

EXPLORING NONSUBSCRIPTION

An Overview of Nonsubscription To Workers' Compensation in Texas

Presented by:

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An Overview of Nonsubscription to Workers' Compensation

Background and History

In the early 1900's before the enactment of workers' compensation, several employers including Western Electric, GE, International Harvester, Westinghouse and Carnegie Steel utilized injury benefit plans to outline compensation for injured workers. In 1910 a plan adopted by International Harvester stated as its objective: *"to ensure that employees at the works, twine, steel and lumber mills, and on the railroads, prompt, definite and adequate compensation for injuries resulting from accidents occurring to them while engaged in the performance of their duties: and to provide compensation for the widow, children and relatives who may be dependant upon any employee whose death occurs from such accident. The benefits provided for by this plan will be paid regardless of legal liability on the part of the company, and no injured employee will require legal assistance to collect the money to which he is entitled."*

The federal government also commended Carnegie Steel on the establishment of an injury benefit and pension fund. *"This fund was created by Mr. Andrew Carnegie in 1901, and provides accident and death benefits and pension allowances for employees of the Carnegie Steel Company and its constituent companies. It is not incorporated. The employees in no way contribute to the fund, Mr. Carnegie having created a endowment of four million dollars of the Carnegie Company bonds, the income from which supplies the annual income of the fund."*

Although a number of employers adopted plans before workers' compensation, data from that period revealed that most employees didn't receive employer-funded benefits. Many employees had to sue to recover damages and when they did their employers often had a courtroom advantage. Employers could assign responsibility to the employee (either because of his/her negligence or because the risk of injury was assumed as a condition of employment) or a fellow employee. Because of their ability to place blame on injured employees, employers often averted responsibility for compensation.

Growing concern for uncompensated employees prompted many states to enact laws to remove the aforementioned employer defenses, starting with the State of Massachusetts in 1887. These laws, better known as Employer Liability Acts, banned the employer's ability to defend a work-related injury claim by placing blame on the employee or fellow employees. For the most part, employers could not contend that the employee caused his/her injury, that they assumed the risk of injury with employment or that the injury was caused by a fellow employee.

After the enactment of the Employer Liability Acts, employers faced an increasing number of occupational injury claims and verdicts that favored injured workers. Employer concern was great and was summarized in a 1911 report by the National Association of Manufacturers: *"Employers' liability laws have perhaps been the most fruitful source of worry, dissatisfaction and friction to the employers and wage-workers of the United States. It is freely admitted that looking at the subject from the humane, economic and legal viewpoint the present system can be changed and ought to be changed."*

Employers responded to the shift in the outcome of liability cases in several ways. Some instituted Release of Liability and Claims Agreements, agreements that waived the employee's

right to litigate altogether. In some cases employees received benefits in exchange for signing the agreements but not always. Relief plans were also introduced to provide funding for workplace injuries. Many employers required participation (and in some instances plans were funded solely by employee contributions) but employees could only receive benefits if they agreed not to litigate.

Employer attempts to thwart liability were once again met with response from the courts and various state legislatures. The courts ruled many of the employer-required agreements invalid for a variety of reasons including lack of proper consideration, "state of mind" (which referred to the employee), fraud, etc. In addition, nearly 30 states enacted laws that allowed employees to maintain their right to pursue work-injury negligence claims (despite having signed a liability release) essentially making the agreements worth less than the paper they were written on.

An example of one such law, enacted in Massachusetts in 1877 provided: "*No person or corporation shall, by a special contract with persons in his employ, exempt himself or itself from any liability which he or it might be under to such persons for injuries suffered by them in their employment, and which result from the employer's own negligence or from the negligence of other persons in his or its employ.*" A 1901 Indiana law also read: "*That all contracts between an employee and a third person, co-partnership, or corporations from liability for damages arising out of the negligence of such third persons, co-partnerships, or corporations by which the employee of such employer is injured, or, in case of the death of such employee, to his representatives are against public policy and are hereby declared null and void.*"

In 1872 the Houston and Texas Central Railway maintained a policy requiring all employees to sign an agreement releasing the company from liability for work-related accidents. Railroad workers demanded the withdrawal of the releases, and when the railroad refused; 80% of their workforce walked out. The result was the largest strike in Texas history that halted railroad operations for several days. Supervisory personnel and new employees were quickly organized to get most of the trains back into service but eventually the releases were withdrawn and the original engineers were re-hired.

