

STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE

In the Matter of: Proposed adoption or amendment of the Insurance Commissioner's Workers' Compensation Claims Cost Benchmark and regulations pertaining to pure premium rates for workers' compensation insurance and the California Workers' Compensation Experience Rating Plan—1995. These regulations will be effective on **July 8, 2009**.

FILE NUMBER REG-2009-00015

DECISION AND ORDER

Last year, in my October 23, 2008 Order and Decision in File Number REG-2008-00027, I approved a 5% increase to the Workers' Compensation Claims Cost Benchmark. In that order, I observed that the 2003 workers' compensation reforms had provided workers' compensation insurers with extensive tools to control medical costs, and that insurers should make full use of those tools to increase efficiency in California's workers' compensation system. I specifically urged insurers to work closely with their insured employers to control workers' compensation costs and keep insurance rates low, thereby assisting California businesses to remain healthy and competitive.

Now, six months later, the Workers' Compensation Insurance Rating Bureau (WCIRB), the sole rating organization for California, whose membership is comprised of workers' compensation insurers, has responded with a request to increase the Benchmark by a record 23.7%, of which 16.9% is attributable to increased medical costs and 5.8% to possible permanent disability repercussions of certain cases now pending for decision before the Workers' Compensation Appeals Board (WCAB). My response to California's workers' compensation insurers regarding this requested increase has not changed: I will not include avoidable costs in the Benchmark.

1. Results of Investigatory Hearing

Upon learning that the WCIRB would request a dramatic increase in the Benchmark due to medical costs, I immediately called for an investigatory hearing to determine whether such an increase was warranted. When the WCIRB presented its data to me at the April 28, 2009 hearing I found the evidence unsatisfactory to address my concerns over the cause and extent of these increases, and decided to continue this matter to conduct my investigatory hearing into the medical cost drivers. The evidence presented at the investigatory hearing provided a dramatic demonstration of the failure of insurers to adequately utilize the cost containment tools given to them, thereby allowing unnecessary costs to creep into the workers' compensation system.

The findings from the investigatory hearing appear in my staff's report, set forth in the addendum to the attached Proposed Decision and lists 27 recommendations on making improvements to the workers' compensation medical system. Of these, many can be directly implemented by the insurers themselves, while others present opportunities for insurers to be a driving force in the implementation of needed regulatory and legislative adjustments to the system.

There is overwhelming evidence that the workers' compensation system is not operating efficiently and insurers are not taking full advantage of the 2003-2004 reforms' cost containment tools. In particular, I noted during the investigatory hearing that insurers have failed to achieve a balance between cost and benefit with medical provider networks and utilization review, and are not communicating effectively with medical providers. Self-insured employers, on the other hand, provided further evidence of how effective medical cost containment can be managed, and presented examples of how efficiencies have been achieved, including establishment of pharmacy networks, close work and communication with medical providers, careful selection of medical provider networks, and decreasing use of utilization review. Self-insured employer testimony reflected widespread success in using these tools.

While self-insured employers face the same medical inflation and other cost drivers challenging the rest of the industry, they have found opportunities to cut costs in other areas that have resulted in a net decrease in overall workers' compensation costs.

2. The Response of Employers to the Requested Increase

Small businesses and their employees are highly vulnerable to cost increases, they are typically unable to self-insure, and they have very little power to negotiate the price of their workers' compensation insurance. There is no evidence that workplace safety has decreased, and employers appear to be doing their job as demonstrated by the continuing decreases in workers' compensation claim frequency.

We are in a deep economic recession, and everyone must do their part to lessen the impact of this financial crisis. Employers complain that any rate increase, much less one of the magnitude proposed by the WCIRB on behalf of its members, would add to their economic burden in the midst of the economic downturn. Such an increase may be the tipping point for those employers and could result in the loss of jobs or of entire businesses. It is understandable, based upon the objections I have received, that employers were overwhelmingly against such an increase.

A healthy workers' compensation system is a high priority for me and the Department of Insurance. Injured workers require prompt and effective medical treatment in order for them to return to work regardless of whether they are working for a self-insured or insured employer. Insured employers need affordable rates that are competitive with other states to keep employers in California and to attract new businesses and jobs. Because of the faltering economy, record unemployment levels, and the objections to the proposed increase, I have focused my efforts to determine whether insurers and other parties are exhausting every available avenue to control costs before deciding to order an increase to the Benchmark.

3 The Obligations of Medical Providers

The testimony of medical providers proved very helpful to understand the difficulties in the medical treatment delivery system. Better communication with medical providers and proper use of networks and utilization review by insurers is needed. However, medical providers must understand that they also need to make efforts to make their industry more cost efficient, and to work constructively with guidelines and utilization review to create standards for a predictable workers' compensation system. Lack of pre-authorization of medical services, balance billing,

and the filing of liens create unnecessary costs. Physicians need to get out of the business of selling pharmaceuticals. If medical costs continue to increase through the use of questionable or unnecessary medical treatment and expenses, there will not be a proper balance between the cost of medical services and adequate compensation of medical providers.

