Employer "Opt-Out": Assessing the Impact on Workers' Compensation Systems

By: Gregory Krohm and Matthew Bryant * © 2012, All Rights Reserved

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Introduction

The notion of allowing an employer organization to elect to not be covered by, or "opting out" of a state's workers' compensation law is not new. There are many manifestations of such an election both historically and in current workers' compensation systems. We define "opt-out" as act of an employer otherwise covered under workers' compensation law to elect not be covered by the exclusive remedy of no fault workers' compensation law.[1] This should not be confused with self-insurance, which is an election to self-fund liabilities payable under workers' compensation.[2]

Texas is the only working model for the opt-out option for private firms. There are manifold reasons for this motivation to leave the workers' compensation system. Employers with operations in Texas who have opted out of workers' compensation can cite lower employee benefit costs for their operations in Texas than in other states where they do business. In this report we will provide details on cost and other advantages of opting-out of workers' compensation.

Beyond cost savings and other benefits to employers, opting out of workers' compensation triggers changes, some potentially profound, for other stakeholders in the workers' compensation system. Some of these changes include the use of tort resolution for occupational injury compensation; the role of arbitration in occupational injury dispute resolution; reduced predictability and uniformity of benefit programs offered to injured workers as a replacement for workers' compensation; the effect of employer insolvency; and cost shifting to medical providers, government programs, and other third parties.

The purpose of this paper is to enumerate the advantages and disadvantages of opt-out for employers and employees, and to weigh these against the consequences for third parties in the workers' compensation system. We conclude this paper with recommendations for addressing problems for employees and third parties from an employer's decision to opt out.

Background

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* Gregory Krohm, B.A. (Economics) 1969, Loyola Univ., Chicago, Ill.; Ph.D. (Economics) 1972, Virginia Polytechnic Institute, Blacksburg, Va.; Matthew Bryant, B.A. (Classics) 1989, Washington & Lee Univ., Lexington, Va.; J.D. 1994, University of Texas School of Law.

[1] This election is also known as "non subscription" to a state's workers' compensation program.

[2] "Captive" insurance and traditional insurance policies with high deductibles are other alternatives to traditional insurance coverage. In all of these alternatives, however, the risk (and remedy) is clearly defined by a state's workers' compensation law.

In the early history of U.S. workers' compensation laws, some states allowed employers an election between acceptance of the administrative solution of work injuries and retaining tort resolution of liability issues. In 1911, nine states enacted the first constitutionally valid workers' compensation laws. Of these states, California, Illinois, Kansas, Massachusetts, New Hampshire, New Jersey, Ohio, and Wisconsin made coverage elective under their 1911 acts.[3] If an employer elected to not be covered, that employer was subject to tort liability without the customary defenses.[4] The election to not be covered was a deliberate attempt to blunt the constitutional objection—which defeated earlier workers' compensation laws—that mandatory participation in a no-fault compensation system deprived employers of their right to due process of law.[5] Once the constitutionality of workers' compensation was safely recognized by the U.S. Supreme Court,[6] states began to revert from voluntary to mandatory coverage. South Carolina, the last to eliminate the voluntary aspect of workers' compensation had an opt-out provision in its law from 1935. That law allowed employers to avoid workers' compensation obligations in exchange for the potential to be sued for negligence without the common law defenses of contributory negligence or assumption of risk. After the number of companies opting out increased in the early 1990s, this option was repealed in 1996.[7] In everywhere but Texas the voluntary participation feature has vanished.

It is still true that the majority of states adhere to the very early exceptions to mandatory coverage. Several classes of business are commonly excluded from mandatory participation, such as sole proprietors, partnerships, small agricultural operations, and some charitable or religious organizations. Government entities are often excluded from mandatory coverage. These excluded companies can—

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[3] See Table 4.3 in Price Fishback and Shawn Kantor, *A Prelude to the Welfare State: The Origins of Workers' Compensation*, National Bureau of Economic Research, January 2000, *available at:* http://www.nber.org/chapters/c9813.pdf.

[4] These defenses to employer liability for damages for an employee's injury include "assumption of the risk," meaning the employee willingly accepted, in exchange for wages, the risk that resulted in the injury, and "contributory negligence," meaning the employee's own actions contributed to the cause of the injury. (In many states, even a proportionally small degree of contribution serves to completely bar any recovery.). Additionally, liability could be shifted from the employer to third parties, including co-employees.

[5] See Fishback & Kantor, *supra*, at p. 93. Interestingly, as will be discussed below, there have been similar constitutional challenges with respect to some more recent proposals that seek to restrict workers' compensation benefits. For example, the Kentucky constitution prohibits the legislature from limiting "the amount to be recovered for injuries resulting in death, or for injuries to person or property." KY. CONST. § 54. In 1996, there were reforms in Kentucky that reduced workers' compensation benefits, which some argued unlawfully limited the remedy available to injured workers. See *McLain v. Dana Corp.*, 16 S.W.3d 320 (Ky. Ct. App. 1999). In fact, Kentucky's initial workers' compensation law, enacted in 1914, was determined to be unconstitutional because it did not provide an adequate remedy in light of this constitutional requirement. *Kentucky State Journal Co. v. Workmen's Compensation Bd.*, 170 S.W. 1166, *modified* 172 S.W. 674 (Ky. 1914). Opt-out proposals being advanced today seek to return injured workers and their employers to their common law tort remedies; however, many opt-out firms practice additional cost-control tactics, such as requiring waivers and arbitration agreements, that are sometimes viewed as unduly restricting the ability to recover even in tort. These tactics, to the extent authorized, or not prohibited by statute, would seemingly violate prohibitions, similar to that in Kentucky, of placing limits on a full recovery for injury.

[6] *New York Central Railroad v. White,* 243 U.S. 188, 37 S. Ct. 247, 61 L. Ed. 667 (1917).

[7] Repealed by 1996 Act No. 424, § 11 (eff. June 18, 1996).

and often do—"opt in" to the workers' compensation system by the purchase of workers' compensation insurance.

In a small way, the opt-out principle is maintained with laws that allow particular classes of employers or workers to elect against inclusion in workers' compensation. For example, almost all the states allow some corporate officers and business owners to opt out of workers' compensation coverage on their own behalf, even though their employees are covered under the law. This usually requires filing a formal election with the state. Kentucky allows individual employees to formally elect to not be covered.[8] Partnerships, sole proprietorships, and some small businesses that are below some overall employee level (usually between 2 and 5 employees) are typically exempt from mandatory coverage under the workers' compensation system. However, these exempt businesses can "opt-in" and purchase workers' compensation insurance. Finally, local governments are often given discretion as to whether they wish to be part of the workers' compensation system or remain outside of it.[9]

Opt-out in Texas

Texas is the only working model in the U.S. for allowing private employers (otherwise covered by a state's workers' compensation law) to opt out of the system.[10] However, other models have been proposed. This section describes the Texas model as well as other proposed opt-out models. In the following sections we will dissect the models to reveal strengths and weaknesses.

It is important to understand that opt-out is not analogous to self-insurance, which is permitted under workers' compensation law. It is distinctly different in terms of qualifying for and maintaining status as either a self-insured or opt-out firm:

- Opt-out firms, at least as practiced in Texas, may not be required to have a specified degree of financial strength or insurance coverage as a condition of opting out, as opposed to self-insured firms, which typically are required to provide ongoing reports demonstrating sustainable solvency as well as posting security to guarantee their obligations.
- There is no mechanism for forcing an opt-out firm to return to the workers' compensation system, while a self-insurance authorization can be revoked.

An additional, and vital, distinction between opt-out programs and self-insurance is that employees of an opt-out firm have no guaranteed benefits for occupational injury or disease. Any voluntary benefits

[8] KY. STAT. 342.395(1).

[9] In these situations where exempt businesses or local governments opt in the workers' compensation system, their employees are necessarily subject to the state's workers' compensation law, and conversely if they do not opt in, they are not covered. In these situations where coverage is not extended, it is not typical for the state to require that the non-covered employees receive any particular level of benefits.

[10] The authors could find no right of opt-out in Canada or Australia, the only countries with sub-national jurisdictional control of workers' compensation. Nor could the authors find any national system of workers' compensation that has an option for private employers to opt out, as in Texas.

that are paid to employees are at the discretion of the employer and depend on the solvency or financial ability of the employer to make payments. Such benefits are no longer governed by workers' compensation. Moreover, since the benefit plans of most private sector employers are regulated by ERISA, they are exempt from most state insurance laws.[11]

In principle, it may be possible for a jurisdiction to impose prerequisites for a firm wanting to opt out of the workers' compensation system. This would be analogous to prerequisites for self-insurance. Such a structure was proposed in Oklahoma in 2012 (discussed further below), but ultimately did not become law. But, as stated above, it is less clear as to how a firm could be required to return to coverage under workers' compensation. Presumably, legislation could expunge the right to opt-out, if there were an agency to monitor compliance and enforce the law.

As discussed below employees of Texas non-subscribers generally enjoy benefits that most of the time imitate standard workers' compensation benefits, at least for income replacement and medical treatment. However, for employers not subject to collective bargaining, benefit types and levels are discretionary for the employer. Likewise, the employer has broad discretion in describing how the plan will be administered and how disputes will be resolved.

