

**The Legal and Economic Evolution of Workers' Compensation:
Prospects for Enhancing Choice in the System**

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I. Introduction

Workers' compensation is a state-based statutory system in the United States that provides comprehensive medical and income benefits for employees who suffer work-related injuries. Under its original concept, workers' compensation provided injured workers a guaranteed recovery of scheduled income benefits and full medical coverage without regard to who was at fault in causing the injury (Epstein, 1982). In exchange, the employer (and the insurer as the employer's agent) gained immunity from litigation and the threat of compensatory and punitive damages. Essential to this *quid pro quo* was the exclusive remedy doctrine which held that the workers' compensation system must be the exclusive forum for an injured worker's redress (King, 1988).

New laws and state judicial interpretations of existing laws, however, have assaulted the traditional realm of workers' compensation and narrowed the exclusive remedy doctrine.¹ These legal developments have significantly expanded injured workers' opportunities to pursue greater awards outside of the workers' compensation system. Litigation within the system also may be increasing.² At the same time, legislative and regulatory changes have tightened eligibility requirements for benefits and facilitated medical cost controls. Changes in the market for workers' compensation insurance in the United States also have contributed to tighter controls on benefit costs. The effects of these changes on workers' coverage and incentives have not been determined, but they could be contributing to increased friction and transaction costs

¹ See Gabel, Mansfield, and Klein (1998) for a detailed review of the literature and case law that supports this statement.

² See Gabel, Mansfield and Klein (1998) for a detailed review of legal developments in workers'

within the system. These problems could undermine the foundation of the workers' compensation system and the cost control initiatives that have been implemented.

The legal and economic evolution of the workers' compensation system presents significant issues that compel a reevaluation of its structure.³ From a legal perspective, should the exclusive remedy aspect of the system be strengthened, or should alternative legal structures be established? From an economic perspective, are changes needed to reduce conflicts between the system's stakeholders, harness their incentives and expand their options to move the system towards greater efficiency? How should the legal and economic structures of the system be coordinated to achieve its goals?

This paper examines the legal evolution of workers' compensation, including state judiciary decisions and federal legislation, along with changes in workers' compensation insurance markets. We then analyze the implications of these trends for the workers' compensation system and the resulting conflicts that threaten to undermine its objectives. Finally, we evaluate two alternative paths to rebalancing and reconciling the interests of the system's stakeholders: 1) restoring the exclusive remedy doctrine and, perhaps, certain other system constraints; and 2) enhancing the choices of both workers and employers to better align their incentives and promote greater efficiency and equity. The paper concludes with a brief discussion of how further research and policy analysis might examine these and other options in restructuring the workers' compensation system.

compensation that support the argument that workers' compensation litigation is an increasing problem.

³ In 1997, the National Academy of Social Insurance established a Steering Committee on Workers'

II. The Historical Legacy of the Workers' Compensation System

This section reviews the legal and economic framework of the workers' compensation system in the U.S. It is important to understand the principles underlying the system and its objectives, in order to assess its evolution and current state. This section also examines principal-agent conflicts within the system, as well as recent cost trends and system responses, which are influencing litigation trends and changes in its legal and economic framework.

A. Legal Framework

To understand the premises underlying the workers' compensation system and how it has changed, it is helpful to briefly review its origin (see Larson, 1984). Workers in the 19th century rarely brought lawsuits against their employers for injuries sustained on the job. A prevailing fear of unemployment made employees wary of suing their employers. During this time, the standard legal defenses of assumption of risk, contributory negligence and negligence of a fellow employee insulated employers from adverse judgments. By the end of the 19th century, however, employers' dominance in work-related tort litigation gained the attention of many state legislators. As industrial accidents increased with industrial development, the demand for an efficient mechanism to secure compensation for injured workers emerged. The German compensation system, enacted in 1893, and the British Compensation Act of 1897, provided U.S. legislators with new models of compensation for work-related injuries.

Compensation composed of leading experts to examine significant issues in workers' compensation.

Despite the popularity of these foreign solutions, the first similar American compensation act, passed by Maryland in 1902, was struck down as unconstitutional. Other state courts struck down similar compensation laws on the grounds that imposing liability on employers without fault amounted to a taking of property without due process of law under state and federal constitutions. Because legislators feared court findings of unconstitutionality, they passed acts that were non-compulsory and less comprehensive than their predecessors. In a landmark decision in 1917, however, the United States Supreme Court upheld a New York compulsory workers' compensation statute that ultimately ushered in workers' compensation laws in every state.⁴

Workers' compensation in the U.S. has grown into a unique system that cannot be categorized purely under tort law or social insurance. The underlying premise of its *quid pro quo* is that the costs of industrial accidents and diseases should, like other costs of doing business, be borne by the enterprises that engendered them and ultimately their customers (Keeton, 1984?). Workers' compensation imposes a social contract between employers and employees which is intended to share its benefits in a way that maximizes their joint profits and incomes and uses price adjustments to match the residual risks assigned to each party (Epstein, 1982). The combination of the employers' strict liability and the employees' limited damages acts as a pre-arranged settlement for future claims. The legal goals of the workers' compensation system are to benefit both employees and employers by: 1) replacing uncertain outcomes with certain remedies; 2) avoiding the expenses, risks and inefficiencies of tort

⁴ New York Cent. R.R. v. White, 243 U.S. 188 (1917).

litigation; and 3) channeling workers' compensation disputes through a presumably less costly administrative system.

It is important to point out that while law and regulation establish the general provisions of the social contract underlying workers' compensation, the contract is realized in the administration of the numerous claims that are filed every year. The resolution of each claim involves employers, insurers and workers exercising their rights under the system and the relative bargaining power each has in negotiating and/or litigating claims. The decisions of administrative law judges and state courts on disputed claims also have significant implications for the resolution of these claims as well as stakeholders' actions with respect to future claims.⁵ The cumulative results of the resolution of various workers' compensation claims ultimately determine the costs and benefits of the system and how they are distributed among its various stakeholders. Hence, in addition to the provisions of workers' compensation laws and their judicial interpretation, the interests, incentives, powers and actions of the system's stakeholders affect its ultimate outcomes and what is exchanged in the social contract.

The social contract of workers' compensation has effectively evolved over time through legislative and regulatory changes, judicial decisions, and the actions of system stakeholders. This evolution is not the result of deliberate planning and formal negotiation *per se*, but rather the result of incremental legislative and regulatory changes and other actions that alter the provisions of the social contract.

⁵ For example, a judicial ruling that favors workers in seeking rehabilitation benefits increases workers' leverage in extracting concessions from employers and insurers in negotiating the monetary settlement of future claims.

B. Economic Framework

The legal framework of workers' compensation is intertwined with its economic framework (Moore and Viscusi, 1990). Workers' compensation can be viewed as a government-imposed economic bargain between employers and workers in which they share the risk and costs of work-related injuries and illnesses. Employers assume a major portion of this risk *a priori* in return for a statutorily and legally constrained set of benefits governed by detailed rules that determine workers' eligibility for benefits. Workers also assume some risk in that they are not fully compensated for their wage loss from work injuries. Benefits replace a significant portion, but not all of a worker's lost income. Hence, by design, benefit limits reduce workers' moral hazard and increase their incentive to return to work. In turn, employees receive guaranteed income and full medical benefits for qualifying injuries, even if their negligence caused the accident that led to their injury. There is a necessary tradeoff between the adequacy of and eligibility for benefits received by injured workers and the incentives to control moral hazard and the overall costs of the system.

While employers nominally pay the costs of workers' compensation benefits through insurance premiums, or directly if they are self-insured, employers and workers ultimately share the burden of these costs. Workers' compensation benefits are a labor cost and are one of several elements of the wage and benefit arrangement between employers and workers. Indeed, research by Moore and Viscusi (1990) suggests that overall increases in workers'

compensation costs have been more than offset by corresponding wage reductions.⁶

An important development affecting workers' compensation benefits and costs is the relaxation of regulatory and statutory constraints on the pricing and coverage options that insurers can offer to employers. Large deductibles, along with other pricing innovations, such as schedule rating, experience rating, loss-sensitive dividend plans, and retrospectively-rated policies, allow employers to retain a larger share of the risk and enhance their ability and incentives to control costs. On the positive side, this can encourage employers to improve workplace safety and return injured workers to productive employment. On the other hand, greater cost sharing between employers and insurers could induce some employers to hamper payment of benefits to injured workers.

Recently, many states have also allowed employers to utilize insurers' managed-care mechanisms in the treatment of work-related injuries (Hughes, 1995; NCCI, 1998). Managed care is becoming an increasingly important cost-control tool in workers' compensation. It arose from interest in constraining rising medical expenses and concern about cost shifting from health insurance to workers' compensation. There has been no explicit cap on the amount of workers' compensation medical benefits that an employee can receive, but, more recently, the states have allowed employers and insurers to implement medical cost containment mechanisms which control the provision of medical services. These mechanisms include medical fee schedules and

⁶ The amount of benefits an injured worker receives should enable the worker to live and receive adequate medical treatment without burdening others or encouraging malingering. There has been a continuing debate over the appropriate amount of workers' compensation benefits. From the late 1970's to early 1980's alone, analysts conducted over 13 major studies investigating the correlation between increased benefits and increased claim frequency (Spieler, 1994).

limits on workers' choice of medical providers. Managed care can offer greater efficiencies in the medical treatment of work injuries. It also raises issues as to quality of medical care received by injured workers and its implications for the distribution of costs and benefits between employers and workers. In theory, employers and workers should share the efficiency gains provided by managed care and other cost control initiatives. How they do so, however, depends on their relative bargaining power in negotiating workers' compensation benefit payments and overall wage/benefit packages.

C. Principal-Agent Relationships and Incentive Conflicts

The relative bargaining power between employers and workers and principal-agent conflicts are important factors in how workers' compensation is administered and how the system is evolving legally and economically. Arguably, principal-agent relationships flow in both directions between employers, insurers and workers. An employer selects and negotiates a contract with an insurer who administers benefits to workers on behalf of the employer. In turn, actions by the employer and workers affect, workplace accidents, the benefits that are paid and the costs incurred by the insurer. Consequently, each party seeks to monitor and control, with some difficulty, the behavior of the other parties whose interests sometimes conflict.

