-known proponent of this approach). Minnesota responded in a different way. After several landmark studies and several campaigns for reform, Minnesota adopted a "two-tier" system, generally supported by business interests as a compromise, but strongly opposed by organized labor. In essence, the system is designed to encourage return to work rather than to reward disability. The temporary wage replacement benefits are to last only until the injured worker attains "maximum medical improvement" ("M.M.I."). At that time, one of two alternative benefits is awarded. If the worker returns to suitable employment, he or she receives a lump sum benefit for any remaining permanent disability (called an "impairment compensation"). If the worker is not offered suitable employment within 90 days after M.M.I., that worker receives a weekly benefit for a finite period (called Economic Recovery Compensation) which will total a greater sum than Impairment Compensation.

Conceptual Chart

Two-Tiered System



Analysis: The incentives provided in the new system are an innovative response to the crises created by the 1970's reforms. However, problems remain:

1. The new system is quite complex. It demands active and effective management from the State Department of Labor and Industry. The 1987 legislation has attempted to simplify and streamline the system. The changes mandated by this legislation are still being implemented and the results are not yet clear. One major area of concern that was addressed was the so-called "Triple Track" system, which was abolished (see III (6), page 15).

2. The system, although apparently an improvement over its predecessor, is still relatively expensive. As other, competing states adopt reform measures, our relative standing may continue to erode. Details on our competitive ranking are being compiled, but because our system is so "different" it is difficult to compare it with systems in other states.

3. The need to find alternative, acceptable occupations that pay approximately what the employee was used to earning in his or her old capacity is particularly acute in cases where the former job was fairly high paying (e.g. construction, trucking, etc.) and the employee has no particular skills transferable to another line of work.

4. The size of the lump sum awards appears to remain excessive.

5. Rehabilitation and medical costs remain high.

6. Although indexing for temporary total disability stops at the point of maximum medical improvement, the availability of supplementary benefits effectively keeps alive the notion of long-term indexed wage replacement benefits. In McBride v. Leon Joyce Blacktop (WCCA 469-40-5382), the Workers' Compensation Court of Appeals held that an employee who was not entitled to temporary total benefits was nevertheless entitled to ongoing supplementary benefits. The case is on appeal to the Minnesota Supreme Court.

Recent Crises:

Despite the reforms of 1983 (and possibly because the full impact of those reforms has not yet been felt in the system sufficiently to affect costs significantly), wor-

kers' compensation costs in Minnesota continue to increase. Some employers have reported increases in premiums of 200 to 300 percent, or more. Others have been more fortunate. The increases are due in part to the recent general crisis in property/casualty insurance, no doubt, but it also reflects imperfections in the current Minnesota WC system centered around the difficulty of providing suitable alternative employment for some injured workers and the continuation of lump sum awards, as well as high health care and rehabilitation costs.

The property/casualty crisis in liability insurance cannot be blamed for Minnesota's cost load relative to other states, because the crisis has been a relative constant and equal factor throughout the country, yet we continue to see significant cost differentials in Workers' Compensation systems. This clearly demonstrates that the state laws and administration of those laws are the driving forces behind relative cost standing.

Recent Legislation:

Little was adopted in this area other than "housekeeping" legislation after 1983, until the 1987 session, which saw enactment of significant administrative reforms aimed at restructuring and simplification. The primary effort was to eliminate the "Triple Track" system and speed the flow of cases. Results are not yet conclusive.

II. Cost Analysis

A broad-ranging discussion was held by the members on December 3, 1986, followed by several conferences. This was supplemented by a number of conferences in the Fall of 1987. From those meetings, we have concluded that several points about Minnesota's present workers' compensation system should be made:

1. The premise underlying the 1983 reform, which was to shift the system's emphasis from compensating for lost work and disability to encouraging return to work, is valid.

2. Hard data to quantify the effectiveness of the 1983 reforms are still not generally available. Because the changes only apply to injuries sustained in 1984 and subsequent years, final costs for those injuries are not yet a significant part of the data base.

3. The 1987 ratemaking report issued by the Workers' Compensation Insurers' Association of Minnesota indicates an overall rate reduction of 2.1%, the first such indicated reduction since 1972. This is not necessarily fully indicative of the effect of the 1983 reforms because the ratemaking report is based on a complicated weighted average of experience over a ten year period, and only one of those ten years is a "new-law" year. Certain other indicators which are imprecise but focus more on "new-law" cases suggest a decrease of 8 percent in indemnity losses and 3 percent in medical losses.

4. The 1988 ratemaking report has not yet been officially released, but apparently it will recommend an increase in overall pure premiums of about 10%. This is a trend in the opposite direction of that noted for the 1987 report, and further complicates any effort to accurately evaluate the effect of the 1983 legislation.

5. According to the National Council on Compensation Insurance, workers' compensation premium level revisions becoming effective during the first quarter of 1986 averaged a 13.8% increase (in 14 states and the District of Columbia). Activities in other states are not known.

6. These indications, confusing as they are, are subject to still further significant qualifications:

    a. Taxes and assessments were not included in arriving at the "pure premium" drop of 2.1% in Minnesota in the 1986 report.

        (1) In Minnesota, a "special compensation fund" exists, the cost of which, if added into the equation, would result in a 25% increase in indemnity benefits.