The Texas Department of Insurance (TDI) does a survey of non-subscribers every two years. This survey is the only source of comprehensive statistics on non-subscribers in Texas. According to the most recent survey,[12] about a third of private sector employers in Texas have opted out, involving about 19% of workforce (1.7 million workers). TDI puts the number of opt-out firms in Texas at 113,000 in 2012.[13] The percentage of non-subscribers was at its highest recorded levels in 1993 and 1995, with the percentage slowly declining since then.

The mix of large versus small employers leaving the workers' compensation system shows an irregular pattern. During 2004-2008 the percentage of the largest two size categories increased, but this seems to have reversed in the 2010 survey with a sharp drop in the share of employers with 500 or more employees. The share of the largest employer size category in the 2012 survey was slightly higher, which might be due to the Wal-Mart addition to the ranks of non-subscribers.[14] According to the 2010 TDI survey, 15% of Texas businesses with more than 500 employees did not carry state workers' compensation coverage, down from 21% and 26% in the 2006 and 2008 surveys, respectively. In the

[11] ERISA, or the Employee Retirement Income Security Act, is the federal law originally enacted in 1974 to establish certain standards regarding management and delivery of employment related benefits. ERISA compliance is enforced broadly by the U.S. Department of Labor, as well as through private litigation. The very broad preemption of applying state laws to ERISA plans, and health plans in particular, is covered in "ERISA and Health Plans," Employee Benefits Research Institute, *Issue Brief* No. 167, Nov. 1995, Washington, D.C.

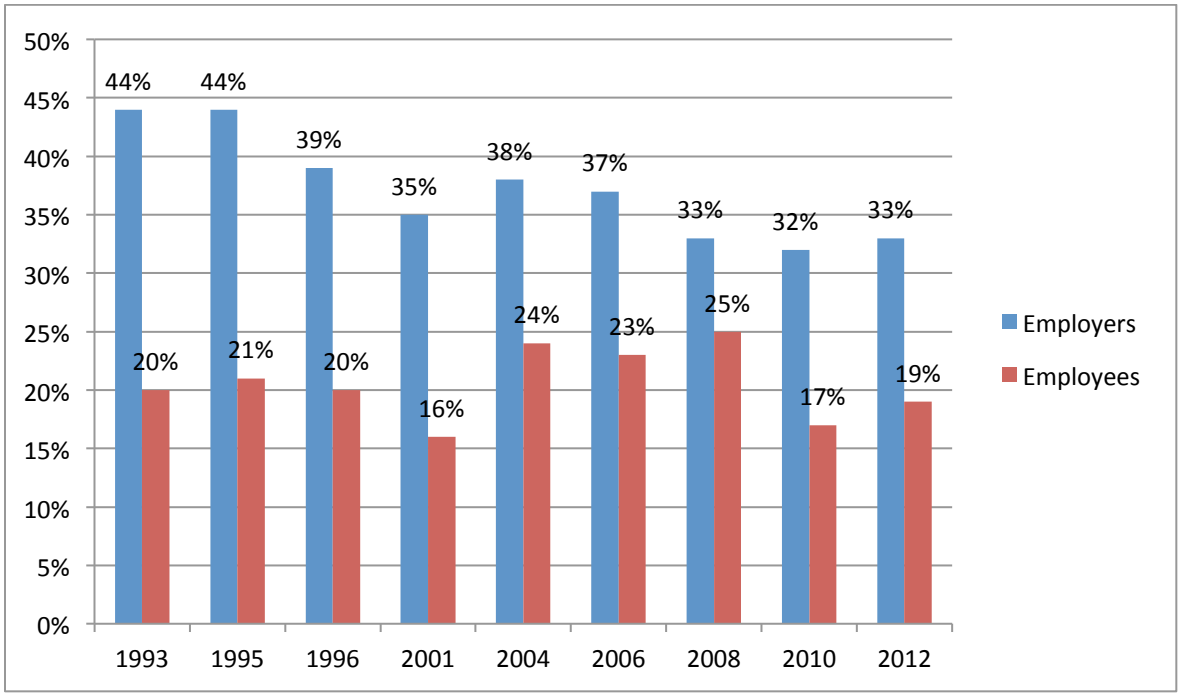
[12] Texas Department of Insurance, *Setting the Standard: An Analysis of the Impact of the 2005 Legislative Reforms on the Texas Workers' Compensation System, 2012 Results*, Austin, TX, available at: http://www.tdi.texas.gov/reports/wcreg/documents/Biennial_2012.pdf

[13] Interestingly, as indicated on the Texas Department of Insurance, Division of Workers' Compensation web page, the firms registered as non-subscribers number around 8,300. A staff member of the Department opined that a reason for this low count could be that many employers are unaware of their responsibility to register with the state. This would seem to indicate a passive approach to regulating non-subscribers.

[14] *Id.* at p. 88.

2012 survey the percentage of the largest size employers that were non-subscribers and the percentage of all Texas employees working for non-subscribers went up slightly. The fact that the largest private employer in Texas, Wal-Mart, decided to opt out of the workers' compensation system in 2012, and its closest competitor Target Stores in 2005, may not be indicative of a trend among the largest employers. The survey data is too mixed to see a clear trend.

Figure 1
Percentage of Texas Employers That Are Nonsubscribers and the Percentage of Texas Employees That Are Employed by Nonsubscribers



Source: Survey of Employer Participation in the Texas Workers' Compensation System, 1993 and 1995 estimates from the Texas Workers' Compensation Research Center and the Public Policy Research Institute (PPRI) at Texas A&M University; 1996 and 2001 estimates from the Research and Oversight Council on Workers' Compensation and PPRI; and 2004-2012 estimates from the Texas Department of Insurance, Workers' Compensation Research and Evaluation Group and PPRI.

According to the 2012 TDI survey, the following shows the rate of non-subscription, as a percentage of all private employers within eight primary industry sectors:

- Arts/Entertainment/Accommodation/Food Services -- 40%
- Finance/Real Estate/Professional Services --32%
- Health Care/Educational Services -- 35%
- Wholesale Trade/Retail Trade/Transportation -- 26%

- Agriculture/Forestry/Fishing/Hunting -- 29%
- Other Services Except Public Administration --49%
- Mining/Utilities/Construction -- 22%
- Manufacturing -- 29%

The relatively low share of non-subscribers in the Mining/Utilities/Construction and the Agriculture/Forestry/Fishing categories is plausibly related to the fact that these are the industries with the highest rates of injury. In general, injury rates in these two categories are considerably higher than the injury rates in the service sector.[15]

As for the benefits provided by non-subscribers, according to TDI, of those Texas employers who opted out, approximately half offer no benefits to injured workers. In essence, the employers have chosen to return to the pre-workers' compensation legal environment, where the only recovery of damages not voluntarily paid by the employer was from a successful lawsuit. However, as noted, such firms that offer no alternative benefits employ only about 20% of the workers within opt-out firms. According to TDI, 35% of opt-out firms offer benefits that would, at least in part, cover either health and wage replacement, or both.

As shown in a survey of over 50 Texas non-subscribers, benefits typically include:

- Paid indemnity from day 1.
- Mandatory arbitration.
- Indemnity benefits for 2 years; capped permanent benefits sometimes available.
- Benefits for death and dismemberment, often covered by an Accidental Death and Dismemberment insurance policy.

It should be emphasized that the above benefits are provided at the employer's discretion (assuming no collective bargaining). Also, the rules of administration of the plan are within the employer's control. As discussed below, this discretionary component can be beneficial to an employer, but also presents some corporate risks as well.

The potential of cost savings has been a major rationale to opt out. The 2010 TDI survey indicated that just over a quarter of non-subscribing employers elected to opt out because of high workers' compensation insurance costs. This stated rationale had dropped to 15% in the 2012 survey. The drop

[15] For example, among private employers in the U.S. in 2011, the rate per 100 full-time employees was 3.8. In "goods producing" employment, which includes natural resources and mining, construction, and manufacturing, the rate was greater than average, or 4.2 per 100; for "service providing" employment, the rate was 3.3 per 100, or 22% lower than the "goods producing" category. "Workplace Injury and Illness Summary," U.S. Dep't of Labor, Bureau of Labor Statistics (Oct. 25, 2012), *available at* http://www.bls.gov/news.release/osh.t01.htm.

in citing savings on workers' compensation insurance as a motivating factor was particularly sharp with respect to large employers.