The insurer's objectives are to minimize its claims payments and other expenses and maximize profits. The employer's objectives are to also minimize its costs, including its insurance premiums, retained losses and its expenditures on loss prevention and control, and maximize profits. The injured employee's objective is to maximize the benefits the employee receives until the employee is ready to return to work. Each party will seek to promote its interests and

objectives in insurance and labor transactions and the resolution of workers' compensation claims.⁷

Moral hazard also arises from the diminished incentives for employers and workers to avoid accidents because their losses are insured. Loss-sensitive insurance pricing mechanisms help to control the problems of employer moral hazard and adverse selection associated with workers' compensation insurance and provides incentives to employers and their employees to increase safety and control costs. These pricing mechanisms tend to have a greater effect on larger employers' incentives, as smaller employers' rates are based largely on industry experience. Larger employers are more likely to retain a portion of the cost of the benefits paid to their workers and also have their rates significantly influenced by their prior claims experience. As noted above, partial wage replacement is intended to control workers' moral hazard.

D. Cost Trends and System Responses

The incremental and ad hoc legal and economic evolution of workers' compensation is reflected in its rapidly rising costs in the 1980s and early 1990s. This cost escalation was not the result of any deliberate renegotiation of the workers' compensation bargain designed to expand benefits to workers. Rather, it was the result of several developments that emerged and gained momentum through the actions of the courts and the individual stakeholders.

⁷ The incentives and actions of individual workers in pursuing workers' compensation and tort claims may conflict with the collective interests of all workers' in maintaining an efficient system. In pursuing a particular claim, a worker will have an incentive to use every means available to maximize their compensation. On the other hand, workers' in general will have an incentive to maintain a reasonable level of costs to

Analysts have identified four primary reasons for the enormous growth in workers' compensation costs during this period: 1) the system evolved to pay many benefits that were not originally contemplated, such as long-term health care, stress-related illnesses, and occupational rehabilitation; 2) medical costs grew; 3) fraudulent claims increased; and 4) litigation costs skyrocketed (Burton, 1993; NCCI, 1994; Gabel, et. al., 1998).

In absolute terms, workers' compensation costs rose by 173 percent from \$22.3 billion in 1980 to \$60.8 billion in 1993, as shown in Table 1 (Statistical Abstract, 1997). This represented, in relative terms, a cost increase from \$1.66 to \$2.17 per \$100 of covered payroll over the same period, as indicated in Figure 1. Increased costs impaired firms' competitiveness and depressed wages. Cost pressure was particularly severe for high-risk industries and brought several state workers' compensation insurance markets to the brink of collapse (Klein, Nordman, and Fritz, 1993).

Rising costs collided with employer and regulator resistance to large increases in workers' compensation insurance rates. The size of residual market mechanisms mushroomed as they became a dumping ground for price-suppressed employers, undermining cost-control incentives and exacerbating system pressures (Klein, et. al., 1993; Danzon and Harrington, 1996).⁸ As a result, the voluntary market shrank dramatically in many states as the system became increasingly unbalanced and costs escalated (NCCI, 1994). Employers faced rising

maximize the resources available to pay benefits and reduce downward pressure on wages.

⁸ Suppressed insurance prices diminished insurers' incentives to maintain safety and control costs. Also, until recent reforms were enacted, residual market servicing carriers were reimbursed for their claims management activities on a pro-rata basis that was not adjusted for performance. Hence, servicing carriers had an incentive to minimize their expenditures on the management of residual market claims, resulting in higher claim costs that were borne by residual market mechanism and the industry as a whole.

premium costs and greater difficulty in obtaining workers' compensation coverage in the voluntary market, causing a growing crisis.

This crisis threatened both employers and labor as the system's high costs impaired firms' competitiveness as well as depressed the demand for labor. This prompted business and labor groups to negotiate system reforms. Reform efforts focused on improved workplace safety, tightened eligibility requirements for benefits, and reduced expenses related to medical care and fraud (NCCI, 1994). Labor representatives generally agreed to greater cost controls in return for higher statutory benefit levels. However, labor interests retain concerns about some of the legislative changes and the cost-control measures that were implemented (**reference**). Consequently, labor, claimants' attorneys, and medical providers have mounted efforts to roll back some of the reforms that were enacted (**reference**).

It appears that these reforms have been successful in reducing cost pressures in many states, at least temporarily. Employers and insurers have utilized legislative changes and other measures to reduce costs through increased attention to loss prevention, screening of claims, improved case management, and pursuit of fraud (NCCI, 1998). Nationally, workers' compensation claim costs decreased from \$2.17 to \$1.87 per \$100 of gross earnings from 1993 to 1995 (Statistical Abstract, 1997).⁹ Insurers have filed corresponding rate decreases in many states and price competition has intensified, a development that would have been unimaginable several years earlier.

It does not appear that workers' compensation reformers, however, have yet solved the

⁹ Total costs also fell to \$57 billion.

litigation problem (Durbin and Helvacian, 1995; Roberts, 1996). Although statistical data on work-related litigation trends is limited, there are some general data available that must be interpreted with great caution. Data on attorney involvement in workers' compensation claims can be extracted from the NCCI's Detailed Claims Information (DCI) survey which records various kinds of information on a sample of closed claims every year. Data from the survey shows that the percentage of lost-time injury claims in which an attorney was involved increased from 10.4 percent for accident year 1992 claims to 13.7 percent for accident year 1995 claims (Figure 2).¹⁰ The average total incurred cost differential between claims with an attorney and claims without an attorney increased from 161 percent to 229.5 percent for the same accident years (e.g., accident year 1995 claims with an attorney had an average cost of \$20,097 compared with \$6,102 for claims without an attorney). This cost differential cannot be solely attributed to attorney involvement, as claims involving more severe injuries would be expected to have a higher incidence of attorney involvement. Also, the increase in attorney involvement could be caused in whole or in part by tightened eligibility requirements that could be eliminating marginal claims that are less likely to involve an attorney.

A better indication of the possible impact of attorney involvement on workers' compensation claims costs is provided by Durbin and Helvacian (1995) who examined data from closed claim surveys for five states for claims closed in 1989 and 1991 and eight states for claims closed in 1990 and 1992. Durbin and Helvacian examined claims involving sprain/strain

¹⁰ These data reflect the second report for each accident year to put the reported figures on a consistent basis in terms of claim development. The authors express their appreciation for the efforts of the NCCI in extracting and providing these data.

and fracture injuries and found that attorneys were involved in 70-90 percent of these claims depending on the state and the type of injury. Their research indicates that attorney involvement is associated with higher claim costs stemming from legal fees and higher benefit awards. For example, in the eight-state survey, the median cost for 1992 claims involving attorneys was 18.6 percent higher for sprain/strain injuries and 39.1 percent higher for fracture injuries.

Also, it is worth noting that loss adjustment expenses for workers' compensation claims, which include litigation costs, have climbed from 13.3 percent of losses incurred in 1987 to 24.9 percent in 1996, as indicated in Figure 3 (NCCI, 1998). Part of this increase may be due to intensified claims management activities that have substituted higher loss adjustment expenditures in return for greater savings in loss costs. However, loss adjustment expense also increased as a percentage of premiums, as Figure 3 shows. Insurers' loss costs dropped by 35.5 percent from \$21.7 billion in 1993 to \$14 billion in 1996, but loss adjustment expenses decreased by only 10.5 percent from \$3.8 billion to \$3.4 billion. The increase in relative loss adjustment expenses also is consistent with anecdotal reports of increased litigation.

At the same time, these figures do not reflect the incidence and cost of litigation related to work injuries that occurs outside the workers' compensation system. Recent legal decisions also may be harbinger of future litigation trends that are not yet reflected in claim costs. In states that allow certain legal actions to pierce their exclusive remedy provisions, the potential for enormous civil judgments looms over employers and insurers and presents a risk not contemplated when workers' compensation was established. New avenues of recovery increase workers' incentives and leverage in extracting concessions from employers under the existing workers' compensation system as benefits and eligibility requirements are tightened.

This induces workers to increasingly utilize legal representation as well as encourages claimants' attorneys to explore new avenues for litigation. Ironically, recent workers' compensation reforms could have had the unintended effect of encouraging workers to increase their reliance on legal remedies.

The generality of the data presented above and their necessary qualification reflects the need to perform more detailed and thorough research to evaluate the implications of stakeholder conflicts in the workers' compensation system. These conflicts could affect the system in a number of ways. These ways include: 1) the likelihood that a worker will file a claim; 2) the transactions costs incurred by all parties in resolving a claim; 3) the benefits paid, both for disputed and non-disputed claims; and 4) litigation and costs incurred outside the workers' compensation system. A proper assessment of stakeholder conflicts and their effects should consider these dimensions as well as control for the significant factors affecting litigation and claim costs.

If litigation is increasing because of greater friction within the system and opportunities to pursue remedies outside the system, it will have the unfortunate effect of increasing overall costs and implicitly reducing the resources available to redress worker injuries.¹¹ Indeed, the recent case law suggests that workers' compensation has begun to assume some of the "lottery" characteristics of other tort systems, such as auto and medical malpractice liability. Hence, there is reason to be concerned that the conflicts between the various stakeholders are being

¹¹ If we assume, as the research suggests, that increased workers' compensation costs tend to suppress the demand for labor and wages, then it is reasonable to surmise that workers' compensation is subject to some resource constraints. Hence, the more resources channeled to transactions costs, the less available to pay benefits and/or higher wages.

exercised in new ways in the resolution of workers' compensation claims that undermine the traditional premises on which the system has been based.

III. The Modern Legal Landscape of Injured Worker Versus Employer

If workers' compensation litigation is increasing, as many observers believe, it is not clear that it can be attributed solely to an increased number of workplace injuries. Workplace fatalities have decreased while disabling non-fatal injuries have increased in absolute terms and in relation to the number of workers (see Figure 4). At the same time, the frequency of workers' compensation claims per worker incurred by insurers has decreased since 1990 (NCCI, 1998). Hence, the perceived increase in litigation would appear to stem, in part, from a greater tendency for workers to litigate and the failure of the workers' compensation system to keep pace with legal and economic changes.