In response to the strike, the Texas Legislature enacted a series of provisions to prevent or severely limit railroad companies from using such agreements/releases. Article 6435, Vernon's Civil Texas Statutes, enacted in 1897 stated: "*No contract made between the employer and employee based upon the contingency of death or injury of the employee and limiting the liability of the employer under the preceding articles of this chapter, or fixing damages to be recovered, shall be valid or binding.*"

Eventually it seemed there was no easy answer. Society wanted employers to be responsible for workplace injuries and employers wanted protection from increasing exposure to tort liability. The eventual compromise was the enactment of workers' compensation laws, which protected employers from most occupational injury claims in return for benefits that are provided without regard to fault.

In their book *A Prelude to the Welfare State, The Origins of Workers' Compensation*, authors Price V. Fishback and Shawn Everett Kantor wrote: "*Instead of being imposed from the top down or the bottom up, workers compensation was enacted because a broad based coalition of divergent*

interests saw gains from reforming the negligence liability system. The catalyst that united these interest groups was an increased awareness of workplace accident problems and substantial changes in the liability system that governed workplace accident compensation. Across the country during the early years of the twentieth century, employers experienced increases in the level of uncertainty of their liability as employer liability laws and court decisions altered the traditional negligence system."

The Texas workers' compensation system has been elective since its passage into law in 1913 and although employers have been able to operate as nonsubscribers since that time, nonsubscription didn't really garner much attention until the late 1980's when a slowing economy and skyrocketing workers' comp rates spelled near disaster for the Texas workers' compensation system.

During the late 1980's, employers faced unprecedented premium increases as high as 150 percent amidst unrivaled fraud and abuse. Conditions became more favorable however after the workers' compensation law was re-written in 1989. Changes to the law, the end of an insurance cycle and record-breaking economic expansion in the mid-1990's prompted reductions in workers' compensation premiums and a reduced interest in the issue of nonsubscription. But the reductions in the cost of workers' compensation premiums were short lived. Today Texas is again one of the most expensive workers' compensation systems in the nation.

Texas' Elective Workers' Compensation System

Workers' compensation in Texas is a "generally" elective system or a system that allows most private sector employers to choose whether or not they will carry workers' compensation insurance. Certain businesses are however required to maintain workers' compensation. For example, governmental entities must provide workers' compensation coverage as must private-sector businesses that engage in state building and construction projects.

Third-party vendors may also require an employer to maintain workers' compensation insurance in order to transact business with them. Sub-contractors, for example, may be required by a general contractor to maintain workers' compensation insurance in order to gain the right to work on their premises.

It's also a little-known fact that employees of subscribing businesses can also elect to opt out of their employer's workers' compensation program. Employees that elect not to participate in the employer's workers' compensation program retain their right to recover damages under common law.

Exceptions in Other States

Although Texas is frequently cited as the only state in the nation without a mandatory workers' compensation system, many other states maintain options to workers' compensation.

To follow are some examples of exceptions to compulsory workers' compensation that exist in other states.

Definition of an Employee - Most compulsory states mandate workers' compensation by requiring businesses to cover all of their employees. There are exceptions however in terms of the definition of an employee that does not necessarily include all persons working at the jobsite. For example, the following are not considered employees in terms of the requirement to provide workers' compensation insurance:

- Employees of limited liability companies
- Employees of charitable organizations
- Employees of religious institutions

Employee Type - Another common exception relates to the job classification of certain employees or in certain industries.

Classification exemptions differ from the aforementioned exception in that the employee may be considered an employee but their particular job classification or industry is exempted. For example, in many states businesses are not required to provide workers' compensation coverage for the following types of employees.

- Aircraft Pilots
- Athletic Officials
- Casual Employees
- Commercial Drivers
- Contractors
- Corporate Officers
- Elected Officials – State
- Emergency Workers
- Employees of:
 - Newspapers
 - Charitable Organizations
 - Family Members
 - Federal Government*
 - Military Personnel*
 - Railroads*
 - Voluntary Fire Departments
 - Welfare to Work Programs
- Farm/Agriculture Employees
- Home Health Care Providers
- Household Employees
- Independent Contractors
- Insurance Agents
- Maritime Employees*
- Members of Limited Liability Corporations
- Police, Fire & Ambulance Personnel
- Product Demonstrators
- Real Estate Agents, Brokers & Appraisers
- Ski Patrollers

- Sole Proprietors/Self-Employed
 - Over 10 Million People are Self-Employed in the U.S.
- State Employees
 - In 8 states, state employees are exempt from workers' compensation but are covered by other benefit schemes
- Truck Owner/Operators
- Volunteer Workers