(2) For 1987, that 25% figure is increased to 31%.

(3) As of 1986, it became clear that assessments soon would be levied on behalf of the "assigned risk pool". The last such assessment amounted to 15 million dollars and was levied over seven years ago. Pool volume more than quadrupled in just the last two years preceding 1986 due primarily to artificially low prices set by the state which paradoxically have attracted employers to the pool, with premiums for calendar year 1986 at approximately $80 million. As of 1984, the pool's incurred loss ratio was over 165% (i.e. $165 was paid out in benefits and expenses for each $100 in premiums received), and the pool's "surplus" had dipped to a negative $24 million. It was evident that if the loss experience continued to deteriorate, the potential for future assessments of a very large magnitude payable by insurers (and therefore by insureds) and by self-insured employers would become very great.

(4) In December of 1986 Commerce Commissioner Michael Hatch ordered a $39 million assessment to fund the then-identified deficit in the assigned risk pool, through an 8% add-on insurance assessment, with a 5% increase effective March of 1987 and a 3% increase effective in March of 1988. Also, Commissioner Hatch provided for overall increases in the assigned risk plan rates of over 6% in March of 1987 and an additional 17%, effective September of 1987. These increases may or may not result in solvency, but the situation has clearly been ameliorated, at least for the moment. It would be desirable to implement legislative changes in accordance with #10 on page 17 to assure continued solvency and integrity in this fund, which is all the more important because of the volume of business it does, accounting as it does for about 36,000 employers and a premium volume of around $100 million.

(5) Minnesota is unique (almost - see Kentucky) among states in having a state-mandated monopoly reinsurance association, which covers all claims exceeding either $180,000 or $380,000 (at the insured's option), at premium rates which we understand will be 5.9% and 10.9%. These premiums are "folded into" overall premiums, but they do not, nor are they intended to, cover all costs of these catastrophic injuries. Unlike other states, Minnesota has chosen to go "without insurance" for claims which may exceed $3.4 million, opting instead to pay any excess amounts, and levy assessments on insurers and employers to cover these amounts, when the excess payments are actually made. The "funded" liabilities of the WCRA, that is those es-

timated future costs for which adequate premiums are believed to have been collected, amounted to $276 million in late 1985 and climbed to $370 million in late 1986. As of September 30, 1987 "funded" liability reached $417.4 million.

In September of 1985, there was more unfunded liability ($353 million) than funded liability; the ratio was about $5 unfunded in addition to every $4 that was funded, a cause for concern. One year later, in September of 1986, the unfunded liability had climbed to $628 million, an increase in one year of almost $250 million, equal to more than half the total annual workers' compensation insurance premiums in the state. The ratio had become about $7 in "unfunded" liability for every $4 that is funded, a cause for more concern. As of September 30, 1987, the "unfunded" liability was only $1 million short of $800 million. The ratio of "unfunded" liability to "funded" liability has reached about 2:1. Even discounting these distant obligations for "present value," the amounts involved are significant, and the trend is also significant.

(6) The state "guarantee" fund, intended to provide payments to injured workers in the event of insurer insolvency, is currently levying the maximum permissible assessment of two percent on the total state insured base, as a result of several recent large insolvencies, and that amount reportedly is still insufficient to cover costs.

b. Profit margins and all company operating costs are excluded from the pure premimum base rate reflected in the 2.1% decrease in 1986 and the increase represented in 1987. These expenses are substantial, of course, and are calculated into the overall rate increases granted in other states.

In sum, the message of the 2.1% decrease and the subsequent increase is mixed. Last year's news is good when compared with previous Minnesota reports calculated on the same basis. The news is bad when it is understood that the "rules of the game" have been changed in recent years, in that more and more costs are shifting rapidly to funds, assessments and other "pots" of money that do not show up in the comparisons. Without folding back in the costs of the special compensation fund, the assigned risk pool overruns, the unfunded liability of the Reinsurance Association, and the guarantee fund assessments, comparisons with earlier eras are impossible. These elements either did not exist then, were much smaller, or operated on a solvent basis. Without further adding operating expenses to the rates, comparisons with other states are inevitably inaccurate. And of course, this year's ratemaking report is depressing.

Obviously, for comparison purposes, we have a classic "apples and oranges" situation. By hiding or dispersing the means of delivering compensation dollars in such a bewildering fashion, the state of Minnesota has made it virtually impossible to compare costs with other jursidictions by "comparing" premium dollars.

It is a fundamental truth that eventually someone will have to pay for whatever gets spent, no matter how intricate the funding mechanisms may have become. In the final analysis, the only appropriate methodology for comparing systemic costs is to measure the volume of dollars being expended or encumbered for future expenditure. So far, little data of value relative to the new system is available. What little there was in last year's report suggested a decrease of sorts compared with old law experience, but the preliminary indications from the new report suggest otherwise. Further detailing, which is in progress, will be essential to arrive at any valid conclusion, however. Recent figures have actually led to a more confused situation than was previously the case, a result which almost no one believed to have been possible.