If current legal trends continue, the traditional structure of the system will continue to erode. Fewer resources will channel into prompt and secure benefits and will be siphoned, instead, into higher transaction costs and highly variable awards to injured workers. To understand the developing threat to the existing workers' compensation system, we examine the new legal landscape faced by employers and injured workers.

A. Judicially-Created Exceptions to the Exclusive Remedy Doctrine

Ironically, as state legislatures widen their workers' compensation acts to channel more injuries into the system, state judiciaries are expanding the escape routes by which injured

workers can seek redress in the courtroom (Kiser, 1983). The allure of large tort recoveries and the weakening of employers' tort defenses have encouraged injured workers to forego workers' compensation benefits and pursue recovery in tort. State judiciaries have supported increased worker lawsuits by adding new exceptions to the exclusive remedy doctrine. The new exceptions include intentional torts, dual capacity, and bad faith.

Intentional torts, in the workers' compensation context, include allegations that an employer intentionally caused a worker's on-the-job injury. Claims of intentional torts are the most common threat to the exclusive remedy doctrine nationwide. Most of the state courts that recognize exceptions for intentional torts require a showing that the employee's injury did not arise out of an accident, while other courts simply declare that their state's workers' compensation statutes do not contemplate intentional acts. Many states do not recognize an intentional torts exception at all. At the same time, states are increasingly enacting laws that make an employer liable for maintaining an unsafe workplace. Table 2 characterizes the legal status of intentional torts in the various states.

The wide variance among states with respect to exceptions for intentional torts is contrary to the workers' compensation system's objectives of uniformity and predictability. The adjudication of claims of intentional tort exposes the exclusive remedy doctrine to legislative and judicial manipulation. This increases uncertainty and potential inequity for employers and injured workers who are subject to different court interpretations of intentional tort claims.

The *dual capacity* exception applies when an employer takes on a role normally assumed by a third party, such as health-care provider or manufacturer of workplace equipment (Larson, 1984; Leonard, 1986). The dual capacity exception forces the employer to assume

liability commensurate with that of a third party instead of claiming the immunity of the exclusive remedy doctrine. The rationale behind the dual capacity exception is that the exclusive remedy doctrine should only bar suits arising out of the employment relationship.

The dual capacity exception establishes that employers acting as third parties should not escape third-party liability. The injured worker who can take advantage of the dual capacity exception, however, can obtain both workers' compensation benefits and tort damages from their employer for a single injury. Employers, under the original workers' compensation exclusive remedy doctrine, faced no such double liability. The dual capacity exception, therefore, presents an additional assault on the legal and economic structure underlying workers' compensation and contributes to higher costs.

The *bad faith* exception, however, is very different from the exceptions for intentional tort and dual capacity (Kiser, 1988; Potter and Gabel, 1996). The emergence of the bad faith exception has dramatically accelerated the erosion of the exclusive remedy doctrine. Injured workers allege bad faith for the malicious failure to commence benefits or the insupportable denial of benefits. This exception undermines the legislative *quid pro quo* more directly than any other by allowing tort litigation for on-the-job injuries that are retained within the workers' compensation system (Gabel and Feldhaus, 1997). Many jurisdictions hold that an employee's cause of action for bad faith lies not within the system of its origin, but in the courts. Because so many jurisdictions allow the courts to snatch such claims out of the workers' compensation system, bad faith is an increasingly significant factor in the relationship between injured workers and their employer. Figure 5 plots trends in their incidence of bad faith claims over the last 15 years.

Abuse of the bad faith cause of action could chill the proper administration of workers' compensation claims. Insurers must have the ability to deny or adjust workers' compensation claims according to the provisions of the law and insurance contracts. Arbitrary claim denials motivated by a slavish overemphasis on cost minimization should engender bad faith claims. However, threats of bad faith suits by claimants and their attorneys to extract concessions from insurers could undermine the legal protections afforded to employers and insurers and undercut recent cost control initiatives.

B. New Federal Rights and Remedies Available to the Injured Worker

State judiciaries and legislatures are not the sole source of erosion of the workers' compensation concept. Federal anti-discrimination legislation has provided new rights and remedies that affect injured workers. Both the Americans with Disabilities Act (ADA) and the Family Medical Leave Act (FMLA) have significant legal and economic implications for workers' compensation (Aron and DeAgazio, 1995).

1. The Americans with Disabilities Act

The ADA is a comprehensive social policy that prevents discrimination and integrates disabled citizens into the mainstream of society and the workplace. Of the ADA's four titles, Title I is most relevant to employment issues. It prohibits discrimination against a qualified individual in connection with: 1) a job application; 2) the hiring, advancement, or discharge of employees; 3) employee compensation; 4) job training; and 5) other terms, conditions and privileges of employment. A qualified individual is an individual with a disability who, with or

without reasonable accommodation, can perform the essential functions of his or her job.

The ADA was not designed to interfere with state workers' compensation systems. The Act states that it shall not "be construed to invalidate or limit the remedies, rights, and procedures of any law of any state that provides greater or equal protection for the rights of individuals with disabilities." Despite this language, the ADA does affect state remedies, particularly workers' compensation (Floyd, 1994). Workers' compensation law focuses on the extent to which an injured worker cannot perform his or her job as a result of an on-the-job accident. The ADA, on the other hand, is designed to obtain the highest possible productivity a disabled individual can offer. As noted by Martucci and Boatright (1994), "The conflict in the systems is obvious: [an injured worker] receives maximum workers' compensation benefits by proving that he or she is totally disabled, but receives maximum protection under the ADA by establishing that he or she can perform the essential functions of his or her job... ." The conflict leaves injured workers unsure of their avenue of recovery and employers unclear as to their obligations if an injured worker is disabled.

Administrative provisions under the ADA and workers' compensation create further conflicts (Walworth, 1993). The first conflict arises before a worker receives a job offer. During the hiring process, employers traditionally explore the medical and workers' compensation history of job applicants.¹² The ADA, however, prohibits inquiry into one's workers' compensation history before making a job offer. Only after offering a job can the employer

¹² In theory, this allows employers to control moral hazard and adverse selection. They can identify job applicants with a history of filing numerous workers' compensation claims and/or numerous previous injuries that reflect an increased risk of filing workers' compensation claims.

inquire into the applicant's workers' compensation history or require a medical examination. If a medical examination is required of one employee, it must be required of all employees. As a result, high-risk candidates for workers' compensation injuries cannot be identified during the hiring process without undertaking an expensive medical audit of all employees. As a result, the employer has limited ability to screen job applicants more likely to suffer a workers' compensation injury and control adverse selection and moral hazard.

The ADA and workers' compensation conflict further once an employee seeks medical care for an injury on the job. A fundamental component of workers' compensation has been complete and unlimited compensation of medical expenses.¹³ Most states mandate medical coverage for as long as the injured worker requires treatment. However, in many states, employers have been increasingly permitted to place some limits on the physicians an injured worker can choose. This "authorized treating physician" becomes the primary medical guide for employers. If the authorized treating physician releases an employee to work without need for accommodation, the employer will likely offer a return to full-time work. The employer will almost certainly seek suspension of any workers' compensation benefits at this time.

The ADA, however, gives no preference for the opinions expressed by a workers' compensation authorized treating physician. Even if the authorized treating physician finds no impairment and effectively closes the workers' compensation claim, the injured worker need only obtain an independent evaluation finding impairment to circumvent the authorized physician. The employee can then create an ADA claim out of the work-related injury, despite the control

¹³ Unlike typical health insurance coverage, workers' compensation medical benefits are not subject to deductibles, co-pays, or caps on the total amount of benefits provided.

the workers' compensation law is intended to provide an employer and its insurer with respect to an injured worker's medical treatment.

Finally, employees whose on-the-job injuries lead to any form of discrimination under the ADA are entitled to the workers' compensation benefits their states provide along with back-pay, reinstatement, front-pay, injunctive relief, attorney's fees, damages for emotional distress, punitive damages, and liquidated damages. The ADA also allows for a jury trial in cases of intentional discrimination. Because the ADA enables an injured worker to sue for workers' compensation benefits, along with tort damages and equitable relief, employers are not insulated from lawsuits as traditionally provided under workers' compensation law in return for their assumption of strict liability.

Underlying the legitimate anti-discrimination protection that is intended under ADA, moreover, is increased bargaining power for injured workers in negotiating workers' compensation claims. A worker can use this leverage to increase the value of a claim by the threat of ADA litigation, regardless of whether any discrimination has taken place.

2. The Family Medical Leave Act

Congress passed The Family Medical Leave Act (FMLA) in response to the increasing number of single-parent households and two-parent households in which both parents are employed. The FMLA provides family or medical leave to eligible employees under four circumstances: 1) the birth of a son or daughter of the employee and the need to care for the

son or daughter; 2) the placement of a son or daughter with the employee for adoption or foster care; 3) the care of a spouse, son, daughter, or parent of the employee if such individual has a serious health condition; and 4) a serious health condition that makes the employee unable to perform the functions of the employee's position.¹⁴ The availability of leave for an employee's serious health condition overlaps with workers' compensation law to the extent an on-the-job injury causes a serious health condition.

When an on-the-job injury qualifies as a serious health condition, employers face a problem integrating workers' compensation leave with FMLA leave. Department of Labor regulations provide an ostensibly simple solution by stating that "the employee's FMLA 12-week leave may run concurrently with a workers' compensation absence when the injury is one that meets the criteria for a serious health condition".¹⁵ In practice, however, employers report heavy administrative burdens (Barnett, 1997). Although FMLA contains exemptions for employers with less than 50 employees, this burden is greater for small and medium-sized companies that are not exempted. Large employers, who can have hundreds of thousands of employees off at any given time, also strain under the FMLA's medical certification and notice requirements.