As described below, based upon the experience of other firms in Texas, the opt-out firm can reduce both health and disability benefits (and thus costs) to below what might be owed (and paid) under workers' compensation. For example, the benefit plan for Texas' largest opt-out employer was described as follows:

> Wal-Mart's in-house plan caps total medical coverage at $300,000 for individual injuries, compared with lifetime coverage for the injury under state workers' compensation. The Wal-Mart plan provides 90 percent of lost wages for injured employees for up to 120 weeks, compared with 70 percent of lost wages for up to 401 weeks under the state system. That is a maximum of $54,000 in lost wages provided under Wal-Mart's policy (for employees that earn $500 a week), and $140,350 under state workers' compensation.[16]

The 2012 TDI survey showed that 33% of non-subscribing employers offered "occupational benefit" plans, which might include wage replacement, permanent injury compensation, and death benefits. This percentage has been sharply declining over the past few years. The TDI survey has consistently shown that larger employers have a higher propensity than smaller employers to offer ERISA health and disability plans. Only 56% of small non-subscribers offer ERISA benefit plans, compared to 95% of large employers.[17] Because large employers are so much more likely to offer occupational benefits, 71% of the employees of non-subscribers enjoy some degree of occupational benefits.[18]

Thus far we have examined the benefits to the employer from opting-out; however, opting out also comes with certain risks. One cost to employers is that they lose the protection against lawsuits afforded by workers' compensation (the "exclusive remedy" protection). If sued by an injured employee, and if a court finds the employer's negligence proximately caused the injury in any way – even if the employee's negligence played a greater role in causing the injury – the employer will likely be held fully financially responsible.[19] Over and above compensatory damages, a court may charge the employer with

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[16] *Becca Aaronson, "As Large Companies Opt Out, Concerns Grow for Workers' Compensation System," New York Times, Apr. 7, 2012, found Oct. 25, 2012 at: http://www.nytimes.com/2012/04/08/us/fears-grow-for-workers-compensation-system-as-large-texas-companies-opt-out.html.*

[17] Texas Dep't of Insurance, "Survey of Employer Participation in the Texas Workers' Compensation System," Public Policy Research Institute at Texas A&M Univ. and the Texas Dep't of Insurance Workers' Compensation Research and Evaluation Group, 2010.

[18] Texas Department of Insurance, Workers' Compensation Research and Evaluation Group, PowerPoint summary of 2012 Survey findings, October 2012, received as personal communication from member of TDI Research and Evaluation Unit, Nov. 29, 2012.

[19] As noted above, some states, such as Alabama, Maryland, North Carolina, and Virginia, bar tort recovery in situations where the plaintiff was contributorily negligent. See, e.g., *Board of Commissioners of Garrett Co. v. Bell*, 695 A.2d 171 (Md. 1997) ("Under Maryland law, contributory negligence of a plaintiff will ordinarily bar his, her, or its recovery."). In Texas, however, this defense, along with those of assumption of the risk and fellow-employee negligence, are specifically precluded in workplace accident tort actions. As described by Peyton Smith and David Johnson, *The First Step in Nonsubscriber Injury Suits*, BAYLOR L. REV. 20. (2007), p. 101), however, employers in Texas still maintain several procedural advantages in such suits, despite the absence of the defenses. This may help

punitive damages. Furthermore, there is the impact of tort defense-related legal expenses, such as attorney fees and expert witness costs, which likely are greater than the costs of defending a less formal, "summary" workers' compensation hearing.

Because immunity from civil suits was the principle reason that employer groups agreed to support workers' compensation in the formative stages of this law, it is puzzling that so many Texas employers are willing to run the risk of civil damages and legal defense costs. Apparently, the threat of lawsuits is remote enough, and liability insurance affordable enough, to make facing up to civil liability an acceptable corporate risk. In its 2001 survey of Texas Non-subscribers the Texas Research and Oversight Council found a relatively benign attitude toward litigation:

- Only 3 percent of non-subscribing employers surveyed reported that they have been sued over a work-related injury in the past five years. This is the same overall litigation rate reported in 1996.
- The majority of non-subscribers (65 percent) indicated that they were comfortable with the level of risk of lawsuit for work-related injuries their company assumes by opting out of the workers' compensation system.[20]

Discussing the civil litigation environment in Texas, one legal expert has contended that Texas appellate courts have continued to favor a narrow duty of the non-subscribing employer to its employees regarding injury prevention.[21] In addition, the application of punitive damages seems to be limited. Thus, there may be certain difficulties in Texas for an injured employee to obtain counsel and successfully prosecute such a suit unless the employer's negligence was clearly implicated in an injury. Finally, as will be discussed below, binding arbitration is a common practice, which does not eliminate the possibility of civil damages, but does offer employers a higher degree of predictability than tort litigation, if not a fair degree of control over the process, particularly when the arbitration agreement provides for employer choice of arbitrator.[22]

Another possible reason for Texas non-subscribers to be comfortable with the risk of tort suits by injured employees is that they might have rigorous safety programs, or otherwise have reduced the

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explain some assertions by industry groups that the impact on costs for Texas non-subscribers from employee tort litigation is small. See, e.g., a Texas property and casualty carrier's website, *available at*: http://www.combinedgroup.com/aboutnonsubscription, found Nov. 8, 2012 (asserting that, for certain non-subscribers with specific insurance products, "the probability of successful litigation is reduced.")

[20] Joseph Shields & D. C. Campbell, "A Study Of Nonsubscription To The Texas Workers' Compensation System: 2001 Estimates**,"** Research and Oversight Council on Workers' Compensation, Feb. 2002, Austin, Texas.

[21] Smith & Johnson, *supra*.

[22] The 2010 TDI survey reports that among all non-subscribing employers, 9% require employees to sign arbitration agreements, but that among large non-subscribers, 76% require such agreements. Of those requiring arbitration agreements, 20% provide for arbitrators who work for the employer, but are selected by both parties, and 10% provide for sole employer selection of arbitrator. Surprisingly, 39% of respondents were unaware of the arbitrator selection process. *See* "Employer Participation in the Texas Workers' Compensation System: 2010 Estimates," Texas Department of Insurance, Research and Evaluation Group, Oct. 2010, found Nov. 10, 2012 *available at*: http://www.tdi.texas.gov/reports/wcreg/documents/Non-sub%202010.pdf.

number of injuries at work. The injury rates of non-subscribers versus those in the workers' compensation system are not known. While non-subscribers are required to report lost time injuries, occupational diseases, and deaths to the Division of Workers' Compensation, a TDI staff member reports that many non-subscribing employers don't understand the concept of reporting injuries to the Division of Workers' Compensation. Apparently even large sophisticated firms mistakenly believe that by becoming a non-subscriber they could not only decide what injuries to accept, but also what injuries they had to report.

One final note about the Texas system is worth mentioning. In recent years Texas has used the rate of employer non-subscriptions as an "important indicator of the relative 'health' of the workers' compensation system since these roughly measure employers' perspectives regarding whether the benefits of participating in the workers' compensation system are greater than the costs of obtaining coverage."[23] Thus, the State views the declining participation by employers in the non-subscription option to be a good indicator of the success in reforming the Texas workers' compensation system. One component of this success is the nearly 50% reduction in workers' compensation insurance premiums since the 2005 legislative reform package. Accordingly, saving money by not buying workers' compensation insurance has sharply diminished as a reason to non-subscribe, as found in the 2012 TDI survey.

Insurance rates are by no means the only factor that affects the decision to opt out of workers' compensation. As discussed above, the discretion to design benefit and benefit delivery mechanisms is a strong appeal to some non-subscribers. Yet, dissatisfaction with the workers' compensation mechanism, including medical care delivery, benefits, and other regulatory requirements, was probably the biggest single motivation to become a non-subscriber. The comprehensive reforms of 2005 seem to have made a big difference in the attitudes of employers toward workers' compensation. The TDI survey of 2006 reported the following levels of "overall satisfaction" by employers with their current system of handling occupational injury: for insured employers 56% were satisfied overall, while for non-subscribers 70% were satisfied overall. The 2012 survey reported a sharp reversal: 72% of insured employers were satisfied overall, while 63% of the non-subscribers shared that opinion.[24]

Oklahoma Version of Opt-out

Employers in Oklahoma have lobbied strenuously for the creation of a similar option in Oklahoma. In 2012, legislation was advanced (H.B. 2155), which would have created a broad option to opt out of workers' compensation for firms that met several criteria. The measure initially advanced to and passed the Oklahoma Senate, but ultimately was narrowly defeated in the Oklahoma House in 2012.

[23] Texas Department of Insurance, *Setting the Standard: An Analysis of the Impact of the 2005 Legislative Reforms on the Texas Workers' Compensation System*, 2012 Results, Austin, TX, available at: http://www.tdi.texas.gov/reports/wcreg/documents/Biennial_2012.pdf

[24] *See* TDI report on the 2005 Texas reforms, *supra*, p. 96.

The proposed Oklahoma system was quite different than the Texas system. First, the bill's definition of "qualifying employer" for opting out included only two groups of firms: (a) those who have a workers' compensation experience modifier, as reported by the National Council on Compensation Insurance (NCCI), greater than 1.00 for the preceding insurance policy year; and (b) those who had total annual incurred claims, as reflected in an NCCI workers' compensation experience modifier worksheet or their workers' compensation carrier loss runs, greater than $50,000 in at least one of the preceding three workers' compensation insurance policy years. The rationale for only allowing employers with relatively heavy compensation losses to leave the workers' compensation system seems to have been that this would alleviate the problem of leaving the employers remaining in the system with poorer loss records and higher premium costs. But another view of this policy direction is that it exposes employees of firms with relatively poor safety records to the uncertainty of benefits administered by opt-out employers, or to pursue tort actions against them.