**Although these employees may not be subject to state workers' compensation laws they may be covered by federal workers' compensation programs.*

Business Type - In addition to businesses that employ certain classifications of employees some types of businesses are not required to participate in other state compulsory workers' compensation systems. Some of the types of businesses include:

- Charitable & Fraternal Organizations
- Churches & Other Religious Institutions
- Employers with a Minimum Level of Payroll
- Horse Racing Facilities
- Indian Reservations and Casinos
- Motion Picture Companies
- Professionals Sports Teams
- Sawmill/Lumber/Logging Operations
- Trucking Companies

Wage and Hour Exceptions - Wage and hour exceptions exclude certain employees based on a minimum number of hours worked or a minimum amount of salary paid. These exceptions disregard the industry type or job classification and merely look for the minimum wage and hour requirements.

Numbers of Employees - According to the U.S. Department of Labor seven states maintain exemptions for three or fewer employees; three states offer exemptions to those with four or fewer and four states exempt employers with five or fewer employees.

What Law Allows Employers to Nonsubscribe?

Nonsubscription in Texas is authorized under Section 406.002 of the Texas Labor Code.

§ 406.002. Coverage Generally Elective

- (a) Except for public employers and as otherwise provided by law, an employer may elect to obtain workers' compensation insurance coverage.
- (b) An employer who elects to obtain coverage is subject to this subtitle.

Statute Making Workers' Compensation Elective for Employees

Section 406.034 of the Texas Labor Code provides that an employee can elect not to accept workers' compensation but rather retain his/her common law rights.

§ 406.034. Employee Election

Except as otherwise provided by law, unless the employee gives notice as provided by Subsection (b), an employee of an employer waives the employee's right of action at common law or under a statute of this state to recover damages for personal injuries or death sustained in the course and scope of the employment.

(b) An employee who desires to retain the common-law right of action to recover damages for personal injuries or death shall notify the employer in writing that the employee waives coverage under this subtitle and retains all rights of action under common law. The employee must notify the employer not later than the fifth day after the date on which the employee:

- (1) begins the employment; or
- (2) receives written notice from the employer that the employer has obtained workers' compensation insurance coverage if the employer is not a covered employer at the time of the employment but later obtains the coverage.”

What Types of Employers Operate as Nonsubscribers?

Approximately 113,000 Texas businesses operate as nonsubscribers and collectively employ approximately 1.5 million employees statewide. This figure does not include sole proprietors or businesses that do not operate on a year round basis.

The following industry sectors represent the highest percentages of nonsubscribing employers.

• Arts/Entertainment/Accommodation/Food Services	54%
• Manufacturing	42%
• Finance/Real Estate/Professional Services	41%
• Health Care/Educational Services	41%
• Wholesale Trade/Retail Trade/Transportation	40%
• Agriculture/Forestry/Fishing/Hunting	39%
• Other Services Except Public Administration	39%
• Mining/Utilities/Construction	32%

Why Do Companies Elect to Nonsubscribe?

Company size plays an important role in the reason employers choose to nonsubscribe. The three most common reasons large employers choose nonsubscription are: premium quotes too high, alternative occupational benefits are a better value than workers' compensation and a desire to manage the selection of health care providers. Small businesses on the other hand (those

businesses that employ 50 or fewer employees) reportedly chose nonsubscription because they have too few employees to purchase workers' compensation insurance or to avoid rising costs.

Although cost is a primary factor there are other reasons businesses choose nonsubscription. For example, some businesses become nonsubscribers by default by simply not purchasing a workers' compensation policy. These are typically very small businesses that are closely aligned with the smaller businesses in other states that may not be required to maintain workers' compensation insurance. Although some small employers may elect to pay occupational injury benefits out of pocket they don't necessarily make a conscious decision to nonsubscribe or develop a workplace injury benefit plan.

Other businesses elect to nonsubscribe because of their frustration with the complexity of workers' compensation, which is arguably one of the most complex systems in the nation. And still others choose nonsubscription for competitive reasons. Nonsubscription lowers costs considerably thereby allowing businesses to compete with employers that operate in other states and nations where the cost of providing work-injury benefits is more affordable.

Ancillary Benefits

After opting to operate as a nonsubscriber businesses report other benefits as well. Nonsubscribing employers can fund other types of benefits with the savings derived from a nonsubscriber injury benefit program. Because nonsubscribing employers are not precluded from providing intergraded 24-hour benefit programs.