Confusion over the integration of workers' compensation leave and FMLA leave worsens when the worker's absence is not continuous. FMLA leave can be taken intermittently or on a reduced leave schedule. Intermittent leave is taken in separate blocks, while a reduced

¹⁴ 29 U.S.C. 2601(b).

¹⁵ 29 C.F.R. 825.207.

leave schedule results from a change in full-time to part-time employment. An employee may take intermittent leave when it is medically necessary to care for a serious health condition. If a workers' compensation injury qualifies as a serious health condition, the intermittent leave provision of the FMLA may apply. If an injured worker, for example, requires medical treatment such as weekly physical therapy, the resulting time off from work may count as intermittent FMLA leave. The FMLA would require the employer to track the hours the employee uses for physical therapy as would most state workers' compensation laws.

In a recent survey, 6 out of 10 human resources professionals cited extensive FMLA compliance costs and one-third stated that they would like to eliminate intermittent leave entirely (Bartnett, 1997). In addition to burdensome administration, they cite the difficulty managers face tracking their employees' whereabouts, staffing temporarily vacant positions, and managing reduced productivity. Congress set no limitation on the amount of leave an employee can take intermittently or on a reduced schedule except for an annual maximum of 12 weeks. If an employee uses his or her 12 weeks in this manner, the employer may have to allocate a full-time position to an employee only working part-time. Administrative problems worsen when a chronic serious health condition stems from an on-the-job injury, bringing state workers' compensation laws into play.

The FMLA leave time provision contributes to the erosion of the workers' compensation system. Fundamental tenets of the workers' compensation system include efficiency and predictability. The FMLA's leave time provision undermines these tenets when a worker's on-the-job injury qualifies as a serious health condition.

Like the ADA, the FMLA does not defer to the workers' compensation authorized

treating physician. If the authorized treating physician finds no serious health condition and returns the employee to work, the employer may presume that the worker's claim is closed. Under the FMLA, however, the employee can seek a second opinion and shift the burden to the employer to show no serious health condition. The employer must then pay for a third and final opinion from a mutually agreed-upon physician.

While the FMLA performs the legitimate function of balancing family and workplace demands, it can create an impediment to returning injured employees to work. If an injured worker who can perform only modified work is entitled to FMLA leave, an employer cannot require that worker to take a modified job. The employer can offer the job, but cannot take action if the employee refuses. The employer may suspend workers' compensation benefits, but any FMLA claim remains viable.

Employers must also contend with the increased leverage injured workers' gain under the FMLA. Injured workers can try to extend any state limits on workers' compensation leave time with the 12 weeks provided by the FMLA. An injured worker can bring an action against an employer for alleged violations of the FMLA in any state or federal court. Employers that violate the FMLA are liable for lost wages, employment benefits, and actual monetary losses that are a direct result of wrongfully denied FMLA leave up to the equivalent of 12 weeks of wages. Additionally, employees are entitled to interest. If a court determines that an employer has acted in bad faith and has no reasonable grounds on which to claim it was not in violation, it is liable for double damages. A successful plaintiff may recover reasonable attorney fees, witness fees, and other costs of the suit. Where appropriate, plaintiffs may also receive salary or wage compensation, restoration of a previous position of employment, including all prior

benefits accrued, or promotion of the employee.

Like those remedies provided by the ADA, the FMLA gives injured workers recovery that exceeds the compensation contemplated under the original workers' compensation system along with additional legal options inconsistent with workers' compensation's *quid pro quo*. The traditional workers' compensation system is incompatible with these new remedies.

C. New Insurance Options and Federal Health Insurance Legislation

Since the advent of workers' compensation in the 1920's, there have been dramatic changes in the insurance options available and benefits provided to workers. These changes have implications for how the legal and economic objectives of the workers' compensation system can be achieved most efficiently. When the workers' compensation system was established, very few employers offered health and disability benefits to workers, and few workers purchased individual insurance coverage. If employees suffered a workplace injury, their only recourse was to sue the employer for reimbursement of their medical expenses and wage losses.

Today, most workers have employer-sponsored health plans or purchase coverage for medical expenses. Many workers also have access to short- and long-term disability coverage to protect against lost wages. Further, the rise of managed care in health insurance is forcing employers and insurers to address the interaction and coordination of workers' compensation and other health insurance benefits. Together, the expansion of health and disability insurance benefits and the development of managed care create opportunities as well as needs for greater integration as health care providers are induced to shift costs to financing mechanisms that are

subject to fewer constraints.

In April 1993, of the 112.5 million American civilians between the ages of 18 and 64 that held jobs, 73 percent of those individuals worked for an employer that sponsored a health insurance plan (EBRI, 1994). Fifty-eight percent of these employees participated in that plan. Of the 16.5 million workers who did not participate in their employer's health plan, 36 percent were denied benefits or were ineligible for benefits, and the remaining employees elected not to participate. Of those who did not participate in their employer's plan, 39 percent had other health insurance.¹⁶ Among all workers, only 16.7 million, or 15 percent, did not have health insurance (see Figure 6).

In addition, many workers have short-term and long-term disability coverage through their employers, as well as through Social Security. In 1993, 87 percent of full-time workers for medium and large private establishments had short-term disability coverage through sickness and accident insurance, paid sick leave, or a combination of both. For state and local governments and small private establishments, these figures were 96 percent and 64 percent respectively, in 1992 (EBRI, 1994).¹⁷

Coverage by private long-term disability plans is less extensive. Forty-one percent of full-time workers for medium and private establishments were covered by long-term disability

¹⁶ Generally speaking, employers' group health insurance plans do not impose underwriting restrictions on individual workers, but do contain certain eligibility requirements that new, temporary or part-time employees may not meet. Some employees may elect not to participate in their employer's health plan, either because they do not want to pay their share of the premiums in contributory plans, or because they are insured through another plan, typically that of a working spouse.

¹⁷ Short-term disability plans typically replace a portion of lost wages (e.g., 70 percent) for a period of less than a year. These plans exclude coverage for work-related injuries covered by workers' compensation.

plans in 1993 (EBRI, 1994).¹⁸ These figures were 28 percent and 23 percent for state and local governments and small private establishments, respectively, in 1992. The federal government, however, also provides long-term disability benefits to workers through the Social Security system. It is estimated that 4 out of 5 workers age 21 to 64 are covered by long-term disability (i.e., inability to work for a period of at least 12 months) under Social Security (EBRI, 1994).¹⁹ While these programs are intended to be secondary to workers' compensation benefits for work-related injuries, they reflect the breadth of programs available to compensate workers for wage loss when they are potentially unable to work (see Figure 7).

Recent federal legislation has sought to further extend the availability of health insurance coverage to uninsured workers. In August 1996, the federal Health Insurance Portability and Accountability Act (HIPAA) was enacted, which is perhaps the most significant coverage-extending legislation. HIPAA provides a number of health insurance reform measures of highly debated scope and significance. HIPAA's germane provisions allow: 1) qualified employees to maintain health coverage when they move from one employer-sponsored group health plan to another; and 2) small businesses of 2 to 50 workers to purchase group insurance plans without fear of rejection from insurance companies.

HIPAA's provisions enhance the opportunities for merging medical insurance coverage for work-related injuries and illnesses with coverage for other injuries and illnesses. However, it

¹⁸ Most employer long-term disability plans provide coverage for one to two years. However, workers can purchase supplemental disability coverage for longer periods up to age 65.

¹⁹ Social Security does impose minimum eligibility requirements for disability coverage, but most individuals who have worked for 5-10 years (depending on their age) are eligible for coverage.

also reflects the potential for the federal government to intervene in health insurance markets that could ultimately extend to the medical care provisions of workers' compensation. Federal legislators have found that HIPAA is less than a perfect solution to the problems it was intended to address, as insurers have responded to its underwriting constraints by raising rates as would be expected. Congress and the Administration have indicated a willingness to consider further restrictions on health insurance and managed care to respond to public concerns.²⁰

HIPAA reflects how changes in health insurance markets, either prompted by legislation or buyer demands, have implications for the options available to achieve the objectives of workers' compensation. The availability of various health-related insurance options has the potential to protect workers much like the existing workers' compensation system does. Given that most workers are now covered by some form of health and disability insurance, it is reasonable to ask whether it still makes sense to have a separate compensation system for on-the-job injuries. Indeed, a number of states are experimenting with variations of "24-hour coverage" which seeks to coordinate or integrate the provision of workers' compensation medical care with other health insurance coverage (NAIC, 1998).

HIPAA makes group health insurance available to cover most medical expenses. In addition, short-term and long-term disability insurance could serve the same function as workers' compensation benefits for lost income. Disability insurance, in fact, has the potential to be an even more effective mechanism for replacing income. It can be purchased to replace lost

²⁰ Congress is currently considering legislation that would regulate managed care. Also, recently President Clinton issued an executive order instructing federal agencies to consider insurers' compliance with HIPAA requirements in determining whether they will be eligible for contracts for federal health insurance coverage, including whether an insurer has increased premium rates for individuals benefiting from HIPAA's

income at a higher rate than workers compensation, which typically replaces only two-thirds of lost income with relatively tight caps for high-income workers.²¹

A comprehensive plan of coverage for workers' health care and income needs, regardless of their source, could reduce transaction costs and increase efficiency. Insurers and employers could achieve administrative efficiency by coordinating or consolidating their provision of health benefits and diminish the transaction costs involved with determining whether an injury is work-related. Increased efficiency would support social goals of assisting workers afflicted by illness or injury and encouraging rehabilitation and return to work. However, observers point out that workers' compensation provides for comprehensive case management in addressing a worker's medical and rehabilitation needs along with their return to productive employment. Interest in preserving effective case management would need to be considered in any program that would integrate medical and disability coverage for work and non-work conditions.

IV. Implications of Evolving Insurance Markets

Changes in workers' compensation insurance markets have expanded the opportunities to achieve greater efficiency in the delivery of workers' compensation services. Workers'

underwriting restrictions.