A second major difference between the Texas system and the Oklahoma proposal was that in Oklahoma, opt-out employers would be required to establish ERISA health and disability benefit programs that provide for a specified type and level of benefit. In particular, section 5 of H.B. 2155 mandated that all electing and qualified employers provide written benefit plans that offered essentially the same (or greater) medical benefits and disability indemnity benefits that the injured employee would otherwise receive under workers' compensation. The determination of essentially equal benefits would present an exceptional administrative challenge, especially with respect to the coverage for extremely serious injuries that involved lifetime medical and nursing care. In addition to the actuarial challenge of evaluating ERISA plans vis-à-vis workers' compensation benefits, there is the question of which state regulatory body would have the resources to monitor compliance and pursue enforcement against employers whose benefits failed to meet standards.

Reports indicate that opt-out will be pursued again in Oklahoma in the upcoming 2013 legislative session. *National Underwriter P&C*, in its August 20, 2012, article "Workers' Comp State Legislation Battles to Watch," reports that Oklahoma "will make another run at an opt-out bill." Similarly, LexisNexis, in its May 2, 2012, article "Oklahoma Opt Out Legislation Fails: A Post Mortem" by Thomas Robinson, noted that the Oklahoma "opt out legislation will likely rise and live again."

Strengths and Weaknesses

This section reviews some strengths and weaknesses of the opt-out model. We will be careful to identify the unique perspective from which some aspect of opt-out is labeled as "good" or "bad." As we will show, opting out may be an unambiguous benefit for a particular employer, but may create clear disadvantages for some workers as well as other stakeholders that may have a different perspective from the opting out firm, e.g., remaining employers in the system, insurers, medical providers, attorneys, state workers' compensation agencies, and other state agencies, programs, and funds.

Benefits of Opting-Out

The forces motivating firms to opt out of workers' compensation appear to include:

- Reduction in the total cost of injury claims.
- Greater discretion as to what occupational injury events should be covered.
- Reduced administrative costs.
- Perception of better benefits for employees.

Administrative costs in adjusting most claims should be similar to a self-insured workers' compensation program, whether administered in-house or by a TPA. There would be only minor cost savings from not having to submit claims reports to the state regulator.[25] From a rate-making perspective, the conversion of a significant pool of policyholders outside the state workers' compensation system would diminish the statistical credibility of the loss reports of the employers remaining in the system. This is not an insurmountable problem, however. The statistical agent that projects loss costs for each class code would employ other state loss experience to make up for the lost data. There may be unpredictable turbulence in the loss experience when a state first moves to an opt-out program, especially if a large and heterogeneous block of policyholders exited the program and impacted the statistical database for workers' compensation rate making.

A much bigger potential for cost difference is in the health and disability benefits payable under the private ERISA plan versus liability under workers' compensation. If cost per claim is lower for opt-out firms, is the reason because workers' compensation rules somehow inhibit the claims adjuster from getting competent medical treatment to heal injuries as quickly as possible? Or do workers' compensation rules somehow inhibit return to work? The authors are unaware of any published study of the differences in adjudicating workers' compensation claims matched with similar claims handled by firms free of the system. It seems likely that benefit costs are lower for opt-out firms largely because benefit levels typically are capped below the levels of workers' compensation.

Another motivation for opting out might be the high dispute rates and litigation costs of the workers' compensation system. Again, the authors are not aware of a published study comparing litigation rates and costs between traditional and opt-out programs. In the workers' compensation program, however, the procedures to protect the claiming rights of injured workers are often seen as inefficient, arbitrary or onerous by some employers. As discussed below under ERISA, we might presume that the employers could exercise far more control over a short-term disability insurance plan than over a workers' compensation indemnity claim. The private plan could by its own rules terminate disability for workers that failed to comply with its reporting and return to work orders. There seems to be less scope for appeal and litigation in ERISA plans. Settling cases outside workers' compensation might be more attractive, too. Resolution by settlement, a predominant feature of civil litigation, is much more

[25] In Texas, the initial accident report must be filed by the non-subscribing firm. TEX. ADM. CODE § 160.2.

restricted in the workers' compensation context; although most states allow settlements, there are varying regulations that many see as diminishing their attractiveness.

However, if litigation were extremely distasteful to employers, might well they fear a barrage of lawsuits for negligence in causing work injuries? One hypothesis is that employers do not fear excessive claims in tort because are paying for many more workers' compensation claims than they had any culpability in causing.[26] Clearly, some employers bitterly complain about paying for the carelessness or negligence of their employees. If indeed employer negligence is minimal in most injuries, employers would lose a small number of tort actions and might benefit from "going bare" without the shield of workers' compensation. More will be said about the risk to opt-out Texas employers from tort litigation.

Disadvantages of Opting-Out

There are strong advocates for the Texas opt-out system. The most fervent devotees are found in the Texas Association of Responsible Nonsubscribers, or "TXANS." TXANS seeks to "promote the use of sound and ethical practices relating to injury prevention and the provision of quality workplace injury benefits by non-subscribers to workers' compensation."[27] No doubt, there are many non-subscribers that are exemplary employers, offering generous benefits and scrupulously fair administration. But, what of other, non-TXANS member employers? What of the risk of "irresponsible non-subscription"? A weakness of the Texas system is that a non-subscriber could offer no benefit plan for employees. This puts the employees in the same position as non-subscribing employers that illegally evade their responsibility to insure.[28] It puts injured workers at risk in that even if they can successfully pursue a claim in court, their employers may be judgment proof because of poor financial condition.

Moreover, even when benefits are available, they would often leave substantial gaps in coverage for injuries or death arising out of employment. Thus, opt-out, as allowed in Texas, exposes employees of non-subscribing firms to the uncertainty and variability of employer decisions on how to compensate for occupational injuries.

An additional component of an employer's poor financial position involves ERISA plan funding. Suppose an employer offered a very good ERISA benefit plan that covered all medical care without deductibles and with long periods of wage loss from disability. Would such a generous benefit plan be the equivalent of workers' compensation? In some situations the benefit obligations may be similar; with respect to the risk of default, however, such alternative plans are not equivalent.

ERISA welfare plans

[26] One example of this involves co-morbidity impacts of obesity, frequently cited, along with the aging workforce, as a major contributor to injury occurrence and recovery.
[27] See http://www.txans.org.
[28] Most state workers' compensation programs, however, provide protection for uninsured employers, in the form on "uninsured employers funds."

The Texas Association of Responsible Nonsubscribers, and other advocates of the Texas system, cite the value of voluntary employee welfare plans in lieu of workers' compensation benefits. For this reason it is useful to focus on the nature of ERISA welfare plans, and compare these plans with workers' compensation. Virtually all employer sponsored health and disability benefits fall under the federal Employee Retirement Insurance Security Act. An ERISA welfare plan is broadly defined to include any "plan fund or program" for providing health coverage, disability income protection, severance pay or other such benefits. It applies whether the employer pays the benefits through insurance or self-funding.

There are very broad requirements established for ERISA welfare plans. The employer must supply a written document setting forth the rules on eligibility, benefits, and any exclusions or limitations on benefits. The plan must be given to all employees. A federal form must be filed for all non-subscriber injury benefit plans that cover 100 or more employees. There are penalties for non-compliance with distributing written plans to employees. There are fiduciary rules that require plan administrators to act in good faith and protect the interests of covered employees. While ERISA does not mandate benefit levels, it does require compliance with COBRA and HIPAA. Proponents of opt-out cite ERISA regulations as strong employee protections.[29] Yet, the right to see a written plan or the requirement that the administrator faithfully follow the plan seems to be a slender protection relative to the panoply of legal rights found in workers in state workers' compensation statutes.

There are three chief concerns that employees might have regarding the replacement of workers' compensation insurance with an ERISA welfare plan. These are:

1. Equivalency of benefits;
2. Rights on disputed administration of benefits; and
3. Financial solidity of benefit promises.

***Equivalency*.** Workers are exposed to new risks and uncertainties from occupational injuries if their employers opt out of the system. Below is an outline of the wage replacement and medical benefits reportedly offered by 48% of Texas non-subscribers:[30]

- 62% report that they pay wage replacement benefits.
    - Of the above, approximately 78% said employees are immediately compensated for lost wages, and 22% said there is a waiting period before wage replacement benefits begin.

[29] Bill Minick makes this claim in "Is It Time for Mandatory Workers' Compensation Coverage in Texas? Two Perspectives On Mandatory Workers' Compensation," Texas Insurance Council, 2006, *available at*: http://www.cartercompany.com/is_wc_mandatory.pdf.

[30] "Employer Participation in the Texas Workers' Compensation System: 2010 Estimates," Texas Dep't of Insurance, Research and Evaluation Group, Oct. 2010*, available at:* http://www.tdi.texas.gov/reports/wcreg/documents/Non-sub%202010.pdf.

- 73% said they pay wage replacement for the entire duration of lost time, and 27% cap wage replacement benefits by duration or amount spent on wage replacement benefits or both.

- 71% of the non-subscribers report that they offer benefits cover medical costs.
    - Of the above, 63% said they pay medical benefits for as long as medically necessary.
    - 37% cap medical benefits based on duration or amount spent on medical treatments.