Many businesses report that nonsubscription allows them to manage their program more effectively, which is one reason employers and employees alike report a high levels of satisfaction with nonsubscriber programs. Unlike workers' compensation where the workers' compensation commission, insurance carrier and complex laws and regulations decide the fate of a company and its injured employee, a nonsubscriber has the opportunity to create and manage a program that meets the needs of the company and its employees. A nonsubscriber program can remove many of the unnecessary barriers that are common in workers' compensation and generate better relationships between employers and employees, improved quality of products and services, increased productivity, satisfaction and more.

When polled, 68% of nonsubscribing employers overall reported higher satisfaction with their experiences outside of the workers' compensation system than their subscribing counterparts (60%). Nonsubscribing employers also expressed satisfaction with their ability to manage claim costs more effectively (74%) and the services being provided by their nonsubscriber insurance carrier (84%). Overall, 78% of nonsubscribing employers considered their nonsubscriber program a good value for the company.

The option to nonsubscribe makes it affordable for businesses to operate and more specifically, expand their Texas operations. One Texas business that maintains manufacturing facilities in Canada, Mexico and five states was forced to close its California facility because it could no longer afford the cost of workers' compensation. The jobs lost by California were then moved to Texas because of the company's success as a nonsubscriber.

Nonsubscription is not Self-Insurance

The terms self-insurance and self-insured are oftentimes interchanged. The term self-insured can be used to both define businesses that are certified to “self-insure” their workers' compensation program or nonsubscribers that “self-insure” their occupational injury benefit program. While both programs involve employers "self-insuring" occupational benefits, there are important distinctions to be made.

Regardless of the scope of the benefits offered by a nonsubscribing employer, nonsubscribers do not "subscribe" to the workers' compensation system and therefore do not enjoy the tort immunity available to employers that utilize traditional workers' compensation insurance.

Self-insured employers continue to participate in the workers' compensation system but self-insure their workers' compensation benefits to bypass the insurance carrier and reduce some of the associated costs. Because they are subject to the laws and regulations associated with workers' compensation, self-insured employers receive the same tort protection as those employers that purchase traditional workers' compensation insurance. Their benefits are also regulated by the state and the employer must demonstrate it has the financial standing necessary to pay its own claims.

To follow are some of the requirements to make application to self-insure:

- An estimated annual insurance premium of at least \$500,000,
- Credit/debt ratings or a qualifying tangible net worth ratio of 1.5 to 1, with a minimum tangible net worth of \$5 million,
- The posting of a minimum security deposit in the amount of \$300,000,
- Excess insurance in the amount of \$5 million per occurrence, and
- An application fee of \$1,000, which must be paid upon application.

Currently there are approximately fifty self-insured businesses in Texas.

Texas Ranks Highest in Medical Cost Drivers

According to a recent study by the Workers' Compensation Research Institute that compared workers' compensation costs in Texas to similar costs in eight other states, Texas ranked highest for work-related injuries at \$9,314 per injury, a figure that is 40% higher than the median state. In addition, the average cost of a workers' compensation medical claim in Texas increased almost 35% between 1999 and 2003.

The study also considered costs associated with chiropractic claims. A chiropractic claim in Texas is 363% higher than the median state and chiropractic visits associated with a single claim in Texas are 101% higher than the average state. Chiropractors are also involved in more 13% of all cases in Texas verses slightly over 5% in California, the second highest state.

Texas also has the highest duration of disability and temporary disability. Employees in Texas visit healthcare providers and average of 15 times more employees in other states.

The report also showed that 34% percent of employees working for subscribing businesses in Texas never return to their jobs after sustaining a work-related injury and fewer doctors see workers' compensation patients than any other state.

Employer Claims Regarding Higher Costs

American Airlines - American Airlines' claim costs in Texas are 133% greater than similar claim costs Oklahoma, 122% higher than New York, 109% greater than Florida and 6% greater than similar claim costs in California.

General Motors - General Motors Corporation is a certified self-insured employer in Texas. GM spends approximately \$3,548 per employee to provide workers compensation in Texas compared to \$1,437 in Oklahoma and \$1,182 in Louisiana. In Wisconsin, GM pays \$931 per employee to provide workers' compensation.

O'Reilly Auto Parts - O'Reilly Auto Parts reports that while only 30% of its workforce is in Texas, the cost to provide workers' compensation represents 60% of their total workers' compensation expenditures nationwide.

Hyatt Hotels - Hyatt Hotels represents that it has approximately the same number of employees working in Texas and Georgia but that the cost to provide workers' compensation in Texas is approximately 58% higher than Georgia.