²¹ Eligibility for disability benefits tends to be stricter for long-term disability than short-term disability. Typically, a worker can receive short-term disability benefits if they are unable to perform their job. However, in order to receive long-term disability benefits, they must be unable to perform a job for which they are reasonably qualified, even if it is a different job than the one that they had performed. Long-term disability will compensate workers for any shortfall (up to the limits of the policy) in wages they suffer in performing a different job.

compensation insurers have developed new options, moving towards greater choice and lower costs. At its inception, statutory law for workers' compensation dictated a standard insurance policy. Price competition was nonexistent as state rating bureaus set uniform rates from which insurers could not deviate. Over time, however, regulatory restrictions on workers' compensation insurers have eased, following more flexible regulatory policies for other lines. As of December 1995, 19 states had competitive rating systems (file and use or use and file requirements) for workers' compensation, and most other states have relaxed requirements for adherence to uniform bureau rates.

The relaxation of pricing constraints on insurers has been accompanied by the easing of restrictions on insurers' and employers' ability to employ new cost containment measures. While insurers are still subject to greater statutory and regulatory constraints for workers' compensation than for other lines, they have been allowed to exercise increasing flexibility in price and service competition within these constraints. This is a natural response to some employers' desire and ability to control costs and policymakers' willingness to permit innovations to relieve cost pressures. Workers' compensation insurers have utilized several devices to vary the effective price of coverage for a given employer, including: 1) deviations from advisory manual loss costs/rates or separately filed rates; 2) schedule rating debits and credits; 3) loss-sensitive policyholder dividend plans; and 4) retrospective rating plans. Price competition in workers' compensation has become very aggressive as costs have declined. Product innovations such as large deductible policies, managed care, 24-hour coverage (where

permitted), and specialized loss prevention and case management services complement price competition. The overall thrust of these developments has been to offer employers an array of risk sharing and cost management options that bridge the gap between full indemnity coverage and self insurance.²²

Increased price and product competition in workers' compensation has been compelled by employers' need to control costs and competition from self-insurance options. Indeed, the proportion of workers' compensation administered through self insurance increased from 18.1 percent in 1980 to 29 percent in 1991 (Johnson & Higgins, 1992). This trend has been motivated by several factors, including the perceived efficiencies offered by self insurance as well as the avoidance of cross subsidies in the rating structure and various regulatory assessments imposed on workers' compensation insurance premiums. The evidence suggests that fierce price and product competition among workers' compensation insurers has recently attracted some self-insured employers back to insurers.

Additionally, anecdotes suggest that employers and insurance agents have been paying increased attention to employers' claims, case management, and the reserves that insurers set on their claims, which can have a significant effect on the employers' experience rating modifications and premiums. This has resulted in increased pressures on insurers to reduce claims payments, decrease claim reserves, and cut prices.

The competitiveness of the workers' compensation market is reflected in its structure and performance. Hence, it is not surprising that there has been increased price and product

²² This trend is also consistent with product innovations in other commercial insurance markets that offer insureds more risk management options.

competition as regulatory constraints have been relaxed. As shown in Table 2, data on concentration and entries and exits indicate a competitive market structure in workers' compensation, as judged by conventional economic benchmarks. A total of 357 insurer groups (a group comprises multiple companies under common ownership, as well as unaffiliated companies) sold workers' compensation insurance in 1995. The top four writers accounted for only 23.9 percent of the market, which is relatively low compared with many other insurance markets.

Significant competition is also reflected by historical loss ratios and estimated profits on insurance transactions plotted in Figure 8. Until 1993, workers' compensation insurers were clearly earning less than a fair rate of return on a calendar-year basis. In 1993, profits began to climb as costs began to drop. Profits peaked in 1995 as price decreases lagged behind decreases in claims payments. However, since 1995, price cuts have exceeded cost declines and profits have dropped.

Experts attribute the recent decline in claims costs and prices to insurers' cost control efforts, as well as legislative reforms (NCCI, 1998). Some insurer and employer measures have been facilitated by legislative changes while others have been implemented unilaterally within statutory and regulatory constraints. Together, this evidence suggests that the workers' compensation market is dynamic and responsive to changes in the economy and employer demands for greater cost control.

The implications of this dynamic insurance market for workers are less clear. Workers' ability to choose among employers and bargain for wages and benefits should enable workers to share efficiency gains from a more diverse and competitive workers' compensation market.

In actuality, workers may differ substantially in terms of their bargaining power and their ability to discern and influence employers' choices regarding workers' compensation insurers. High-skilled workers with greater bargaining power may be in a stronger position to choose employers that offer better workers' compensation services or alternatively bargain for compensating measures such as higher salaries or more generous employee benefits. Workers with low bargaining power may be forced to accept changes that effectively diminish their entitlement to workers' compensation benefits without compensating increases in wages or other employee benefits. The end result could be some diminution of and less uniformity in workers' compensation benefits and services for employees.

Employers' and insurers' greater control of benefit payments could increase the attractiveness of alternative remedies for work injuries for some workers, particularly those who perceive diminished protection from the workers' compensation system and greater opportunities through alternative remedies. Indeed, workers face a more sympathetic legal system today than they did in the 1920's. The potential for larger recoveries through tort suits may decrease workers' incentives to utilize the established workers' compensation system and increase their incentives to use alternative venues

V. Analysis of Alternatives to the Current Workers' Compensation System

The legal and economic changes to the worker's compensation system discussed above beg the question of whether and/or how should the workers' compensation system be structured and integrated with other mechanisms to address workers' health and disability

problems. We compare two alternatives: 1) restoring the original exclusive remedy doctrine, and 2) enhancing worker choice in selections of workers' compensation insurers and coverages. The first approach could constitute a return to the historical structure of workers' compensation, which placed tight constraints on the choices of all participants. Specifically, restoring the primacy of exclusive remedy might require compensating restrictions on employer and insurer flexibility, and/or increased benefit levels, to obtain labor's agreement to the legislative reforms that would have to be enacted.

The second approach contemplates a system that would provide more flexibility and choice to employers, insurers and workers in a manner that would be acceptable to all parties and that also would enhance the efficiency and equity of the system. Strengthening the exclusive remedy provision also could be coupled with enhancing worker choice in other areas. It is useful to examine both alternatives in terms of their implications for the objectives of workers' compensation and the interests of its stakeholders in the context of the changes in employee benefits and insurance markets discussed above.

A. Restoring the Exclusive Remedy Doctrine

Restoring the exclusive remedy doctrine implies that all injured workers' claims would channel through the workers' compensation system. It should be noted that, in enacting workers' compensation reform, state legislators have progressively widened the categories of injuries that fall within the workers' compensation system, implicitly reinforcing the exclusive remedy doctrine. State judiciaries charged with interpreting laws applicable to worker injuries, on the other hand, have been expanding workers' access to the tort system, thereby

undermining the exclusive remedy doctrine. If state legislatures could force the courts to adhere to the historical interpretation of the exclusive remedy doctrine in the areas where it has been pierced, it would revive the primacy of workers' compensation laws in governing the compensation provided for work-related injuries.

The ADA and FMLA could also be tailored to support a viable exclusive remedy doctrine. The EEOC and Department of Labor have already issued regulations offering guidance on the interaction between the federal laws and state workers' compensation systems. Despite the guidance offered by these regulations, exclusive remedy doctrine purists remain unsatisfied. Proponents of the exclusive remedy doctrine insist upon a reversal of the finding that the ADA and FMLA preempt state workers' compensation laws. Instead, state legislatures could incorporate the anti-discrimination protection offered by these federal statutes into their respective workers' compensation acts while limiting the resolution of disputes over these protections to the workers' compensation system. Injured workers with a disability and/or serious health condition need not receive any less anti-discrimination protection. Rather, that protection would be provided through the state workers' compensation system. Federal preemption could be retained for states that failed to enact appropriate anti-discrimination provisions as determined by federal agencies.

Reinforcing the exclusive remedy doctrine would help to promote many of the original goals of the workers' compensation system. First, supporters on the bench maintain, "exclusiveness of remedy is a rational mechanism for making the compensation system work in

accord with the purpose of the [Workers' Compensation] Act.”²³ So long as an injury is not wholly separate from the employee/employer relationship, maintaining the exclusive remedy doctrine is the only way to maintain the legislative bargain underlying the traditional workers' compensation system. Without it, the delicate balance imposing no-fault liability in exchange for tort immunity becomes illusory.

Second, restoring the exclusive remedy doctrine has the advantage of reducing litigation costs and the risk of tort damages for an on-the-job injury. The transaction costs of a claim administered through the workers' compensation system are typically lower than those of a workers' compensation or tort claim litigated through the regular court system. Workers' compensation, unlike the tort system, is unfettered by expensive determinations of fault or pain and suffering. Most importantly, workers' compensation claims have typically involved less adjudication historically, thus allowing more resources to compensate injured workers.

Finally, much of the stability of the workers' compensation system is grounded in predictability. Restoring the exclusive remedy doctrine maintains that predictability by making the avenue of recovery clear. Some commentators argue that tortious conduct can only be deterred through tort exceptions to the exclusive remedy doctrine (Achman, 1983). The fundamental flaw in such reasoning is the assumption that the exclusive remedy doctrine is synonymous with immunity. The workers' compensation system is a shield only to the extent that it confines recovery to that provided by the legislature under the workers' compensation act. So long as legislatures ensure that workers' compensation laws incorporate appropriate

²³ *Massey v. Thiokol Corp.*, 368 F.Supp. 668, 676 (S.D. Ga. 1973.).

benefits and penalties, negative behavior is deterred and the system itself remains viable.

Legislative restoration of the exclusive remedy doctrine raises the issue of the need for compensating measures that would balance the interests of employers and workers in a manner acceptable to both. Labor might require such measures to secure their political support for strengthening the exclusive remedy doctrine. Compensating measures could include higher benefit levels, greater constraints on employer and insurer cost control initiatives that are viewed negatively by workers, or enhanced choice for workers. Both sides would have to weigh the costs and benefits of such a bargain and may perceive them differently. We discuss the potential for increasing worker choice below.