Note that less than half of non-subscribers offer benefits, and an even smaller proportion offer both health and wage replacement benefits. But, for sake of discussion, assuming that an employer voluntarily elects to supply comprehensive 24-hour coverage for medical costs and lost wages from disability, it is quite possible that an employee might get better coverage from these plans than they would get under workers' compensation in Texas. This is particularly true for injuries involving short durations of lost time and with little need for medical care.

On the other hand, injured workers requiring extensive medical care likely will be subject to co-payments and deductibles not allowed under workers' compensation. Also, for workers with very long periods of disability from work injury, the extent of care required would likely exceed the disability benefits offered by their employers. According to estimates made by NCCI for countrywide experience, temporary disability for workers' compensation insurance had an average duration of 149 days (measured in the first six months of 2011).[31] This average duration would likely be covered by short-term disability insurance, which is commonly designed to provide six months of benefits. But, if an employer does not offer a separate long-term disability policy, claimants with longer than average disability will suffer uncompensated wage loss. This is not a trivial benefit gap. NCCI estimates that more than 10% of TTD claims exceed 300 days in duration.[32] Note, too, that long-term disability insurance usually pays less than the full wage replacement.

According to NCCI estimates, permanent injury accounts for 25 percent or more of workers' compensation costs. However, permanent impairments, e.g., amputation of a limb or blindness, are seldom compensated by disability insurance, nor are vocational benefits offered for workers unable to return to their previous employment due to injury. Finally, an employer may not offer employer-paid life insurance, which would deny survivors compensation they now enjoy under workers' compensation. There is no comprehensive "score card" to show how many Texas workers obtain fewer benefits under employer sponsored alternatives to workers' compensation. Using the Wal-Mart welfare plan, described above, a significant share of seriously injured workers would exceed their plan coverage for medical and lost wages.

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[31] NCCI estimates that the ultimate mean duration of TTD indemnity benefits rose from 130 days for accident year 2005 to 147 days for accident year 2009. *See* Barry Lipton, John Robertson, & Katy Porter, "Workers' Compensation Temporary Disability Indemnity Benefit Duration—2012 Update," *NCCI Research Brief*, July 2012, Boca Raton, Fla.

[32] *Id.*

A *prima facie* case can be made that health benefit plans for an opt-out employer are unlikely to cover the huge expense of catastrophic injuries or illnesses currently handled by workers' compensation. This concern is worse for the more than 65% of non-subscribers that do not offer health insurance benefits.[33] To illustrate the magnitude of large medical claims, one medical management organization cites five traumatic brain injury cases in workers' compensation that cost $801,000 to $4,920,000.[34] To provide a rough idea of the overall exposure, one actuary estimated that catastrophic medical claims are 1% of all workers compensation cases but account for 20% of the medical costs.[35]

Inevitably a small fraction of work injuries will have costs that fall outside of an ERISA programs limits. Who will pay for the costs that go uncovered by employer plans? Most likely, the injured employee and his or her family will suffer a loss in their standard of living due to a reduction of income and injury related debt. The likely sources to fill the benefit gap are charity care by hospitals and doctors, financial support from family or friends, or government insurance programs such as Title 19 and Social Security Disability Insurance.

In addition, permanently injured workers will probably have lifetime earnings losses. It would be very unusual for an ERISA benefit plan to consider this loss of future earning capacity. Say an employee had an amputation, which required medical care, therapy and several months of time away from work. The ERISA plan might cover all of these expenses, but likely would not indemnify the worker for his or her loss of job options or promotions due to the permanent impairment. For example, a skilled and experienced tradesman that loses the use of a hand would generally be forced to find a job outside the trade. Suppose a worker was permanently and totally disabled. Under the best of circumstances they would get indemnity for lost wages for a fixed period, often 6 to 12 months. After this, the permanently injured worker is uncompensated.

The duration of workers' compensation claims is another facet of this issue. It is not uncommon for workers' compensation claims to remain in active payout status for 20 or more years of indemnity benefits, and even longer for medical care. This likely would far exceed the longevity of the most generous employer ERISA welfare plans, whether insured or self-funded. Few firms exist for more than 20 years, and so too would vanish their benefit plans. Finally, return-to-work programs, which are often

[33] Based upon 52% of the non-subscribing employers offering no benefits, plus the 29% of those employers that do not offer medical benefits.

[34] Paradigm Management Services, "Complications that Drive Expenses in Medically Complex Cases," January, 2012, *available at*: http://www.paradigmcorp.com/blog/?m=201201.

[35] Steve Miller, "The Impact of Catastrophic Cases on Workers Compensation Medical Loss Reserves," Casualty Actuarial Society, 2001 Fall Forum, *available at*: http://www.casact.org/pubs/forum/01fforum/01ff281.pdf.

cited as having significant positive impact on improving outcomes for injured workers,[36] may not be as well supported in an ERISA benefit plan as it is in workers' compensation.[37]

Rights Under Disputes. Beyond benefit levels, opt-out is often viewed negatively because of the lack of procedural controls and employee rights. The opt-out employer has discretion about the level of payment it will make to a worker in case of work-related injury or illness, including wage replacement and the type and extent of medical care. Moreover, the employer has the sole authority to decide who is eligible and which injuries and illnesses are covered under the benefit plan. Disputes about benefits are initially determined by the employer.

Disputes naturally arise in the course of delivery of any employee benefit plan. If the ERISA plan is paid via an insurance contract, some state insurance laws may apply. Whether a state law is preempted by ERISA is a very complex subject, and beyond the scope of this paper.

ERISA benefit plans often include arbitration clauses that govern the way benefit disputes are settled. According to the 2012 Texas Department of Insurance survey, 14% of non-subscribers said that they ask their employees to sign an agreement (usually before injury) stating that the employee will resolve disputes through arbitration. Approximately 41% of the non-subscribers said that an employee would not receive medical or wage replacement benefits if the employee did not agree to resolve disputes through arbitration. Critics of these dispute resolution features assert they are slanted against the employee with a grievance.[38]

Information about arbitration in the Texas Department of Insurance surveys is limited, but the available information indicates that arbitration is used very differently across opt-out firms. The practical impact of this is that injured workers, seeking to recover under varied benefit programs, also must resort to varied dispute resolution mechanisms, some of which seem to use employer-only selection of arbitrator

[36] *See generally* Hunt, H.A., *The Evolution of Disability Management in North American Workers' Compensation Programs,* Upjohn Report, (2009), *available at:* http://research.upjohn.org/reports/179 (describing the improved outcomes of such programs as follows: "The employee gets back to work sooner with less wage loss and a reduced expectation of permanent impairment. The employer gets the employee back at work to minimize interference with production and with reduced costs for workers' compensation and other benefit programs.").

[37] Although the authors are not aware of any published studies or other formal evidence on the subject of the use of return-to-work among non-subscribers, it is suspected that, at least for relatively minor injuries, opt-out employers in Texas continue wages at pre-injury levels and seek return injured workers to duty to minimize economic loss.

[38] For a review of binding arbitration in health plans, and the arguments made for and against this form of dispute resolution, see: Karl Polzer, "Emerging Issues in the Use of Binding Arbitration to Resolve Disputes between Individuals and Health Plans," National Health Policy Forum, The George Washington University, Nov. 2000, Washington, DC.

mechanisms, and some of which have been found to go to "unconscionable" lengths to constrict coverage.[39]

A related concern is the intersection of arbitration agreements and waivers. Although Texas enacted legislation prohibiting pre-injury waivers, some employers continue to use them. As will be discussed in more detail below, in cases where the Federal Arbitration Act applies, these waivers, although violative of the Texas pre-waiver prohibition, have been upheld.

Since the passage of ERISA in 1974, many worker advocates have expressed deep concerns over the rights of employees to contest the handling of their claims under an ERISA welfare plan. For an ERISA plan the only legal remedy outside of the policy or plan is to ask a court to review the claim denial decision to see if there was an abuse of discretion. According to many experts, such abuse is extremely difficult to establish.[40] Moreover, proving abuse only entitles the employee to receive the benefit or service that was originally denied. Unlike an insurance policy not subject to ERISA, the indiscretion or abuse of the plan administrator cannot be sanctioned by a punitive damage award.

The concerns about ERISA appeal rights were expressed by Justice Ginsberg in her 2004 concurring opinion in *Aetna Health Inc. v. Davila*:

> Because the [Supreme] Court has coupled an encompassing interpretation of ERISA's preemptive force with a cramped construction of the . . . relief[ ] allowable under [ERISA], a "regulatory vacuum" exists: "[V]irtually all state law remedies are preempted but very few federal substitutes are provided."[41]

There is little question that health and disability plans offered under ERISA avoid many of the consumer protection requirements imposed by most state laws for health and disability insurers. In addition they deprive the plan beneficiary of some remedies in court actions against the ERISA plan administrator. A much cited 1995 memo of an executive of a disability income insurer drives home the point:

> The advantages of ERISA [to a litigation defendant] are enormous: state law is preempted by federal law, there are no jury trials, there are no compensatory or punitive damages, relief is usually limited to the amount of benefit in question, and claims administrators may receive a deferential standard of review. The economic impact . . . from having policies covered by ERISA could be significant. As an example, [we] identified 12 claim situations where we settled for $7.8

[39] See *In re Poly-America*, 262 S.W.3d 337 (2008) (finding a mandatory arbitration agreement "unconscionable" for several reasons, including limits on the remedies available to the arbitrator and significant limits on discovery during arbitration).