III. Outline of Problems and Goals for 1987 - 1988 Legislative Activity in Workers' Compensation

1. Problem: Weekly benefits are too high.

Recent studies by the Workers' Compensation Research Institute have shown that in many cases Minnesota's workers' compensation system replaces well over 100% of the income lost by individuals in the system. (see attached study, "A") This amount of replacement can be as high as 160% or more of previous usable income. This is excessive.

There are four jurisdictions in the nation, Iowa, Michigan, Alaska and Washington D.C., which have moved to a "spendable earnings" basis for awarding benefits. The tables used by the state of Iowa are very clear on this topic and easily understood. These jurisdictions generally provide for replacement of 80% of spendable earnings by someone who is on workers' compensation.

The WCRI data was calculated prior to significant income tax reform at the federal and state levels, and may have to be refigured. In any event, it appears certain that many recipients will continue to receive benefits in excess of former take-home pay.

Also, Minnesota is in a minority of states which provide for automatic indemnity adjustments. Further, several states that had automatic adjustments have repealed them recently.

GOAL: Adopt 80 percent of spendable earnings as basic benefits standard, with statewide average weekly wage as the maximum.

2. Problem: Supplementary benefits and the special compensation fund.

The Legislature should repeal the payment of supplementary benefits (prospectively), and the special compensation fund in an effort to simplify the administration of the system and to eliminate the costs associated with maintaining the special compensation fund. Additionally, the second injury fund should be repealed because of its administrative complexities and costs. Employment discrimination laws effectively prohibit discrimination on the basis of physical handicap.

GOAL: Repeal second injury fund or significantly tighten up access to the fund, repeal the payment of supplementary benefits prospectively and repeal special compensation fund.

3. Problem: Cost impact of automatic escalator clauses.

Unlike most states, Minnesota provides for automatic escalating bene-

fits of up to 6% each year for benefits paid after a valid claim is established. Whatever the merits of the notion of automatic escalators may be, the fact of the matter is that they lead to cost increases not encountered in most other states. In fact, three states have recently abandoned their automatic escalators.

GOAL: Repeal or limit the automatic escalators.

4. Problem: Temporary Partial Disability payments are an emerging problem.

Under the old law (pre-1984), temporary partial disability was paid to an injured employee who had the ability to earn a wage which was less than his preinjury wage. Temporary partial disability benefits are paid at the rate of two-thirds of the difference between the preinjury wage and the wage which the injured employee now has the ability to earn. (Example: An employee is earning $300 per week, is injured and becomes temporarily totally disabled. He has a wage loss of $300.00 per week, and will receive a temporary total benefit of $200.00 per week. He cannot go back to his old job because of his injury. He later finds a lighter duty job at a lower wage of $150 per week. He has a wage loss of $150 per week, and will therefore receive a temporary partial disability benefit of two-thirds of his wage loss, or $100.00 per week).

Under the old law, the "ability to earn" was the legal standard. Actual earnings were evidence of the ability to earn, but not conclusive. (Example: The injured employee above did not accept the $150.00 per week job. At the hearing, the employer introduced evidence that the employee was physically able to do the job, and was therefore not temporarily totally disabled. The Compensation Judge could find him to be temporarily partially disabled. His compensation benefit would be changed from $200.00 per week (temporary total disability benefit) to $100.00 per week (temporary partial disability benefit).) Minn. Stat. Section 176.101, Subd. 2 was not repealed under the new law, and provides that in all cases of temporary partial disability, compensation shall be 66-2/3% of the difference between the weekly wage of the employee at the time of the injury and the wage the employee is able to earn in the employee's partially disabled condition.

Under the new law temporary total disability ceases, at the latest, 90 days after maximum medical improvement. Then either impairment compensation or economic recovery compensations are paid, depending upon whether or not a job has been offered to the employee and whether or not he has accepted it. However, there is no statutorily defined termination for temporary partial disability benefits under the new law. In fact, Minn. Stat. Section 176.101, Subd. 3h provides that an employee who accepts a job offer and begins that job shall receive temporary partial compensation pursuant to Subd. 2, if appropriate. Minn. Stat. Section 176.101, Subd. 3n provides that if the employee

has been offered a suitable job and has refused it, he is not entitled to temporary partial disability benefits. Minn. Stat. Section 176.101, Subd. 3p provides that economic recovery compensation shall begin if no job offer is made to the employee 90 days after maximum medical improvement. It further provides that temporary total compensation ceases upon commencement of the economic recovery compensation payments, and that temporary total compensation shall not be paid concurrently with economic recovery compensation. No mention is made in this subdivision of temporary partial benefits.

The position being taken by the plaintiff trial lawyers in cases currently pending before the Minnesota Supreme Court is that temporary partial disability benefits may continue indefinitely into the future, since the "ability to earn" test remains in the statute and since the 1984 statutory formula does not provide for any specific termination of temporary partial disability benefits at the end of the maximum medical improvement plus 90 day period when temporary total disability must cease. Many observers of the situation believe that, because of the way the law is drafted, the trial lawyers' position has a reasonable chance of success and that the law must be changed to avoid this peculiar and expensive interpretation. Otherwise, ongoing temporary partial disability benefits could be payable where temporary total disability benefits must cease. (Example: A highly paid steel worker earned $15.00 an hour, or $600.00 per week. Ninety days after MMI, his temporary total disability benefits cease and economic recovery compensation benefits begin. At a hearing the employeee's attorney introduces evidence that he is able to work at a light duty assembly line job paying $3.00 per hour and claims that, concurrently with economic recovery compensation payments, he is entitled to temporary partial disability benefits of $8.00 per hour ($15.00 less $3.00 = $12.00 X 2/3rds). This benefit, which would be $320 per week, would continue indefinitely into the future.