Lockheed Martin - Lockheed Martin is a certified self-insured employer in Texas. Lockheed reports that its workers' compensation costs in Texas are 48% higher than similar costs in Georgia.

Who Cannot Nonsubscribe?

Nonsubscription is an option for most private sector employers with a few exceptions. Employers that perform work on state construction contracts are required to carry workers' compensation insurance. Section 406.096 of the Texas Labor Code provides "*A governmental entity that enters into a building or construction contract shall require the contractor to certify in writing that the contractor provides workers' compensation insurance coverage for each employee of the contractor employed on the public project.*"

Certain entities licensed and/or regulated by the Texas Department of Transportation and the Texas Railroad Commission can utilize accident coverage to operate as nonsubscribers but they must maintain specific levels of coverage. Section 643.106 of the Texas Transportation Code reads:

§ 643.106. Insurance for Employees

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(a) Notwithstanding any provision of any law or regulation, a motor carrier that is required to register under Subchapter B and whose primary business is transportation for compensation or hire between two or more municipalities shall protect its employees by obtaining:

- (1) Workers' compensation insurance coverage as defined under Subtitle A, Title 5, Labor Code; or
- (2) Accidental insurance coverage approved by the department from:
 - (A) A reliable insurance company authorized to write accidental insurance policies in this state; or
 - (B) A surplus lines insurer under Article 1.14–2, Insurance Code

(b) The department shall determine the amount of insurance coverage under Subsection (a)(2). The amount may not be less than:

- (1) \$300,000 for medical expenses for at least 104 weeks;
- (2) \$100,000 for accidental death and dismemberment;
- (3) 70 percent of an employee's pre-injury income for at least 104 weeks when compensating for loss of income; and
- (4) \$500 for the maximum weekly benefit

Liability and Nonsubscription

Businesses that purchase a workers' compensation insurance policy are protected by the doctrine of exclusive remedy, which provides that in most cases an employee's only redress following a work-related injury are the benefits offered by workers' compensation. So in most cases, an employee that is covered by workers' compensation insurance cannot bring a tort claim against his/her employer.

Section 406.031 of the Texas Labor Code provides that when an employer purchases a workers' compensation policy "An insurance carrier is liable for compensation for an employee's injury without regard to fault or negligence if:

- (1) at the time of injury, the employee is subject to this subtitle; and
- (2) the injury arises out of and in the course and scope of employment.

(b) If an injury is an occupational disease, the employer in whose employ the employee was last injuriously exposed to the hazards of the disease is considered to be the employer of the employee under this subtitle.

The Texas Labor Code does not provide nonsubscribing employers similar exclusive remedy protection, nor does it allow nonsubscribers to assert (as a legal defense) contributory negligence, assumption of risk and the fellow servant doctrine.

§ 406.033 (a). Common-Law Defenses; Burden of Proof

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In an action against an employer who does not have workers' compensation insurance coverage to recover damages for personal injuries or death sustained by an employee in the course and scope of the employment, it is not a defense that:

- (1) the employee was guilty of contributory negligence;
- (2) the employee assumed the risk of injury or death; or
- (3) the injury or death was caused by the negligence of a fellow employee.

However the same Section does provide that, "The employer may defend the action on the ground that the injury was caused:

- (1) by an act of the employee intended to bring about the injury; or
- (2) while the employee was in a state of intoxication.

Addressing Nonsubscriber Liability

In the a 2001 survey by the State of Texas, 65 percent of nonsubscribing employers reported they were comfortable with the level of risk they assumed as nonsubscribers and only 3 percent reported being sued (in connection with an occupational injury claim) in the past 5 years. Although nonsubscribing employers are not entitled to the same liability protections afforded a subscribing employer, there are a number of other ways nonsubscribing employers can mitigate liability.

Limiting the Occurrence of Workplace Injuries - An effective workplace safety program can play an important role in limiting the frequency and scope of workplace injuries.

In a lawsuit for personal injuries (stemming from a work-place injury), Section 406.033(d) of the Texas Labor Code places the burden of proof on the plaintiff, "In an action against an employer who does not have workers' compensation insurance coverage, the plaintiff must prove negligence of the employer or of an agent or servant of the employer acting within the general scope of the agent's or servant's employment."

Therefore, discovery documents in a nonsubscriber suit might ask:

- Did the employer provide a safe place to work?
- Did the employer warn employees of dangers inherent in the workplace?
- Did the employer train the employee to work in a safe manner?
- Did the employer provide proper tools?
- Did the employer properly maintain tools and equipment?
- Did the employer properly supervise the employee?
- Did the employer provide adequate and competent fellow employees?
- Did the employer establish and enforce safety regulations?
- Did the employer inspect for safety hazards?