[40] For a recent legal analysis of employee rights in tort actions against ERISA plan administrators, see Peter Stris, *Erisa Remedies, Welfare Benefits, And Bad Faith: Losing Sight Of The Cathedral*, HOFSTRA LAB. & EMPL. L. J.26 (2009).

[41] *Aetna Health, Inc. v. Davila*, 542 U.S. 200, 222 (2004) (Ginsburg, J., concurring) (*quoting DiFelice v. Aetna U.S. Healthcare*, 346 F.3d 442, 456 (3d Cir. 2003)).

million in the aggregate. If these 12 cases had been covered by ERISA, our liability would have been between zero and $0.5 million.[42]

A major difference between ERISA plans and workers' compensation is in how the rules of due process are written. ERISA gives employers a free hand in writing the rules. In most states, the dispute resolution processes of state workers' compensation has many pro-claimant protections imposed by the legislature. Employers may regard these as obstacles to fair and expedient dispute resolution, but a contrary opinion is held by worker advocates. In workers' compensation, both sides – employer and claimant – have equal access to state appointed judges and rights of appeal. The dismal assessment of Justice Ginsberg above would not apply to appeals of workers' compensation claims before state courts. In ERISA plans, however, employers are free to develop such dispute resolution systems according to priorities established by a particular employer. Such priorities may or may not be aligned with the fairness that has come to be expected in most state workers' compensation programs.

Financial Security. The ERISA plan is only as good as its funding source. Furthermore, employers can terminate ERISA benefit plans, subject to administrative plan terms and ERISA notification requirements. If the employer becomes financially impaired and goes into Chapter 7 bankruptcy protection, its benefit plans might continue as before or be modified under the reorganization plan.[43] More likely than not the court plan may include some reduction in outgoing payments. If the firm applies for Chapter 12 bankruptcy its health and disability benefits would doubtlessly be terminated.[44] Even for those with open claims there could be a risk of default or benefit reduction under Chapter 12.

While it appears to be legally possible for a state, like Oklahoma, to mandate the benefits that an opt-out firm must offer as a condition of leaving the workers' compensation system, such mandates do not apply to a self-insured ERISA plan. In such cases the state would lose practical enforcement control over benefit amount, eligibility or delivery mechanism. Clearly, the state cannot regulate, as it can under workers' compensation, prompt delivery of promised benefits, resolve disputes over eligibility and compensation, and provide other assistance and relief to injured workers.

Workers' compensation systems in every state take extraordinary measures to guarantee payment of statutory benefits. Among the steps taken, self-insured employers not only must be sufficiently large to pay claims directly but also are required to post significant financial security as a condition of being self-insured. To further guarantee the obligations of a self-insured, some states also maintain workers' compensation self-insurance guaranty funds, financed by self-insured employers in the state, to pay

[42] Taken from evidence in an ERISA related court case. Cited by Stris, "Erisa Remedies," *supra*, at p. 389.
[43] This risk, at least theoretically, arguably is also present in traditional workers' compensation programs, however, as shown by the recent litigation surrounding GM bankruptcy. See General Motors' Bankruptcy Petition and the Impact on WC Claims Payments, June 2009*, available at* http://www.iaiabc.org/i4a/headlines/headlinedetails.cfm?id=101&archive=1.
[44] In a bankruptcy, the court would instruct the liquidator to give employees notice of cancellation of coverage and the need to supply a "proof of claim" for any health care bills not paid by the insurer. This claim may or may not be honored in full by the bankruptcy court.

benefits should a self-insured employer become insolvent. States without self-insurance guaranty funds make other self-insureds jointly and severally liable for the default of another self-insured. For commercially insured employers, the obligations of insurers to injured workers are protected from the insurer's insolvency through insurance guaranty funds. These funds exist in every state and pay 100% of benefits owed to covered workers. These considerable assurances vanish when a firm opts-out. The public policy question is then: How will employers opting-out replicate workers' compensation's 100% benefit guaranty?

Contrasting recovery in workers' compensation with ERISA plans

There are other important contrasts between workers' compensation and ERISA welfare plans, the foremost of which is the difference in the provision of medical benefits. Workers' compensation medical care is more expensive than group health plans offered by employers. Group health plans have tighter controls on what treatments will be covered, how patients can access providers, and how providers will be compensated. Also, co-payments and deductibles are powerful incentives for consumers to limit care. These efficiencies are enjoyed by non-subscribers in Texas.

However, workers' compensation medicine has features that might be lost if work injuries were treated indiscriminately from all other care. In workers' compensation, medical care tends to be more intensive if the extra expense will shorten disability. Return to work takes a central role in handling medical claims; adjusters work with providers to facilitate rapid healing and re-integration into work. One doubts whether the same emphasis is placed on return to work in non-subscriber ERISA health plans, particularly if there is no concurrent disability payment.

Workers' compensation medical care is open ended in terms of medical coverage, typically providing for lifetime treatment for work injuries, without policy limits or ceilings. Also, the scope of treatment available is quite broad, including virtually any treatment or device that will restore function, e.g., prosthetic devices or reconstructive surgery.

Another major difference between ERISA plans and workers' compensation involves what is covered. Workers' compensation law tends to take a broad view of causation of covered events. Thus, even cases of employee negligence or very weak connections to the workplace may be covered claims. Yet, there are limits to coverage and workers' compensation insurers will resist claims that they believe are outside the scope of workers' compensation law. ERISA benefit plans would generally provide health and disability benefits regardless of cause.

The timing of claims is also unique in workers' compensation. Workers can file claims for workers' compensation injuries well past the date of injury or its manifestation. They have coverage even when they leave employment by the employer implicated with the injury. Contrast this with group health plans, where a claim generally is based on the need for covered treatment, as opposed to a covered event. In workers' compensation, the insurance policy in place at the time of the injury will cover required treatment. The public policy implications of this distinction can be significant where, for

example, an employee suffers an injurious exposure at work, but the exposure manifests itself only after the employment ends. Without workers' compensation (and assuming that recovery from the employer in tort is not available), the risk of this exposure is transferred away from the employment where the injury occurred. As will be discussed further below, recovery in tort is far from routine. It is also unclear, in the non-subscription context, whether subsequent payors, such as Medicare, are subrogated to the rights of injured workers to recover in tort. In workers' compensation coverage, recovery, and the right subrogation is much more clear.

Finally, workers' compensation programs offer other benefits not typically available elsewhere. For example, vocational rehabilitation benefits, such as job re-training, are available in workers' compensation, but likely not offered by non-subscribers. Also, workers' compensation statutes typically offer job protection to workers who report workplace injuries and file claims for benefits.

Contrasting Torts and Workers' Compensation

Although there is minimal statistical evidence on the subject, anecdotal evidence suggests that tort actions in Texas against non-subscribing employers for causing work injuries are rare. At first appearance this is surprising, considering that the Texas Labor Code strips the non-subscribing employer of key defenses in a tort action over injury at work. Non-subscribers are barred from raising defenses that an employee's own negligence or the negligence of another employee contributed an injury or accident and that the employee was aware of the risk of injury and voluntarily assumed that risk.[45]

Given this loss of defenses it is logical to conclude that if an employer were only 1% negligent in causing an injury to an employee the employer would be found fully liable for damages. While this may be theoretically true, Texas courts have held employers to a seemingly narrow duty to provide a safe workplace. Several appellate court cases have held that employers have only limited duties with respect to workplace safety. For example, an employer was determined to have no duty to warn an employee of the danger of climbing over a truck gate or slipping on a wet floor. These cases would have been routinely covered by workers' compensation.

The authors know of no good statistical data on the number of legal actions brought against non-subscribing employers in Texas for either: 1) negligence in causing an occupational injury; or 2) the administration of benefits offered by an employer. Without such data it is not possible to compare the relative cost of defending such actions to the defense of disputed claims under workers' compensation. Anecdotal evidence suggests that tort actions are rare, which is plausible given the barriers to recovery in tort before the Texas courts.

The particular legal environment in Texas seems to present specific and formidable barriers to plaintiffs in tort actions against employers for negligently causing their injuries. In a recent law review article, Peyton Smith and David Johnson summarize the court cases in Texas by concluding as follows:

[45] TEX. LABOR CODE 406.033(a).