In an analogous situation, the Workers' Compensation Court of Appeals recently held that an employee, who suffered injuries both before the 1984 change and after the 1984 change was entitled to have ongoing temporary total disability benefits after maximum medical improvement, paid by the employer and insurer at the compensation rate in effect at the time of the 1984 (new law) injury. See James P. Joyce, Jr. vs. Lewis Bolt & Nut Company, File #474-60-7333, filed November 18, 1986, attached as "B". The decision by the Workers' Compensation Court of Appeals in Joyce was recently reversed by the Minnesota Supreme Court, and the matter is currently on appeal to the U. S. Supreme Court.

GOAL: Reform the temporary partial law to effectuate 1983 legislative intent, as necessary.

5. Problem: High minimum benefits.

The minimum benefits payable in Minnesota are automatically increased annually and moreover are far too high to begin with. As pointed out

in the study by the Workers' Compensation Research Institute, our minimum benefits are sufficiently high that a large number of people will receive much more in benefits than they did in salary.

GOAL: Lower the minimum benefits.

6. Problem: Dispute resolution has been too complex, and may still be.

The mechanism for dispute resolution of workers' compensation claims before the 1987 reform legislation was almost hopelessly complicated. This mechanism consisted of a "triple track" system whereby claimants may be forced (or choose) to bounce from one arena to another, thus adding a great deal of cost which is probably unnecessary. Prior to 1981, all of the workers' compensation administrative and quasi-judicial functions were in the Department of Labor and Industry except for the Workers' Compensation Court of Appeals which had been separated in the late 1970's from the Department. In 1981, the Compensation Judges were moved from the Department of Labor and Industry to the Office of Administrative Hearings. Some "Settlement Judge" positions, however, did remain in the Department of Labor and Industry. In 1983, the law provided for a number of "Rehabilitation Specialists" to hear issues regarding rehabilitation or medical expenses. The 1983 law also created a Rehabilitation Review Panel, to hear appeals from Rehabilitation Specialists, and a Medical Services Review Board, to hear appeals.

Under the old system, an injured employee filed a Claim Petition alleging disability benefits, medical expenses and possibly rehabilitation. The matter was pretried before a Calendar Judge. The matter and all the issues were heard before a Compensation Judge. The Judge's decision could be appealed to the Workers' Compensation Court of Appeals. Any further appeal was to the Minnesota Supreme Court.

The "triple track" system provided that the injured employee file a Claim Petition for disability benefits with the Department of Labor and Industry. The matter could be referred to a Settlement Judge for a Settlement Conference. The matter was then referred to the Office of Administrative Hearings for hearing by a Compensation Judge. Any appeal from the Compensation Judge's Decision was to the Workers' Compensation Court of Appeals. If the employee had any claim for medical expenses, he filed an M-4 form with the Department of Labor and Industry. The matter was referred to a Rehabilitation Specialist. The Rehabilitation Specialist may have had more than one conference with the party before finally reaching a decision. Any appeal of the Rehabilitation Specialist went to the Medical Services Review Board. The matter was, however, referred to a Settlement Judge for possible settlement before being heard by the Medical Services Review Board. Any appeal of the decision of the Medical Services Review Board went to the Workers' Compensation Court of Appeals. If the employee had a rehabilitation issue, he filed a request for Administrative Conference

before a Rehabilitation Specialist. Again, the Rehabilitation Specialist may have had more than one conference with the parties before reaching a decision on the rehabilitation issue. Any decision of the Rehabilitation Specialist could be appealed to the Rehabilitation Review Board. However, the matter was referred to a Settlement Judge after the appeal but before any hearing before the Rehabilitation Review Panel. Any decision of the Rehabilitation Review Panel could be appealed to the Workers' Compensation Court of Appeals. In addition, the Settlement Judges could hold more than one Settlement Conference if the parties were unable to agree at the first conference before referring the matter to the Rehabilitation Review Panel or Medical Services Review Board.

Thus, an injured employee (and an employer and insurer) could, on the same case, have had a hearing on the Claim Petition scheduled before a Compensation Judge in the Office of Administrative Hearings, a hearing on the M-4 scheduled before a Rehabilitation Sepcialist, and a hearing on the rehabilitation issue scheduled before another Rehabilitation Specialist, not to mention the attendant Settlement Conferences on each issue as the issue wound its way through the system. It would be difficult to have concocted a more convoluted system if that had been the goal at the outset.

In 1987 legislation was adopted which was directed toward simplification of this system. It provided for jurisdiction for all claims by a compensation judge at the Office of Administrative Hearings, although it retained a modified form of the administrative conference in the Department of Labor.

> GOAL: Assure that the new "single track" jurisdictional system functions smoothly and equitably.