4. Lack of Regulatory Leadership and Proper Oversight

The reforms in the workers' compensation system dramatically increased the need for regulations and the workload of the Department of Industrial Relations (DIR). Though DIR has made progress, many of the recommendations in the Report point to slow or inadequate action in providing needed regulations and oversight from both DIR and its Division of Workers' Compensation. This includes lack of regulations to assist the industry with pharmacy networks, standard billing forms, electronic billing, and updated fee schedules. I will offer DIR any assistance I can to move these and any other regulations that will promote efficiency and accountability in the system and to monitor how these will affect costs in the system.

In addition, the WCAB is in need of review and guidance. Its process of handling liens in Southern California especially is creating additional costs in the system. The inconsistency of its judges' decisions and failure to promote the use of guidelines and evidence based medical standards in its findings on medical treatment result in increasing medical costs. The problems with the WCAB are illustrated by its decisions in *Ogilvie* and *Almaraz/Guzman*, wherein the WCAB attempted to reverse the Legislature's mandate of permanent disability standards and impose a new and costly way of dealing with permanent disability under the guise of fairness, creating such an outcry that it is now re-thinking itself and causing even greater uncertainty in the workers' compensation system. The WCAB actions betray a failure to understand the need for predictability in the workers' compensation system both for injured workers and employers based upon the Legislature's directions.

5. Workers' Compensation Costs Advisory Group

The workers' compensation system is intended to promptly compensate injured workers in a no-fault system. Instead, California has developed a complex, inefficient, and costly system. The system and benefits that are established by the legislature are overseen by many state agencies, such as DIR, CDI and the WCAB. The State Compensation Insurance Fund plays a major role in insuring California's businesses along with various private insurers and benefits provided by self-insured employers. However, there is no way to accurately account for how much the entire system costs or how effective it is. The WCIRB only monitors the state's insurers and has limited data. Added to this are the various stakeholders in the system, including labor, employers, medical providers, and others, all of whom need information on what is happening in the system.

I intend to take a leadership role and create a workers' compensation costs advisory group, comprised of a cross-section of all participants, to meet on an ongoing basis. This will accomplish the purpose, similar to the investigatory hearing, of informing my staff and me of the cost issues in the system and make ongoing recommendations to deal with them.

6. The Rate Setting Process

As Insurance Commissioner, I do not control the rates that can be charged by insurers and I do not oversee the entire workers' compensation system. I do review and determine what the costs are in the workers' compensation system through determination of the workers' compensation claims cost benchmark. The process through which the Benchmark is determined is in need of review and change, since the process can promote inefficiency by allowing insurers to pool their cost information and seek increases without being held specifically accountable for the management of their costs. The rate setting process, which predates the 2003-2004 reforms, will be examined to determine its continued effectiveness in the post-reform workers' compensation environment.

My inquiry into the costs in the workers' compensation system does not end with this Decision. Insurers will have to be as innovative and cost efficient as self-insured employers before I can agree to increase the Benchmark.

The WCIRB has gradually improved its efforts to determine the costs in the system. However, greater improvement is needed based upon the dramatic difference between the requested 23.7% request and the amount proposed by my staff. Also, my examination of the WCIRB revealed major problems that need to be rectified by the WCIRB in its rate proposals. Again, the WCIRB has not fully or adequately prepared its proposed rate change and should have taken the time to obtain and analyze the data before coming to me for a rate request just six months after I rejected and modified its previous request.

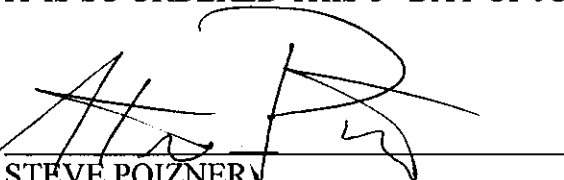
Based upon my review of the Proposed Decision, the evidence provided to me, and for the foregoing reasons, I reject the filed Benchmark change requested by the WCIRB. I also reject the attached Proposed Decision to the extent that it is inconsistent with this Decision, and accept the remainder of that document as a portion of my final disposition of this matter.

ORDER

I hereby accept in part and reject in part the attached Proposed Decision and Proposed Order of Hearing Officer Christopher A. Citko dated July 7, 2009 in the above entitled matter, as specifically explained above.

WHEREFORE, IT IS ORDERED that the Workers' Compensation Claims Cost Benchmark remain unchanged;

IT IS SO ORDERED THIS 8th DAY OF JULY, 2009.

A handwritten signature in black ink, appearing to read 'Steve Poizner', is written over a horizontal line.

STEVE POIZNER
Insurance Commissioner