Restoring the exclusive remedy raises other issues. It would enhance predictability only to the extent that it would prevent continued attempts by creative claimants' counsel to find new ways to circumvent the exclusive remedy doctrine. It also would frustrate those who see inequity in the limited recovery injured workers receive in a no-fault system. Injured workers, by design, receive only partial income replacement in order to encourage them to return to work. Accordingly, two identical injuries could result in vastly disparate recoveries, depending on whether the injury occurred on-the-job. The injured party who can sue in tort is presumably fully compensated, while the injured worker is not. The disparity of recovery between one injured at work and one injured by a third party is not addressed by simply restoring the impenetrability of the exclusive remedy doctrine. Additionally, differences in state workers' compensation laws result in differences in the benefits received by injured workers, depending

on where they live.²⁴ Perceived inadequacies in workers' compensation benefit levels in some states could result in fierce labor opposition to attempts to strengthen the exclusive remedy doctrine.

It also could be argued that the progression away from the original exclusive remedy doctrine has proceeded too far to reverse. Not only are legislatures and judiciaries at an impasse, but new cost control options probably make a return to the original *quid pro quo* unacceptable to labor without employers and insurers relinquishing access to some of the cost control measures they have obtained. As noted above, in return for agreeing to legislation restoring the primacy of exclusive remedy, labor might insist on greater restrictions on the options that employers and insurers are utilizing or could utilize to control workers' compensation costs. The end result could be a less efficient system than the one we have today, or a system we could reasonably construct that allowed more choice and greater efficiency for all participants. Hence, it is worthwhile to consider an alternative choice-based system that could take maximum advantage of options that would better align the incentives of all stakeholders and increase efficiency.

B. Enhancing Choice

If compensation for on-the-job injuries is channeled through the workers' compensation system and recent cost-control options are retained, then it is reasonable to consider measures

²⁴ The adequacy of workers' compensation benefits in some states is an issue of concern to labor and some workers' compensation experts. Economic competition among states and its effect on benefit levels could cause some states to fall behind standards recommended by the National Commission on State Workmen's Compensation Laws issued in 1972 (Burton and Schmidle, 1992).

that would compensate injured workers for confining their avenues of recovery.²⁵ Developments in workers' compensation insurance markets could facilitate enhanced worker choice in the purchase of workers' compensation services, as suggested by Barth (1983). Workers could be given some discretion in choosing a workers' compensation insurer and/or the type of coverage they receive. The most radical approach would be to allow workers the option to choose any workers' compensation insurer willing to provide coverage to them. A less radical option would be to allow workers to choose among a limited set of insurers or workers' compensation insurers/plans, akin to the choices that many employers offer for health coverage.

One obvious consideration in implementing such an approach would be workers' incentives to choose efficient and price-competitive insurers. To preserve appropriate incentives, workers would have to be subject to some form of budget constraint or have their choices limited in some other way. Given the logistical difficulties and administrative inefficiencies potentially associated with allowing workers in the same company to choose among hundreds of insurers, offering several group workers' compensation insurers/plans might be the most practical alternative. Alternative group workers' compensation plans negotiated by employers also could protect employees from being individually underwritten by insurers, which would disadvantage workers considered to be higher risk because of their age or health condition. Indeed, employees could be offered a "cafeteria plan" that included various workers' compensation, health and disability options that employees could tailor to their particular needs

²⁵ This strategy is reflected in the response of a coalition of major HMOs to proposed federal managed care legislation. The coalition is agreeable to certain benefits mandated in the legislation, including greater access to specialists, but strongly opposes provisions that would strengthen policyholders' ability to sue

and preferences. In other words, workers could choose a workers' compensation plan that involved managed care or other cost controls, or greater employee risk sharing, in return for more generous health and disability benefits as part of comprehensive and integrated coverage for injury and sickness.

The structural competitiveness of the workers' compensation insurance market would support enhancing worker choice. Competition between insurers should prompt them to be responsive worker needs, as has occurred in other areas of insurance. Further, to harness the benefits of competition for workers as well as employers, it could be argued that workers should be permitted to exercise greater direct choice in the selection of workers' compensation insurers.

Presumably, the primary objective of enhancing worker choice would be to increase insurers' incentives to provide higher quality service and be more responsive to workers' needs, subject to budget constraints negotiated between insurers, employers, and workers within statutory constraints.²⁶ It would also increase employees' ability to negotiate the terms of their workers' compensation bargain (prior to injury) and sharing the efficiency gains from reasonable and effective cost controls. Enhanced worker choice could address concerns raised by integrating health and workers' compensation coverage mechanisms that reduce the breadth of medical benefits provided under the historical workers' compensation contract. The exercise of enhanced worker choice should reduce their incentives and ability to utilize alternative remedies

HMOs and insurers in claim disputes.

²⁶ It is assumed that employers would be required to provide certain minimum workers' compensation benefits, depending on the plan chosen by a worker.

outside the workers' compensation system. On the other hand, employers may perceive that enhancing worker choice would diminish their ability to control workers' compensation costs and undermine some of the recent efficiency gains from which they have benefited. Hence, it is not obvious that employers and insurers would support enhanced worker choice relative to the situation that they currently face.

Another option would be to let workers opt for the no-fault system of workers' compensation or, alternatively, rely solely on tort remedies. In other words, a choice/no-fault system would allow injured workers to select between workers' compensation coverage (i.e., no-fault coverage) and the ability to sue in tort. The notion of choice/no-fault system for workers' compensation could be based on the automobile insurance model wherein insureds can choose at the time they purchase automobile insurance whether they want to participate in a no-fault or a tort system (O'Connell and Boost, 1986).²⁷ Before any accident, motorists in the states with a choice/no-fault system can reject no-fault coverage and retain the right to litigate automobile-related injuries. If motorists choose no-fault coverage, they have guaranteed recovery regardless of fault, but are unable to litigate. The theory behind a choice/no-fault system is to give consumers a choice instead of surrendering their choice to state legislatures which has impeded the enactment of strong no-fault systems that would be imposed on all car owners.

²⁷ Keeton and O'Connell (1965) first proposed a no-fault system for auto insurance. O'Connell and Boost (1986) subsequently proposed the choice/no-fault approach in response to state legislatures' reluctance to establish effective comprehensive no-fault systems in the face of strong opposition by the trial bar. Several states have since instituted auto choice/no-fault systems but the performance of these systems is yet difficult to discern given that were implemented only recently. There is some evidence that auto owners have been slow to choose no-fault when given the option, reducing the cost savings that can be achieved.

Under a choice workers' compensation system, those who value the right to sue would not receive the guaranteed benefits of the system nor be subject to its constraints, while those who prefer compensation without litigation could elect to participate in a true no-fault workers' compensation system. In effect, workers would elect whether or not to participate in the social contract underlying workers' compensation. Presumably, those workers who opt for a no-fault system would relinquish their right to circumvent its exclusive remedy provision through filing tort suits, but would retain the other legal remedies currently available within the workers' compensation system. In order for a choice system to be workable, workers would have to make their choice before they were injured to avoid moral hazard. A choice approach could help to support restoration of the exclusive remedy doctrine under workers' compensation as workers would have to voluntarily agree to be bound by its constraints. Whether the same cost and efficiency benefits would emerge in the choice no-fault workers' compensation system as anticipated in choice/no-fault automobile insurance is a question that requires further study, however.

A shortcoming of the choice/no-fault system is that uniformity and predictability would be substantively diminished. Employees with identical injuries working for the same employer could have dramatically different recoveries. The length of time that an employee may wait for redress also could be greatly disparate, depending on the choice he or she has exercised. Additionally, there could be significant moral hazard and adverse selection issues even if worker choice had to be exercised before an employee suffered a work-related injury or illness. For example, employees opting for workers' compensation may be less inclined to care for their own safety and employers may care less about protecting an employee for whom they have

limited liability. Of course, in the same vein, employees who have the right to sue in tort could be less inclined to return to work since the financial incentive to sue may outweigh any income the employee could earn. There also would be additional administrative costs involved with maintaining two different systems for workers. Hence, as with the notion of worker choice of insurers and workers' compensation plans, it is unclear whether employers and insurers would favor a choice/no-fault workers' compensation system.

Still, whether enhanced worker choice applies to the selection of insurers or participation in a no-fault system, it is a concept worthy of further analysis. Worker choice of insurers and benefit plans could help to secure and even expand the options available to employers and insurers and what they might offer to workers. This would allow the system to take advantage of recent and future innovations in which both employers and workers could benefit from the efficiency gains. Worker choice with respect to system participation could help to secure its no-fault nature and the *quid pro quo* between employers and workers that it embodies. In either case, greater consistency and efficiency could be achieved in a manner agreeable to both employers and workers.

VI. Conclusions

Today, the intended simple *quid pro quo* of workers' compensation is anything but simple. Workers face multiple and occasionally mutually exclusive legal avenues of recovery for on-the-job injuries, and their employers face overlapping and often conflicting liability exposure. Judicially-created exceptions to the exclusive remedy doctrine, in combination with new federal anti-discrimination protection, erode the *quid pro quo* beyond recognition. Employers face an

increased risk of litigation and damages for which workers' compensation previously granted them immunity. Injured workers, lured by large judgments and the opportunity to circumvent the constraints imposed by workers' compensation, lose the rapid and guaranteed recovery workers' compensation provided. All workers are negatively affected by the increased transaction costs caused by the current state of affairs, which siphons resources away from benefits to litigation.

At the same time, workers' compensation prevents employees from benefiting from the coverage options available for non-work related injuries and illnesses. By reconciling the emergence of insurance innovations with the objectives of workers' compensation, both employers and employees could gain and have an incentive to support an efficient and fair system. Workers' compensation, therefore, is a social contract that should be reassessed.

The alternative approaches discussed in this paper are admittedly provocative and should be carefully studied and debated. There is no assurance that business or labor interests would agree to the tradeoffs involved with either path. The likelihood of agreement is further remote without the information needed to evaluate these tradeoffs. Hence, there is a need for further research on the pertinent developments in the current workers' compensation system and the probable effects of structural changes to the system.