7. Problem: Qualified rehabilitation consultants seem to be used indiscriminately.

The role of the qualified rehabilitation consultant should be redefined in our statutes. There are currently over 500 licensed QRC's in the state of Minnesota. Department of Labor & Industry statistics show that a disproportionate percent of lost time cases in Minnesota get involved with the rehabilitation process, adding unnecessary costs to the system. It is simply good claims management and good business, particularly in light of the new workers' compensation benefit structure, to return workers as quickly as possible to suitable jobs. In this effort, the services of a rehabilitation consultant could be valuable. However, to require that highly paid rehabilitation consultants be employed in virtually every claim of significance seems pointless.

Labor also seems to object to much of the activities of the QRC's, viewing them as "employees" of and answerable to insurance carriers. This is not the case, because although QRC's are paid out of the in-

surance premiums, their selection is up to the employees. Nevertheless, the concern is understandable.

So the options here are several. One is simply to dispense with the QRC's as a mandatory statutory function. A second approach would be to limit their usage or to put in mandatory fee schedules for their payments.

GOAL: Reform the QRC system.

8. Problem: Permanency benefits probably are too high.

There's a good deal of controversy about the "two-tier benefit system" in Minnesota. It is probably premature to recommend its abolition, but it is also probable that the benefit levels provided in that system are still quite high compared to those in effect in other states. Our information on this is somewhat outdated. More information on the present competitve position of Minnesota's benefits, both in amount and structure, is called for.

GOAL: Study and suggest new alternatives.

9. Problem: Weekly benefit calculations can artificially overstate the income lost.

Minnesota should adopt the notion of annualized income for the payment of disability benefits. A number of workers who are hurt on the job are people who work only a portion of the year and make high income during that portion of their work year. If a worker who's earning $450 a week for only 35 weeks of the year is hurt, that worker is entitled to $300 a week in benefits, tax free, possibly for life (escalated in future years for inflation). Those benefits are available each week of the year, year round. Thus the worker in our example, who earned a total of $15,750 in salary before any taxes, before any social security deductions, before any of the rest of the deductions that are made from everyone's paycheck, could obtain disability benefits of $15,600 year-round. And that $15,600 in benefits would not include any deductions for any payroll taxes or anything else. This seems unreasonable. Minnesota should move to a system, in supplement to the 80% of spendable earnings test advocated in number 1, above, which provides for weekly disability based upon the weekly pay for the first 26 weeks of disability and then reversion to an annualized computation of weekly benefits at a level somewhat in excess of 1%. This amount could be as high as 1.3%.

GOAL: Move to annualized concept.

10. Problem: The Assigned Risk Pool is underpriced.

The rates charged to employers who are participating in the assigned

risk pool should be adequate to fund the benefits that are paid out of that pool to employees of those employers. Simply put, enough money to pay the claims should be collected, which is not now the case. Earlier discussion indicated the magnitude of the deficit and the downside potential for the healthiness of the competitive marketplace in Minnesota. In fact, bacause of a similar political rate-making problem in the assigned risk plan, the State of Maine found their plan assuming control of virtually the entire marketplace, negating competitive choices for employers. And when an underfunded plan can no longer shift its shortfall to solvent employers, it is in deep trouble.

GOAL: Adopt statutory standards to ensure that adequate rates are charged employers going into the plan and that it functions as a "market of last resort" at prices that accurately reflect risks above those of the voluntary marketplace.

11. Problem: The Reinsurance Association has massive unfunded liability.

Current projections are that almost $800 million will have to be raised in the future to pay claims that are already in existence. When the WCRA was instituted in the late '70's, it was intended to address the perceived problem of huge reserves being built up in present-day dollars to pay for huge claims anticipated decades hence, arising from long-term "catastrophic" cases. Since that time, however, insurers' reserving practices have changed markedly, first being subjected by statute to "present value" discounting of those long-term claim costs, and then being shaped by the competitive forces of the open market. So the rationale for the "pay as you go" funding of the WCRA is not as compelling as it once was.

At the very least it should be recognized that the costs incurred here are merely costs delayed, not costs avoided.

GOAL: Recognize liability; study advisability of continued operation on a deficit basis.

12. Problem: Employers pay virtually all costs of operating the WC system.

The administration costs of the special compensation fund should be paid out of the state general fund. In 1985 virtually all the costs of administering the entire workers' compensation system were shifted out of the general fund of the State of Minnesota to the special compensation fund. What this means is that employers are saddled with the responsibility of paying for all the costs of all the government agencies, courts and so forth that deal with workers' compensation. This is unfair. Also there is cause to examine the possibility of requiring filing fees to be paid by people filing workers' compensation

litigation actions which could be at least in part used to defray some of the costs of the court system.

GOAL: Revert to funding system similar to that used in other arenas of litigation.

13. Problem: The unpaid bills of employers who forego insurance must be paid for, in a "double dip", by employers who are covered.

A separate uninsured claim fund, with revenues derived from general fund appropriations and penalties, should be established. There is no reason for employers who are honest and buy insurance to have to pay higher premiums to cover charges for employers who fail to properly insure, whether intentionally or otherwise. If an employer buys insurance, that employer pays both for its own costs and for those of people who do not purchase coverage. That is regressive.

GOAL: Correct these deficiencies.