Provide Excellent Care - Nonsubscribing employers should treat their employees with respect and fairness and develop their nonsubscriber program with that in mind. A nonsubscriber program

should contain a well-documented and well-defined benefit plan and the employer should make certain employees understand the plan and the benefits offered.

Nonsubscribing employers should also utilize quality health care providers and work closely with medical providers to manage claims. Nonsubscribers should stay abreast of injured employees and offer programs to enable injured workers to return to work.

Employee Communication - Another very important part of a nonsubscriber program is communication. Nonsubscribers should ensure employees understand the parameters of the program, what is required of them and the benefits available under the plan. Many nonsubscribing employers utilize regularly scheduled safety meetings to present and discuss nonsubscriber issues.

Legal Defense - Nonsubscribing employers should make themselves aware of their legal defenses before injuries occur and institute effective risk management programs. For example, the employer might consider:

- Was the plaintiff's injury the fault of the employer or solely because of the plaintiff's negligence?
- Were the plaintiff's acts and/or omissions the primary cause of the injury?
- Was the plaintiff's injury the result of an unavoidable act?
- Did the plaintiff's injury occur while he/she was intoxicated?
- Did the plaintiff's injury occur in the course and scope of employment?
- Was the plaintiff's injury self-inflicted?
- Did the plaintiff's injury actually occur at work?
- Has the Statute of Limitations expired?

Nonsubscribing employers frequently obtain offsets for damages (i.e. medical expenses, wage replacement benefits, etc.) paid prior to trial but it is important to remember jurors are human and an employer's failure to provide benefits or adequately care for an injured employee, can lend strength to their willingness to return a verdict in favor of an injured plaintiff.

Internal Dispute Resolution - Nonsubscribing employers can develop internal dispute resolution programs to address claim disputes and further minimize the frequency of litigation.

Arbitration and Mediation - Work-related injury claims can be referred to arbitration or mediation. Some nonsubscribing employers have successfully maintained arbitration provisions as a part of their nonsubscriber benefit plan for more than a decade.

Settlement of Claims - After medical and wage replacement benefits are provided to an injured employee, nonsubscribing employers can settle the claim. Employers should be wary of schemes that purport to limit liability.

Insurance - Many facets of nonsubscriber liability are insurable through a variety of nonsubscriber insurance products. Nonsubscriber insurance is available to cover medical expenses, wage replacement benefits, judgments, damage awards and legal defense costs.

Determining the Feasibility of Nonsubscription

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There is no one single method for deciding whether or not the adoption of a responsible nonsubscriber program would be a worthwhile option. Every company is different and as such many of the parameters that are used to determine the viability of nonsubscription are relative to the uniqueness of a particular company's operations. Companies that are considering nonsubscription do however typically fall into three distinct categories.

- *Companies that choose to unsubscribe somewhat out of necessity.* The cost of workers' compensation insurance may be so high for some smaller companies that they choose to institute a nonsubscriber program without a formal study or an extensive decision-making process.
- *Companies that conduct a limited analysis of nonsubscription.* Mid-size to larger companies may opt to conduct an in-house study to decide if the company should maintain workers' compensation or adopt a nonsubscriber program.
- *Companies that retain the services of a third-party.* Many larger employers elect to conduct a formal analysis of nonsubscription and may employ a third-party to conduct the analysis and provide a recommendation regarding nonsubscription. This process is commonly referred to as a feasibility study or analysis.

Who Should Conduct a Feasibility Study?

One the more popular ways of analyzing the feasibility of nonsubscription involves a joint effort between management and third party professionals. Members of management that actually work with the company's workers' compensation program and/or have a role in the decision-making process are excellent candidates to assist with a feasibility analysis. While third-party professionals may be able to provide information regarding specific issues (claims information, insurance costs, etc.) it is also important for management to assess the company's objectives to ensure it has adequate resources to introduce and maintain a nonsubscriber program. It is also important for employers to evaluate both the actual cost required to become a nonsubscriber as well as the company's philosophies and work practices.

When using an outside consultant the company should consider:

- Instituting an agreement whereby the consultant will advise the client if or when they believe a feasibility study is no longer warranted. In other words, if a consultant finds the company cannot operate as a nonsubscriber the consultant should stop the investigation and notify the employer.
- Have the consultant outline (in writing) any conflicts that may bias the study. A conflict of interest arises when private or personal interests might interfere with professional obligations to the client company. This might include a business association, interest or other circumstance that could influence their judgment or the quality of their service. If conflicts exist it doesn't necessarily mean the services of the consultant should be rejected but they should be considered when the final results are presented.