One area deserving of detailed study is the occurrence and implications of increased litigation over work injuries inside and outside the workers' compensation and its effects on system costs. Have recent developments increased the bargaining power of workers and their tendency to litigate? If so, how has this affected the settlement of workers' compensation claims and system costs? Secondly, we might assess the effects of recent legislative and market

changes on the distribution of costs and benefits among employers and different groups of workers. Has the historic balance of employer and worker interests in workers' compensation been altered? Have the interests of workers been positively or negatively affected, and how has this influenced their behavior? Gaining a better understanding of the answers to these questions would provide a foundation for analyzing the effects of the alternative structural changes discussed in this paper, as well as other options that might be considered.

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It should be noted that income benefit levels vary significantly among states. Many statutory provisions cause these differences, including variations in the wage replacement ratio and the relationship of the maximum benefit to the state average weekly wage (DOL, 1997). Some of these variations are caused by differences in state economies and wage levels, but they also are influenced by differences in the relative political influence of labor and business interests. Relatively low benefit levels in some states may cause increased friction and greater litigation.

Table 1
Selected States That Allow Exception for Intentional Torts

State	Conditions
Alaska (and a handful of others)	None
Maryland	Only certain torts, including false arrest, defamation, intentional infliction of emotion.
California	False imprisonment only; intentional infliction of emotional distress not allowable cl
Delaware	Only if committed by employer
Florida	If committed by employer or alter ego

Table 2
Status of Independent Bad Faith Action By State

State	Allows Independent Bad Faith Action	Year
Alabama	No	
Alaska	Yes	1974
Arizona	No	1977
Arkansas	No	1962
California	Yes	1972
Colorado	Yes	1985
Connecticut	No	1985
District of Columbia	Unclear	1985
Delaware	Yes	
Florida	No	1971
Georgia	No	1996
Hawaii	Yes	1996
Idaho	No	1996
Illinois	Yes	1975
Indiana	No	1987
Iowa	No	1983
Kansas	No	1984
Kentucky	No	1986
Louisiana	No	1981
Maine	Yes	1978
Maryland	No	1984
Massachusetts	No	
Michigan	Yes	1978
Minnesota	Yes	1987
Mississippi	Yes	1984
Missouri	Yes	1979
Montana	Yes	1980
Nebraska	Unclear	
Nevada	Unclear	
New Hampshire	Unclear	
New Jersey	No	1987
New Mexico	Yes	1988
New York	No	1984
North Carolina	Unclear	
North Dakota	Unclear	
Ohio	Yes	1985
Oklahoma	No	
Oregon	No	
Pennsylvania	No	1988
Rhode Island	No	
South Carolina	No	1977
South Dakota	Yes	1987

Tennessee	No	
Texas	Yes	1988
Utah	No	
Vermont	Unclear	
Virginia	Unclear	
Washington	Yes	1987
West Virginia	Unclear	
Wisconsin	Yes	1979
Wyoming	Unclear	

Table 3
Workers' Compensation Premiums and Benefits
1980-1995

Year	Premium Amounts Paid (\$B)					Annual Benefits Paid (\$B)			
	Private Carriers	State Funds	Federal Programs	Self-Insurers	Total	Private Carriers	State Funds	Self-Insurers	Total
1980	15.7	3.0	1.1	2.4	22.3	7.0	4.3	2.3	13.6
1985	19.5	3.5	1.7	4.5	29.2	12.3	5.7	4.1	22.2
1987	25.4	5.3	1.8	5.5	38.1	15.5	6.8	5.1	27.3
1988	28.5	6.7	1.9	6.2	43.3	17.5	7.5	5.7	30.7
1989	31.9	7.2	2.0	6.9	48.0	19.9	8.0	6.4	34.3
1990	35.1	8.0	2.2	7.9	53.1	22.2	8.7	7.4	38.2
1991	35.7	8.7	2.1	8.7	55.2	24.5	9.7	7.9	42.2
1992	34.5	9.6	2.5	10.8	57.4	25.3	10.7	9.7	45.7
1993	35.6	10.9	2.5	11.8	60.8	24.1	10.6	10.6	45.3
1994	34.0	11.1	2.5	12.8	60.4	22.6	10.6	11.5	44.7
1995	31.6	10.4	2.6	12.4	57.0	21.4	10.9	11.2	43.5

Source: Statistical Abstract

Table 4
Workers' Compensation Market Structure
1995

Direct Premiums Written (\$B)	32.1
Number of Insurers*	357
Market Concentration	
Top 4 Writers	23.9%
Top 8 Writers	38.0%
Top 20 Writers	56.9%
HHI	248
Entry/Exit (1991-1995)**	
Entries	146
Exits	125
Net Change	21

* Number of insurer groups

** Based on insurance companies

Source: NAIC Database

Figure 1
Workers' Compensation
Benefits and Costs as Percent of Payroll

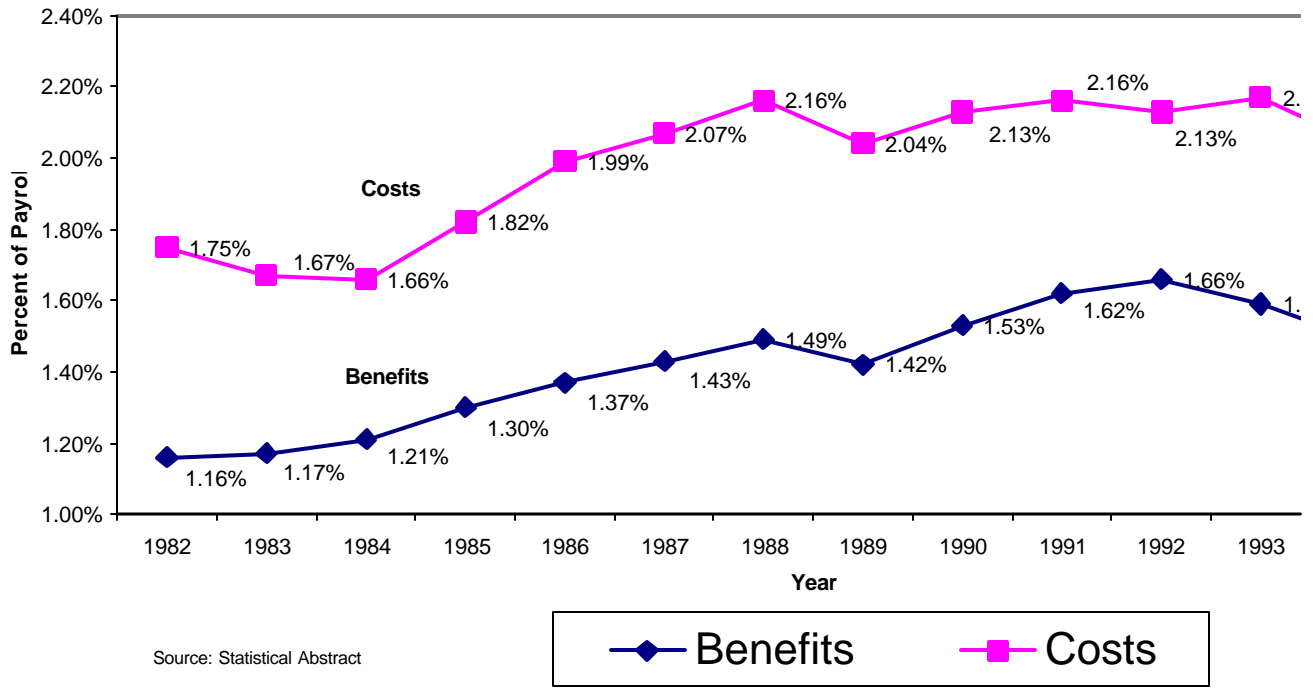
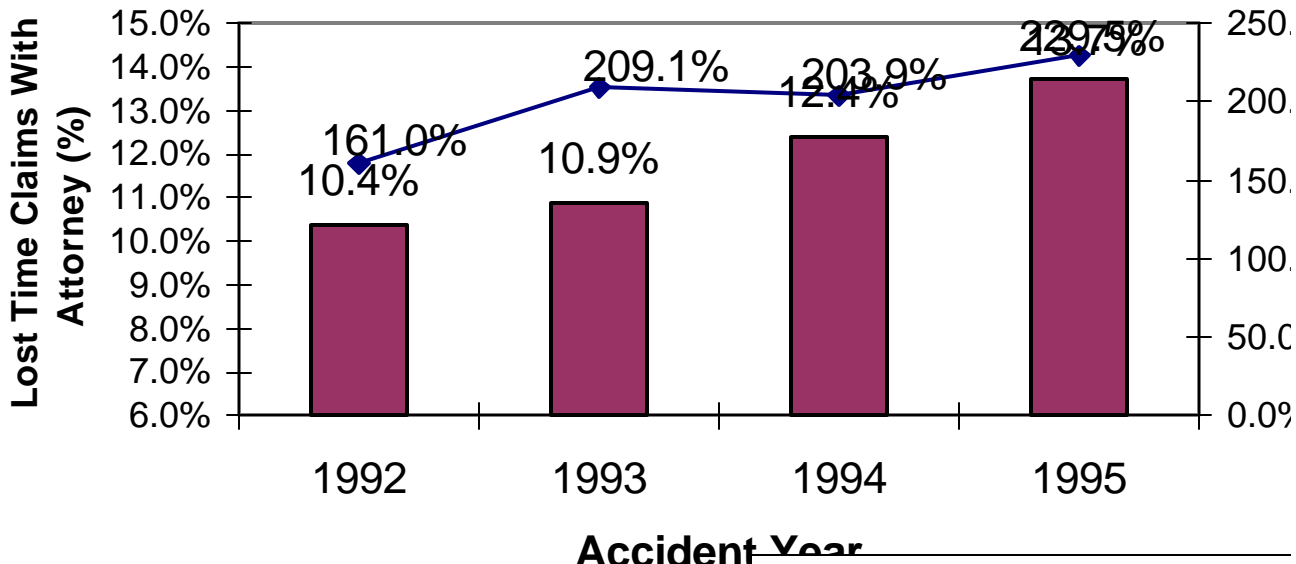


Figure 2

Workers' Compensation Attorney Involvement

Detailed Claim Information Survey - 2nd Report



Source: National Council on Compensation Insurance

Att. In. % Cost Dif.