"Nonsubscriber cases are much more complicated than most attorneys think."[46] First, the Texas Supreme Court has placed strong requirements on the need to show "proximate cause" between the injury and actions or conditions required by the employer. Establishing "proximate cause" requires proof of "foreseeability" and "but-for" causation. Foreseeability typically involves some "danger" present in the action causing the harm, such that the employer should be expected to warn the employee of the danger. So, for example, carrying a 100-pound sack of potatoes is not an action that a grocery store should foresee injuring its employees.[47]

Beyond proximate cause, the Texas courts have put limiting conditions on the employer's duty to provide a safe workplace. The Texas Supreme Court has held that the employer's specific duty to an employee is conditioned on both the character of the work involved and the experience of the employee; i.e. an experienced worker need not be specifically warned about the dangers of a task. For example, in *Kroger v. Elwood*, the court considered the case of a grocery store clerk who was injured when a customer shut a car door on his hand while the clerk loaded groceries in the customer's car.[48] The court determined that the employer owed no duty to warn the clerk of the dangers of placing his hang on the car door jamb. The court concluded as follows: "Kroger had no duty to warn Elwood of a danger known to all and no obligation to provide training or equipment to dissuade an employee from using a vehicle doorjamb for leverage. Employers are not insurers of their employees."[49]

Similarly, in *Aleman v. Ben E. Keith Co.*, a delivery driver for a restaurant food supplier was injured when he slipped on a wet surface in his delivery truck and broke his leg.[50] The evidence showed that the wet surface was caused by a leaking refrigeration unit in the truck. The court concluded, however, that the employer's duty to the employee did not include providing trucks without malfunctioning refrigeration units: "Aleman produced no evidence that he was injured by the activity of failing to maintain the trailers — rather, he produced evidence that the failure to maintain the trailer caused water to be present on the floor."[51] Such legal distinctions are not generally involved in no-fault workers' compensation cases. Although this paper does not seek to describe the vagaries of coverage under workers' compensation, it is well established that "hazards of the employment" that result in injury are covered.[52]

Second, as described above, binding arbitration agreements are commonly used among non-subscribing employers in Texas. Although there is little data to analyze the difference, if any, in the outcomes of

[46] For a recent legal analysis of the risks of tort actions against non-subscribing employers in Texas, see Peyton Smith and David Johnson, "The first step in nonsubscriber employee injury suits is defining the scope of the employers' duty – it affects everything," Baylor Law Review, Spring 2007, pp. 101-133.
[47] *Great Atl. & Pac. Tea Co. v. Evans*, 175 S.W.2d 249 (1943).
[48] *Kroger v. Elwood*, 197 S.W.3d 793 (Tex. 2006); also see discussion of case in Smith & Johnson, *supra*.
[49] *Id.* at 794.
[50] 227 S.W.3d 304 (Tex. Ct. App. 2007).
[51] *Id.* at 312.
[52] *See generally* Larson, Arthur, *Workers' Compensation*, ch. 7 ("All risks causing injury to a claimant can be brought within three categories: risks distinctly associated with the employment, risks personal to the claimant, and 'neutral,' risks—i.e., risks having no particular employment or personal character. Harms from the first are universally compensable.")

injured workers who participate in such programs, as opposed to workers' compensation dispute mechanisms, it is certain that arbitration provisions vary among non-subscribing employers. At a minimum, this variability can present procedural challenges to litigants. In the workers' compensation context, procedural difficulties are no doubt present; however, Ombudsman programs, designed to provide assistance in understanding and dealing with technical difficulties, are common in workers' compensation programs. Such an "independent" voice, outside of retained legal counsel, does not appear feasible in the non-subscriber setting, particularly with widespread variability of due process.

Third, the use of waivers is a feature of opt-out that is not present in workers' compensation. As described earlier, such waivers are enforceable if appropriately created, and not unconscionable. Jason Ohana reports that a substantial share of Texas non-subscribers force their employees to sign waivers of negligence claims against their employer as a condition of receiving benefits.[53] However, in the 2001 survey of non-subscribers by the Texas Research and Oversight Council, only 7 percent of non-subscribing employers indicated that they asked their employees to sign waivers of negligence. Since waivers were more common among larger employers, an estimated 18 percent of the non-subscriber workforce was employed by firms that requested liability waivers. Also in 2001, Texas enacted legislation prohibiting pre-injury waivers, but allowing post-injury waivers under certain conditions.[54] These conditions include a "cooling off" period of at least ten days and completion of a non-emergency medical evaluation of the injured worker.[55]

Thus, an employer can construct a well-worded post-injury waiver, complying with Texas labor law, that is enforceable in court. Waivers can serve to "control" for the risk of losing the exclusive remedy protection in the non-subscription settings. However, it is far from clear how well waivers are used as a risk control measure by the many small firms that opt out of workers' compensation. The legal and human resource sophistication of a small salon or building contractor may not be quite up to the task of crafting and obtaining valid waivers.

Pre-injury waivers, although prohibited by Texas law, present an interesting intersection of federal and state law that exhibits some of the unintended consequences of shaping public policy on workplace safety issues outside the workers' compensation context. As just mentioned, non-subscribing employers in Texas often require pre-injury arbitration agreements. Before prohibition of pre-injury waivers, such agreements included waivers, and despite the prohibition, some non-subscribing employers did not re-negotiate pre-employment agreements. The result of this, however, has been of benefit to employers,

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[53] Jason Ohana, *Texas Elective Workers' Compensation: A Model of Innovation?*, 2 Wm. & Mary Bus. L. Rev. 323 (2011).

[54] Tex. Stat. 406.033(f) provides as follows: A cause of action described by Subsection (a) may not be waived by an employee after the employee's injury unless: (1) the employee voluntarily enters into the waiver with knowledge of the waiver's effect; (2) the waiver is entered into not earlier than the 10th business day after the date of the initial report of injury; (3) the employee, before signing the waiver, has received a medical evaluation from a nonemergency care doctor; and (4) the waiver is in a writing under which the true intent of the parties is specifically stated in the document.

[55] For more information on waivers, see Attorneys Logan, Mayer, & Fischer, "'Opting Out' of the Texas Workers' Compensation System: Pros and Cons of Becoming a Non-Subscriber," found Oct. 25, 2012 at: http://www.krcl.net/index.php?src=gendocs&ref=Litigation-Alert%202012%200201.

engaged in interstate commerce, that seek enforecement of pre-injury waivers. A panel of the Texas Court of Appeals, in a case where a pre-injury waiver was at issue, held that although Texas law clearly prohibited such waivers, they were allowed under federal law, which pre-empted application of the Texas law.[56]

The only publicly available evidence of which the authors are aware on the issue of tort litigation on opt-out firms comes two sources:

- The Texas Association of Responsible Nonsubscribers (TXANS) website, which provides its members with resources on this and other issues relating to opt-out. They present a qualitative picture of litigation rates, which are portrayed in a favorable light.

- A 2006 symposium published by the Texas Insurance Council. In that symposium, Bill Minick, an attorney and proponent of non-subscription stated: "Through research in court records and surveys among defense counsel, insurance carriers, third party administrators and employers, we have identified (to date) thirty-four (34) settlements or judgments against non-subscribing employers of $1 million or more. The largest judgment against a non-subscribing employer for negligence resulting in employee injury was for $22 million."[57]

Summary of Differences

The following table summarizes the differences between opt-out and workers' compensation as practiced under Texas law.

Table 1

Contrasting Texas Workers' Compensation with Non-Subscription

	Workers' Compensation	Opt-Out
Cost per injury claim	Loss costs comparable to other states*; slow increase in insurance rates	Average payout appears to be lower for both medical and disability
Medical Benefits	Unlimited cap with no copayment	**For large employers**: May meet or partially exceed the average medical payout for WC **For small employers:** Frequently no medical benefit

[56] *See In re R&R Personnel Specialists*, 146 S.W.2d 699, 705 (2004) ("The FAA preempts the nonwaiver provision of Texas Labor Code section 406.033 and any public policy underlying the Texas workers' compensation statutes that is contrary to the enforceability of arbitration agreements.").
[57] Minick, "Is it Time for Mandatory Workers' Compensation Coverage in Texas . . .," *supra.*

Wage Loss Benefits	67% percent of gross wage, subject to 7 day waiting period	**For large employers:** Meets or exceeds the WC wage replacement up to employer defined cap (less than WC) **For small employers:** Generally, no disability benefit
Dispute Resolution	Administrative law and appeal rights, with attorney fees regulated	Generally through binding arbitration, often with choice of arbitrator favoring employer
Guarantee of benefits	Insurance insolvency fund and self insured fund guarantee full payment of statutory benefits	No guarantee; even employers with ERISA plans can terminate the health or disability plan at will.

* According to the current benchmarks of the Workers Compensation Research Institute, Texas compares favorably on paid and incurred benefits per claim, but has relatively high claims expenses. See http://www.wcrinet.org/benchmarks.html

On balance, the evidence seems to point to considerable cost savings to employers from opting out of the workers' compensation system. The evidence of savings tends to come from the larger employers with sophisticated human resources programs, legal departments, and relatively good risk management programs. It is not clear how well small employers fare relative to workers' compensation when all the costs are added up, including tort actions against them.

The allure to opting out for a corporation with a very good health and safety record is obvious. They avoid paying for extremely expensive claims that are arguably not related to employment, or if they are employment related, are not due to the employers' negligence. Employers naturally struggle with paying for claims of employees who caused their own injuries through negligence. Likewise, they object to paying for health issues that are very weakly related to work. So, many cases now covered by workers' compensation would revert to employer health insurance and cost less than workers' compensation medical payments.[58] Heart attacks at work but not related to work, injuries from horseplay, injuries while on "personal comfort," injuries to traveling salesman off hours, etc., would be treated by health insurance, and may not involve any indemnity for lost time. Finally, even the most "responsible" of Texas non-subscribers can mitigate the consequences of the worst injuries. That is to say, their ERISA benefits would not match the cost of a catastrophic injury under workers' compensation, and costs would shift elsewhere.