The following questions should be addressed in any feasibility study.

- Does the company have an adequate commitment to workplace safety?
- Does management and supervisory personnel have a good understanding of nonsubscription?
- Does the company have the commitment and ability to establish and fund a nonsubscriber program?
- Is the company prepared to manage a nonsubscriber program effectively?
- Is the company prepared to establish a program to address employee claim disputes?
- Is the company prepared to meet the regulatory requirements for nonsubscribers?
- How will the company address open claims and pending issues?
- Is the company prepared to develop adequate steps for communicating the program to employees?
- How will nonsubscription affect relationships or impact agreements with other companies?
- Will the institution of a nonsubscriber program create any potential conflicts with other insurance coverage, contractual relationships, financial goals, etc?
- Does the company maintain copies of insurance policies, payroll information (by classification codes), loss runs, etc. and can the information be accessed to assist with a nonsubscriber feasibility study?
- If the company is union employer, is the company prepared to address the issue of nonsubscription?

Claims Data

Claims data can provide valuable information when comparing a subscriber program to a nonsubscriber program. In order to balance the cost savings associated with nonsubscription, employers should first analyze the costs associated with workers' compensation. A good start would be to examine loss runs and claims information including types of injuries, injury patterns, length of claim, medical costs, wage replacement costs, questionable or fraudulent claims, etc.

Loss Forecasting - In many cases nonsubscribers do not report a decline in frequency of claims but do experience declines in the severity, duration and overall number of claims being reported.

A Texas manufacturing company reported a drop in lost time days from approximately 1,200 as subscribers to 17 as nonsubscribers. Another large restaurant group (employing approximately 2,500 employees) reported a 46 percent reduction in the total number of workplace injuries and a 65 percent reduction in lost injury claims after becoming a nonsubscriber. The company also reported returning \$60,000 of the money it saved to its employees in the form of safety bonuses.

Claim Patterns - Unexplained injury patterns or challenging claims that correlate to certain health care providers may be addressed more effectively in a nonsubscriber program than in workers' compensation. Establishing effective relationships with quality health care providers is essential to a successful nonsubscriber program.

Nonsubscriber Litigation - Litigation data can also serve as a valuable resource. Claim and injury data stemming from litigation can be compared statewide or in certain geographic areas. It

is not uncommon for a company contemplating nonsubscription to have their claims reviewed by an experienced nonsubscriber defense attorney to gain a helpful prospective of areas that may warrant extra attention.

Comparing Claims Data: Subscriber vs. Nonsubscriber

To follow are a few pointers for comparing subscriber claim data to nonsubscriber claim data.

- Ensure the data is relevant. If a trucking company were considering nonsubscription, claims data from another trucking company would have much more relevance than data from businesses in other industries.
- Ensure the benefits are comparable. Nonsubscribers provide a wide variety of benefits so it is important to look for similarities in the benefit structure.
- Ensure there is an adequate supply of data.
- Ensure the data is mature. In order for claims data to be effective, the claim has to have matured to a level that reflects an accurate assessment of costs. When comparing claims data, check to see that the data has similar maturation periods and that the period accurately reflects the actual costs.
- Include adequate amounts of data from similar geographic regions. The cost to provide occupational injury benefits can vary considerably from one geographic region to another so it is important to compare data that has been collected from the same or similar geographic regions.

Using Data to Support Decisions

After the claims data has been analyzed and other factors like the cost of insurance have been considered, a formula for comparison should be developed. While it may seem oversimplified, you may want to compare the total estimated cost of workers' compensation to the total estimated cost savings associated with nonsubscription. And if the savings is adequate, further investigation might also examine the cost to establish a nonsubscriber program.

While many employers give a lot of weight to the cost comparison when evaluating the feasibility of nonsubscription, a number of other factors may play an important role. For example, nonsubscriber programs allow better opportunities to manage claims. Nonsubscriber programs can also offer many of the benefits that are typically found in workers' compensation (i.e. disability benefits, wage replacement benefits, etc.), which could affect employee morale and therefore also play affect an employer's decision to nonsubscribe.