Figure 3
Workers' Compensation Loss Adjustment Expenses

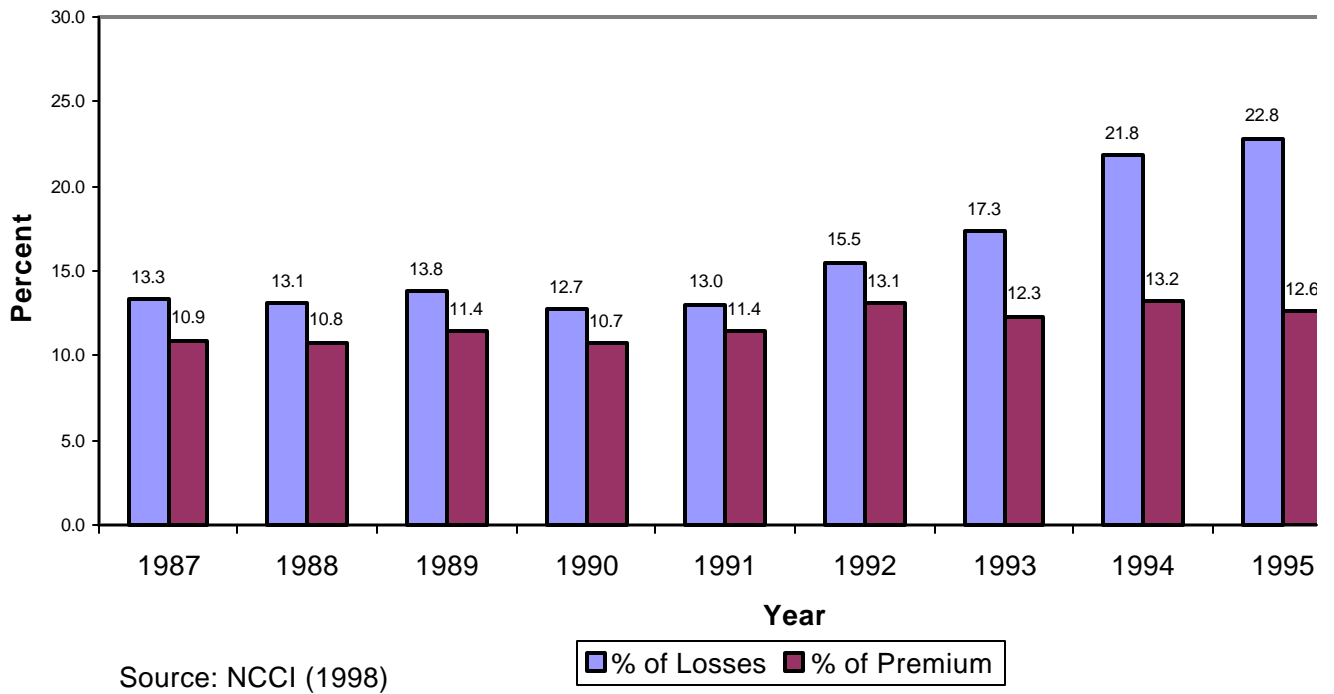


Figure 4
Workers' Compensation Rate of Return on Net Worth

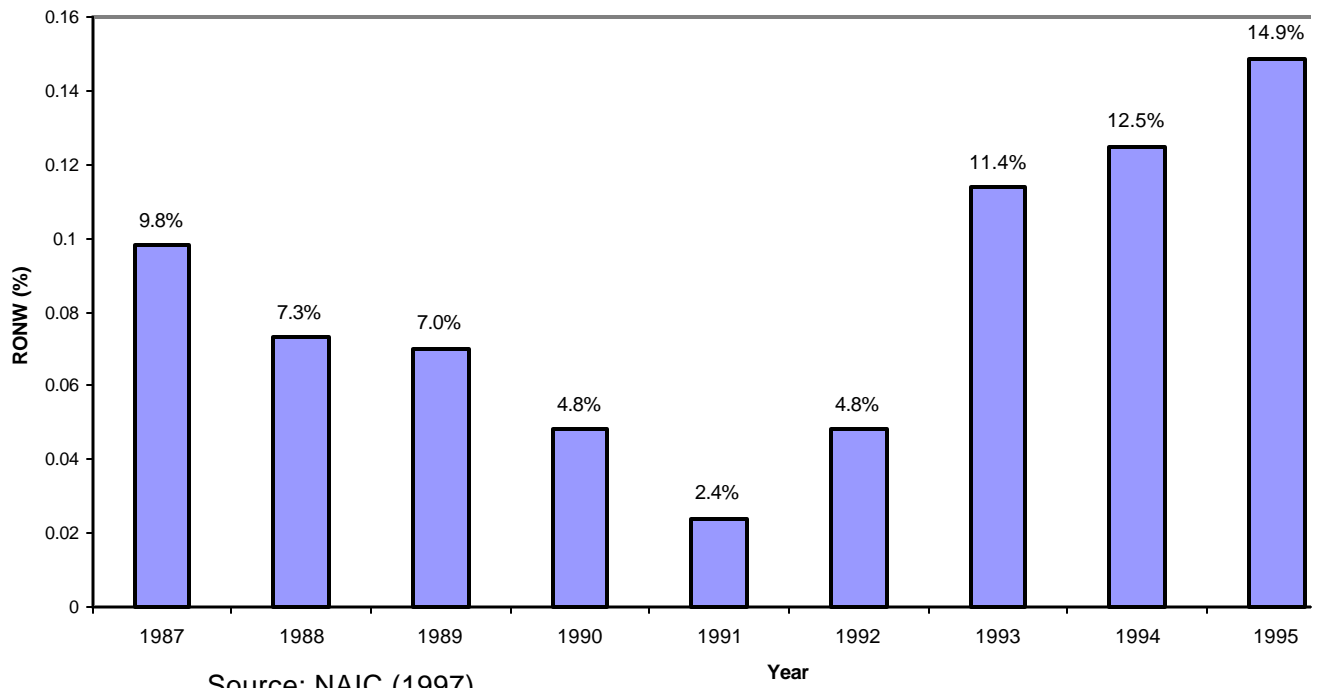
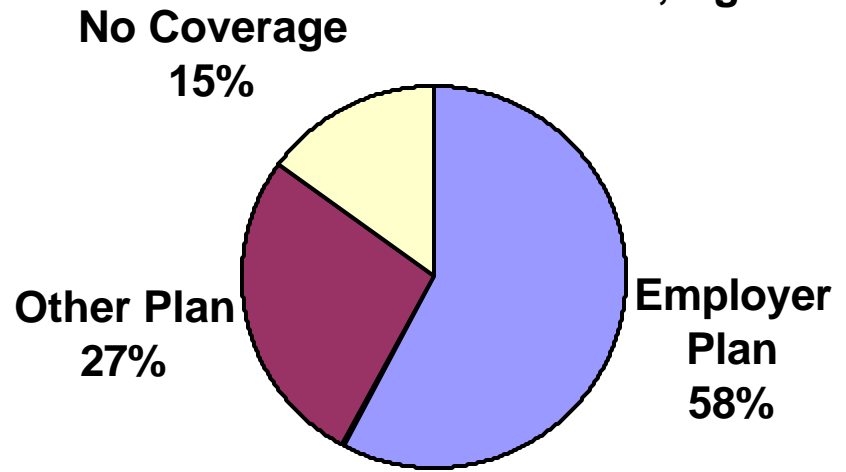


Figure 5
Health Insurance Coverage of Workers

112.5 million, Age 18-64, 199

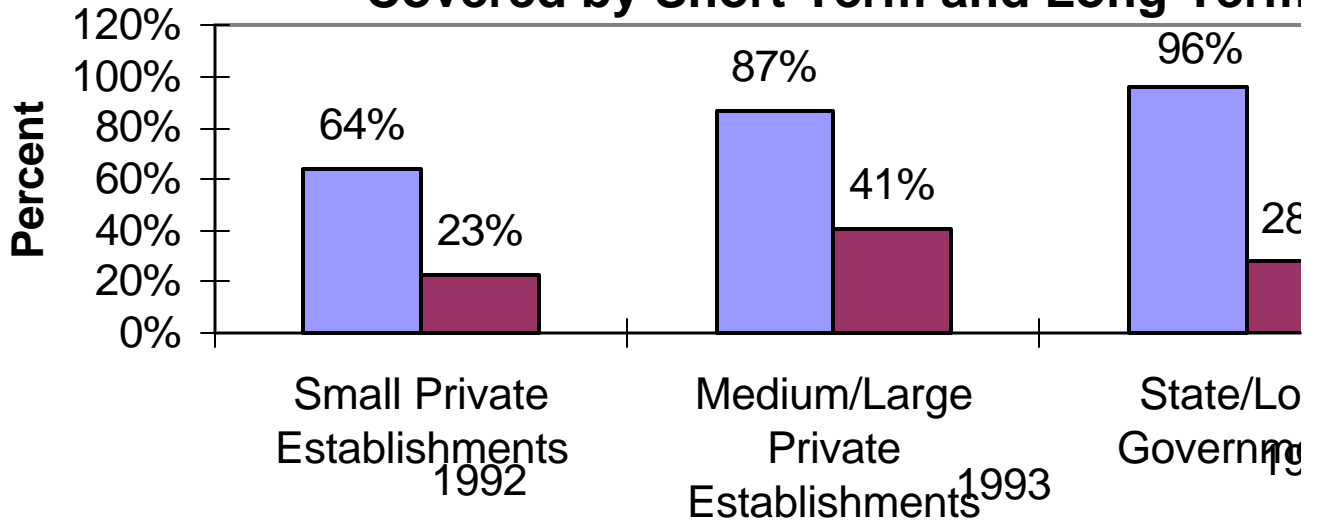


Source: EBRI (1994)

Figure 6

Percentage of Full-Time Employees

Covered by Short-Term and Long-Term



Source: EBRI (1995)

■ Short-Term Disability ■ Long-Term Disability