14. Problem: Litigation practices are unfair.

A number of litigation practices ought to be revised.

a. Employers should have the absolute right to depose employees whenever a petition is filed and have an absolute right to see all medical records.

b. Full, final and complete stipulations of all types should not be reopened if both sides are represented by counsel, unless there is an unanticipated material change in condition or there is fraud. Too frequently cases are reopened and reopened endlessly.

c. A "suitable job offer" should not be the basis for a claim for discrimination because of disability. This quirk in the law can actually hamper the ability of injured workers to return to work. If they are in a significantly diminished condition due to their workers' compensation injury, the offer of a job which inevitably is less rewarding than the job that they had held previously should not be the cause for discrimination litigation on the basis of that offer.

d. Currently there is no statute prohibiting workers' compensation fraud, similar to that barring welfare fraud. Such a statute should be enacted in the criminal code.

e. The statute of limitations for initiating workers' comp cases has been greatly eroded by judicial decisions and should be reinforced. The statute should provide for a limitation of six years after date of injury in the case of a denial of primary

liability and six years from the date of the last benefit payment in cases involving admitted injuries. Medical payments, however, should remain open for life in any case involving an admitted injury to cover situations where there have been unanticipated material changes in condition. The statute should clearly provide that the action necessary to toll the statute of limitations would be the filing of a claim petition itself.

GOAL: Implement a more even-handed system.

15. Problem: Benefits from a variety of sources are not well coordinated.

Coordination of benefits should be improved by strengthening the retirement presumption to include presumed withdrawal from the competitive labor market when an employee takes his or her private pension, and also provide for apportionment of permanent partial disability between work-related and non-work-related causes in cases of gradual minute trauma breakdown.

GOAL: Achieve better coordination.

IV. Conclusion

The attainment of a competitive position in workers' compensation costs is a reasonable goal for the system, and it has not yet been achieved. In this respect it is premature to label the 1983 reform a success or a failure. Administrative and judicial actions could make it one or the other. Assuming that no catastrophic judicial decisions alter the delicate balance of the benefit structure, it appears that the new law is somewhat less expensive than the prior system, if the old system were to be projected into the current years.

While the early evidence suggests that progress is being made relative to Minnesota's prior experience, that evidence does not support the notion that progress is being made in the drive to achieve overall cost levels more competitive with other states. Drawing conclusions from comparisons of our "cost data," which simply no longer includes a number of significant and rapidly growing debts, with data from other states tabulated on a vastly different basis, is at best uninformative. The current system is a compromise, and should not be understood to have addressed all of the ills of workers' compensation. Clearly more attention is called for.

Efforts to "equalize" cost data are likely to be difficult and controversial, although the efforts should be made. Efforts to compare benefit payouts are less difficult, although not without problems of their own. The preferred course is to build on the basis of a system that at least in concept is valid, and to hammer it into a shape that is fair for all concerned. The foregoing recommendations, we hope, will prove useful in that daunting task.

Finally, it should be noted that the opinions and views reflected in this document do not necessarily reflect the views of the organizations represented by the individual members.

Respectfully submitted,

Employer Members

Robert Johnson
Laurence F. Koll
John B. Lennes

The following Employer Members did not take part in the 1987 revision of this Report, but concur in result:

Francis Fitzgerald
Charles Nyberg

The following Public Member also concurs in the result:

Nancy Christensen

Attachment A

WCRI RESEARCH BRIEF

WORKERS COMPENSATION RESEARCH INSTITUTE • 245 First Street • Suite 402 • Cambridge, MA 02141 • (617) 494-1240

MARCH 1986—VOLUME 2, NUMBER 3

INCOME REPLACEMENT IN MINNESOTA AND WISCONSIN

Benefit issues are central to any discussion of how a workers' compensation system is functioning and how it might be improved. A recent WCRI research report provided the basic data needed to address many benefit issues (especially adequacy, equity, and return-to-work incentives) in five states.[1] We have received a number of requests to conduct an analysis and provide these data for other states. From time to time, we will do so, presenting the results of our examination in a WCRI RESEARCH BRIEF. This is the first of this series, presenting data for two neighboring north central states, Minnesota and Wisconsin. The next RESEARCH BRIEF in this series will present data for California.

Scope of the Study

This analysis augments our earlier study, examining the percentage of a worker's after-tax income that is replaced by workers' compensation benefits. That study analyzed workers' compensation systems in five states: Georgia, Illinois, Massachusetts, Michigan, and Pennsylvania. This RESEARCH BRIEF adds Minnesota and Wisconsin to that list. The study examines income replacement for short-term disabilities, those lasting less than one year. And it analyzes income replacement by workers' compensation alone. Future studies will examine income replacement for longer-term disabilities and for workers' compensation in combination with other government and private benefit programs.

Research Approach

We have developed a computer-based model that determines the percentage of a disabled worker's after-tax income that is replaced by workers' compensation benefits. By *after-tax*, we mean gross income net of federal and state income taxes and social security taxes. We call this measure the *income replacement rate*. To construct and implement this model, we have used benefit levels and tax rates in effect in 1985. (The income replacement rates reported in the earlier publication were based on 1983 benefit levels and tax rates. Consequently, comparisons with those results are slightly distorted.)