However, the apparent gains to employers must be balanced against the adverse consequences to other stakeholders in the current workers' compensation system. In addition, parties not affected by workers' compensation might be adversely affected by uncompensated occupational injury claims, e.g., Social

[58] It is more costly to handle the same injury under workers' compensation versus group health. See John Robertson and Dan Corro*, "Workers Compensation Vs. Group Health: A Comparison of Utilization,"* NCCI Issues Brief, Nov. 2006; Casualty Actuarial Society, "Comparison of Cost Drivers in Worker's Compensation Versus Group Health," CLRS 2008 Meeting, Washington, DC, Sept., 2008, found at: www.casact.org/education/clrs/2008 /handouts/kuehn.ppt.

Security Disability Insurance, Medicare, Title 19 payments for long term nursing care, and other state or private welfare programs.

Most workers' compensation insurance companies will view the opt-out option as a threat to their ability to effectively and affordably provide coverage to those remaining in the system. The American Insurance Association has pointed to uncertainty in pricing risk on workers' compensation coverage, as well as the inability to accurately balance experience. Additionally, there will be a loss of premium revenue. However, disability income and other liability insurers likely will see an increase in premium revenue. In any case, gains and losses from different insurers should not drive public policy on this issue, and in fact many carriers are pursuing the opportunity to shift to "opt-out" policies in Texas.

Addressing Additional Impacts

Even with restrictions on the types of employers than can opt out and requirements on the type of alternative benefit structures they must offer, problems remain with respect to a firm leaving the workers' compensation system to return to civil liability for workplace injuries. There are potentially significant negative consequences for some injured workers, other employers, other insurance plans and funds, and the state taxpayers generally. These potentially negative consequences, discussed above, include: Inadequate benefits; potentially weak long-term funding benefits; difficulty recovering in civil actions; and waiver of civil remedies, even in the absence of a workers' compensation remedy. To address these, legislative proposals to allow opt-out should be prepared to resolve the following deficiencies:

- Inadequate Benefits must be sufficiently robust as to protect the vast majority of injured employees for both medical care, lost wages during disability, and vocational and rehabilitation services as needed. Neither the Texas system nor the failed Oklahoma bill had a defined benefit structure that covers the needs of injured employees with above average injury severity. Workers' compensation liability is open ended in amount and duration of payment period. This would be expensive to match in an ERISA plan, but not impossible to design.

- Benefits must be secure against default by insolvency. Employer bankruptcy would likely curtail some benefits to injured workers. Likewise, a large civil award for a seriously injured worker may trigger bankruptcy for a weakly capitalized and poorly insured firm. This places not only the seriously injured worker at risk, but also other workers at the firm with less minor claims. Even without the prospect of insolvency, benefits must not be reduced to meet the financial convenience of employers. Securing benefits can be practically achieved through the purchase of excess insurance, as done by many Texas non-subscribers.[59] Presumably, state law could require minimums for back up insurance as a condition of opting out of the workers' compensation system.

[59] At least one major insurer has created a customized insurance program for Texas non-subscribers to offer a policy that "wraps around" ERISA plans and offers broad coverage for liability for lost wages and defense costs.

- Not only should employer defenses (contributory negligence, fellow-employee negligence, and assumption of the risk) in civil actions be limited, but employers' duties to their employers should be defined in such a way to provide greater predictability in prosecuting tort claims against employers for breach of duty that caused workplace accidents. In essence, if an employee is clearly injured while working, the odds of a favorable judgment should swing heavily in the favor of the employee. Increasing the odds of recovery would also make more attorneys interested in representing tort cases.

- Employees should not be allowed to waive their rights to sue their employer as a condition of employment and ERISA benefits except under very limited circumstances. As demonstrated in Texas, state law prohibiting pre-injury waivers can be pre-empted by the Federal Arbitration Act. Thus, a change in federal law may be required to correct this problem.

- Arbitration provisions should provide some degree of predictability for injured workers seeking recover, as well as protection from what courts have found to be "unconscionable" agreements. Again, the requirements of federal law must be changed.

- Even where state protections of the rights of injured workers are not pre-empted, there must be an adequate enforcement authority to monitor compliance of firms opting-out, and to take action against firms that breach state requirements, e.g., weakening ERISA benefits or specifying arbitration clauses that violate principles of fairness.

There is potentially additional "collateral damage" to stakeholders in the system from opt-out programs that should be addressed. Even under relatively generous ERISA benefit plans, some seriously disabled workers are likely to exceed the employer benefits, if any exist. A few of the many situations in which this might occur:

- A paralyzed worker that needs nursing care for the rest of his or her life. Every so often $1million medical claims occur in every state. Most likely, if the employer does not accept responsibility under the law, or the injured worker's recovery is otherwise limited, the worker will receive indigent care under a state-administered program or Medicare.

- An injured worker leaves employment with the opt-out employer (voluntarily or involuntarily) and is left with on going medical expenses.

- An injured worker leaves employment with the opt-out employer and cannot find other employment because of his or her work injury impairment.

- By shifting occupational injury into health insurance by non-subscribers, the cost of health insurance must increase to cover the additional exposure formerly covered by workers' compensation insurance. Thus, dollars saved in workers' compensation premiums will be partially shifted back to health plans.

How will the increased demands for uncompensated care by medical providers be met? If the employer is not financially responsible, medical providers are likely to face a collection problem, especially for high

cost injuries. Seriously injured workers without any source of employer compensation are likely to present a variety of additional demands on special state health insurance plans, both for themselves and their dependents. A worker who is the major source of family income support and who becomes totally disabled from a workplace injury will present a dramatic drop in family income and potentially lead to greater dependency on public and private aid resources.

Finally, to the extent that employers with better than average safety and workers' compensation programs leave the insurance pool, the insurance rates for other employers in their industry would likely go up. This possible effect on the insurance market should not, in principle, block firms from opting out, but it should be considered as a likely consequence.

Conclusion

In conclusion, interest in opting out of coverage under workers' compensation is not a new concept. It is justified on the basis of cost saving, expedited delivery of benefits, fairness, and stimulating competition with traditional mandatory workers' compensation programs. As shown in Texas, results for employers have been considered favorable, sufficiently so to spur interest groups to action in other states. There are significant policy considerations, however, in addition to considerable impacts on injured workers, insurers, and other workers' compensation stakeholders.

Foremost among the policy considerations is the consequence of insolvency on ERISA plans, particularly those that are self-funded. The negative impacts, particularly in cases of severe injury, can be profound and result in significant and unintended socio-economic consequences. The solvency concerns and fallout to third parties are magnified in the case of employers "going bare," i.e., without liability insurance or a benefit plan. Unlike self-insurance, opt-out as practiced in Texas or in other states previously, does not have rigorous controls by the state to guaranty payment in the event of employer insolvency.

Even without the insolvency risk, the uncertainty of employees' protections against occupational injury are substantial. This uncertainty stems from the freedom of opt-employers to design and administer their health and disability plans, or to not offer benefits at all. This flexibility is undoubtedly attractive to employers, but a loss to workers. Even among the "responsible" Texas non-subscribing employers the plans for responding to occupational injury or disease are varied, inconsistent, and unpredictable. Contrast this with the standard workers' compensation insurance policy, which sets forth directly that the carrier will pay promptly when due the benefits required by the workers compensation law. This insurance contract is open ended on the limits of liability and the causes of occupational injury, as covered by law.

The workers' compensation industry has seen tremendous evolution since its inception in the U.S. in the early 20th century. This change has been driven by many factors, including reaction to unintended consequences, such as judicial coverage expansion; efforts to control costs; changes in the workplace, such as new occupational hazards; and changes to workers, such as an aging and less healthy workforce.

Another driving force is undoubtedly poor administration of workers' compensation programs. These factors, on the whole, however, are interwoven among countless industry functions and processes, containing carefully constructed levers designed to promote predictability, security, and consistency.

While opt-out has roots in the earliest workers' compensation laws, it now strikes against a historic social policy bargain between employers, workers, and the government. Opt-out is a re-alignment of the relative rights and obligations of the principals – employers and employees – and a skewing of the "great compromise" that is workers' compensation. It also represents a significant adjustment in the assignment of risk for workplace harm, not just between employer and employee, but encompassing a much wider societal context.

The issues concerning opt-out, as highlighted in this paper, should be addressed broadly, not just in terms of the cost per claim. And, the costs should be broadly construed to include third party costs. In this way, measured adoption of opt-out alternatives can be approached by the diverse collection of workers' compensation stakeholders. Without this, solutions likely will be driven by political interests. "Ad hoc opt-out," with its potential "winners and losers," bears a remarkable resemblance to the industrial and legal setting in the U.S. in the early 20th century, when the call for reform grew loud enough for widespread adoption of a relatively new approach to economic security – workers' compensation.