An example: a Wisconsin worker earning $20,000 a year who suffers a four-week disability. The worker's gross wage loss is $1,538. From that, the

1. Karen R. DeVol, *Income Replacement for Short-term Disability: The Role of Workers' Compensation* (Cambridge, Mass.: Workers Compensation Research Institute, 1985, WC-85-2). This book can be obtained from the Institute free of charge to members, $15 to nonmembers.

WCRI RESEARCH BRIEF is a periodic publication of the Workers Compensation Research Institute. It reports on significant ideas, issues, research studies, and data of interest to those working to better understand and to improve workers' compensation systems.

WCRI RESEARCH BRIEFS augment WCRI's primary publications for reporting the results of its work: RESEARCH REPORTS, SOURCEBOOKS, and WORKING PAPERS. All WCRI publications are widely distributed to policymakers and others interested in workers' compensation issues.

WCRI is a nonpartisan, not-for-profit public policy research organization funded by employers and insurers. For further information about the Institute, its work, membership, or the material in this WCRI RESEARCH BRIEF, contact Dr. Richard B. Victor, Executive Director.

model subtracts federal, state, and social security taxes totaling $562. This results in an after-tax income loss of $976. Workers' compensation benefits (two-thirds of the worker's gross average weekly wage) equal $1,025. The replacement rate is the ratio of benefits received ($1,025) to after-tax income lost ($976), or 105 percent.

Chapter 2 of the earlier report presents a full explanation of the computer model and research methodology.

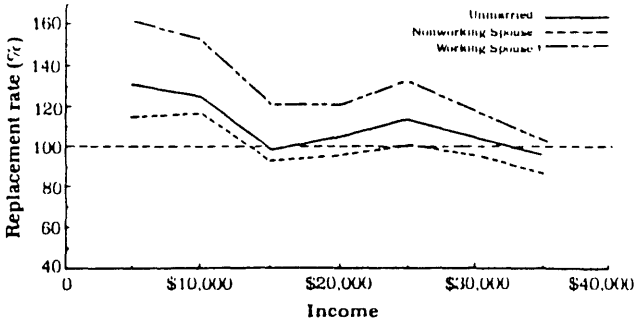
Income Replacement Rates in Minnesota

BENEFIT AND TAX STRUCTURES. Workers' compensation benefits in Minnesota are two-thirds of the worker's gross average weekly wage, subject to statutory maximum and minimum benefit levels. The maximum benefit is 100 percent of the state average weekly wage, or $342 in 1985. The minimum benefit is 50 percent of the state average weekly wage ($171 in 1985), unless the worker's actual average weekly wage is below $171. In that case, the minimum benefit is 100 percent of the average weekly wage, but never less than $68.40 (20 percent of the state average weekly wage).

Minnesota has a graduated state income tax with the top tax rate at 9.9 percent. This is germane because tax-free workers' compensation benefits are more valuable to those in higher tax brackets.

INCOME REPLACEMENT RATES. The percentage of a worker's after-tax income that is replaced by workers' compensation benefits depends on a number of factors: preinjury earnings, marital status, the duration of the disability, whether the worker has a working spouse, and what that spouse earns. The way that these factors influence income replacement rates is outlined in detail in the earlier report.

Figure A. Income Replacement Rates, Minnesota, 1985*

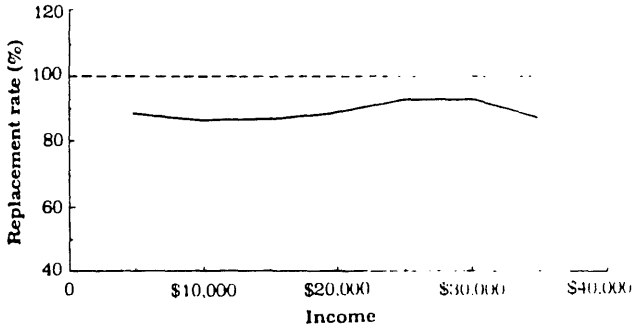


*Four-week disability
†Earning $25,000 annually

Workers' compensation benefits replace anywhere from 76 to 162 percent of most workers' after-tax income. The precise replacement rate for any given worker depends on the factors listed above. Figure A depicts the replacement rates received by workers of differing incomes who incur a typical (four-week) temporary total disability. As shown, the replacement rates vary widely according to marital status, the presence of a working spouse, and the worker's predisability income.

This picture raises at least two issues. First, how adequate are the benefit levels in Minnesota? Judged by the adequacy standard articulated by the National Commission on State Workmen's Compensation Laws, the overwhelming majority of workers who suffer a disability lasting less than one year receive adequate compensation. In fact, our rough estimates are that nearly two-thirds of these workers receive more than 100 percent of their after-tax income from workers' compensation — raising questions about the incentives to return to work in Minnesota.

Figure B. Replacement Rates Using Spendable Income, Michigan, 1983*



*Four-week disability, unmarried worker

Second, the wide variation in replacement rates received by different workers raises questions about equity. Why should some workers receive replacement rates that are double those received by others? Why should workers with a spouse earning a significant income receive higher levels of income replacement than an unmarried worker or a married worker who is the family's only source of support? These often-striking differences are an artifact of the tax-free status of workers' compensation benefits and the progressive structure of state and federal income taxes. The higher a worker's tax bracket, the more valuable the work-

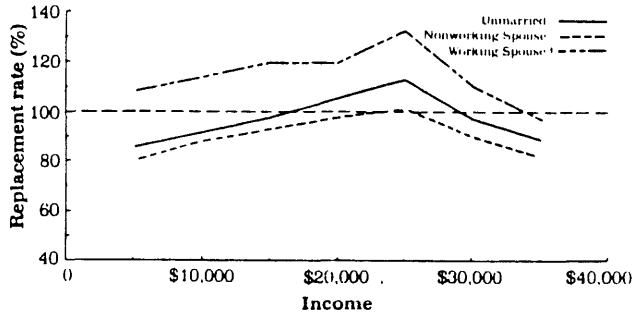
ers' compensation benefits and the higher his or her replacement rate.

As our earlier report demonstrates, some of these equity questions could be redressed by basing benefits on a percentage of the worker's after-tax (spendable) income. This approach has been adopted in four jurisdictions—Alaska, Iowa, Michigan, and Washington, D.C.—and was endorsed by the national commission. The Michigan system, for example, bases benefits on 80 percent of spendable income, producing a far more equitable distribution of income replacement (Figure B).

Income Replacement Rates in Wisconsin

BENEFIT AND TAX STRUCTURE. Wisconsin has a workers' compensation benefit structure that is typical of many state systems. Benefits are based on two-thirds of the worker's average weekly wage, subject to a maximum benefit equal to 100 percent of the state average weekly wage ($321 in 1985) and a minimum weekly benefit of $30.

Figure C. Income Replacement Rates, Wisconsin, 1985*



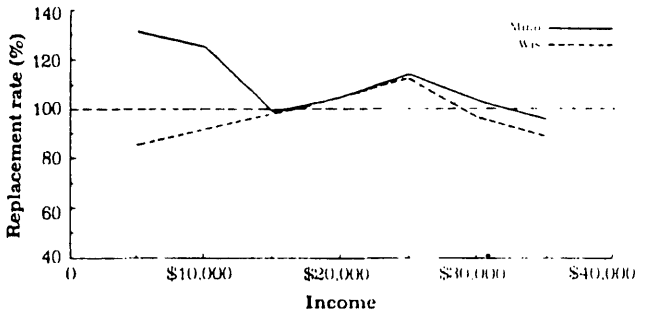
*Four-week disability.
†Earning $25,000 annually.

Wisconsin has a graduated state income tax that is similar to Minnesota's, with the top tax rate at 10 percent. This is important because tax-free workers' compensation benefits are more valuable to those in higher tax brackets.

INCOME REPLACEMENT RATES. Workers' compensation benefits replace anywhere from 72 to 132 percent of most workers' after-tax incomes. Although this is a much narrower range than that of Minnesota, the variation across individuals does raise questions of equity (Figure C).

As to the adequacy issue, the replacement rates for the overwhelming majority of Wisconsin workers meet or exceed the national commission standard. And of the Wisconsin workers who suffer disabilities lasting less than one year, we estimate that about 40 percent receive more from workers' compensation than they lose in after-tax income.

Figure D. Income Replacement Rates, Minnesota and Wisconsin, 1985*



*Four-week disability, unmarried worker.

The patterns of income replacement provided to workers in Minnesota and Wisconsin are similar (Figure D), with two significant exceptions. First, the relatively high minimum benefit in Minnesota means that unmarried workers who were making less than $15,000 annually receive replacement rates greater than 100 percent. The Wisconsin system does not do this. Second, the Minnesota maximum benefit is slightly higher than the Wisconsin maximum. Consequently, higher-income workers receive slightly higher replacement rates.

Additional Information

For your further information, the appendix on the next page presents estimates of income replacement rates for workers with different characteristics (income and marital status) and injuries of different durations for both states.

APPENDIX. REPLACEMENT RATES IN MINNESOTA AND WISCONSIN

Minnesota

Marital status	Single	Married	Dual Earners	
Spouse earnings	—	0	$15,000	$25,000
PREDISABILITY INCOME (ANNUAL)		FOUR-WEEK DISABILITY		
$ 5,000	131	115	145	162
$10,000	125	117	135	153
$15,000	99	93	108	121
$20,000	105	96	115	121
$25,000	114	101	119	133
$30,000	104	96	108	118
$35,000	96	87	102	103
		THIRTY-FIVE-WEEK DISABILITY		
$ 5,000	116	108	144	162
$10,000	115	107	132	148
$15,000	92	86	102	113
$20,000	97	90	106	116
$25,000	101	94	109	119
$30,000	93	86	99	109
$35,000	82	76	87	95

Wisconsin

Marital status	Single	Married	Dual Earners	
Spouse earnings	—	0	$15,000	$25,000
PREDISABILITY INCOME (ANNUAL)		FOUR-WEEK DISABILITY		
$ 5,000	86	80	98	109
$10,000	92	88	101	114
$15,000	98	93	108	120
$20,000	105	98	114	120
$25,000	113	101	118	132
$30,000	97	90	100	110
$35,000	89	82	95	97
		THIRTY-FIVE-WEEK DISABILITY		
$ 5,000	79	75	97	108
$10,000	85	82	99	111
$15,000	91	87	102	113
$20,000	96	91	106	115
$25,000	100	94	108	119
$30,000	86	81	93	101
$35,000	77	72	81	89