The Nonsubscriber Program

If a company decides nonsubscription is feasible, the next step is to develop an occupational injury benefit plan (also referred to as a nonsubscriber plan). Nonsubscriber programs rely on a well-designed benefit plan to manage all of the program's elements. A nonsubscriber plan is a

document that is provided by a nonsubscribing employer to its employees, detailing the company's work-related injury benefits and any all applicable rules, regulations and/or guidelines. Think of it as a bicycle wheel -- the plan is the hub and each other element is a spoke.

One of the primary roles of the plan is to provide answers to virtually every question that may arise regarding the programs and benefits related to occupational injuries. For example:

- Are employees responsible for reporting injuries and if so, how, when, to whom, etc.?
- What medical benefits are available?
- When do benefits begin and/or end?
- What is the maximum amount of benefits allowed under the plan?
- What wage replacement benefits are offered?
- Is drug or alcohol testing required?
- What happens when the health care provider releases an employee to work?
- Does the company have a return to work program?
- What expenses are not covered under the plan?
- Are there subrogation rights under the plan?
- Who interprets the provisions of the plan?
- Who makes determinations regarding benefits?
- How are claim disputes addressed?
- What options are available to employees if their claim is denied?
- Can the plan be amended or terminated?
- What benefits are not provided under the plan?
- Does the plan provide "workers compensation" benefits?

Health Care Providers - Another important aspect of a nonsubscriber plan relates to the selection of health care providers. Before a nonsubscriber program is instituted, the company should establish relationships with local health care professionals because selecting quality health care providers can be one of the most beneficial aspects of a nonsubscriber program.

Claims Administration - Nonsubscriber claims are different from subscriber claims. Unlike a subscribing employer that hands off their claims to the insurance providers, a nonsubscribing company must be prepared to address workplace injury claims. Nonsubscriber liability makes nonsubscriber claims unique and the same rules and procedures do not apply.

There are a number of Texas companies that specialize in claims administration for nonsubscribers.

Claim Disputes - Claim disputes will arise in any situation, including nonsubscriber programs, so the plan should contain procedures for addressing claim disputes. Many nonsubscribers choose to implement internal dispute resolution procedures or utilize mediation and/or arbitration. A formal plan to address claim disputes should be in place before the company becomes a nonsubscriber.

Insurance/Funding - While the Texas Labor Code does not require employers to carry workers' compensation it also does not prohibit those who don't from purchasing nonsubscriber coverage as long as it is not represented as a substitute or replacement for workers' compensation.

Section 406.052(b) of the Texas Labor Code states, “This section does not prohibit an employer who is not required to have workers' compensation insurance coverage and who has elected not to obtain workers' compensation insurance coverage from obtaining insurance coverage on the employer's employees if the insurance is not represented to any person as providing workers' compensation insurance coverage as authorized under this subtitle.”

A variety of nonsubscriber insurance coverage options (and benefits) are available to those employers that elect not to carry workers' compensation; however for the purposes of discussion, we will discuss the products typically used by different employers (small, mid-sized and large nonsubscribing employers).

Small Employers - Many small employers utilize accident insurance, which typically pays benefits directly to the employee with a low deductible for the employer. The scope of the benefits offered by accident insurance can be limited (i.e. they are offered for a limited length of time or to a specific dollar amount) and in many cases costly injuries may be subject to a maximum dollar amount that is determined by a disability schedule. Accident insurance can offer benefits for both medical and wage replacement expenses but it does not typically cover occupational sickness, occupational disease, cumulative trauma or employer liability.

Mid-Sized Employers - Coverage options utilized by mid-sized employers can offer a wider range of benefits options, including employer liability. Mid-sized employers might utilize a reimbursement policy that allows the employer to submit expenses to the carrier for reimbursement or a policy that pays-on-behalf-of policy the employer. In most cases, coverage can be obtained for medical expenses, wage replacement benefits, legal costs and judgment awards (which in some cases may include arbitration and mediation costs) as well as occupational sickness, occupational disease and cumulative trauma. While benefits associated with reimbursement and pay-on-behalf-of policies may also be capped, the limits are usually greater than those offered by accident policies.

Large Employers - Larger nonsubscribing employers might employ the use of a multitude of coverage options, including those described for mid-sized employers, excess insurance and stop loss coverage.

Excess insurance is written on top of a primary insurance policy and is designed to offer additional coverage for claims that exceed the maximum amount set forth in the primary policy. Stop-loss insurance also provides coverage for costly claims by offering benefits for claims that exceed a pre-determined dollar amount. But unlike excess coverage, stop-loss insurance is not always necessarily associated with other insurance. In the nonsubscriber scenario, stop-loss insurance usually offers coverage for a specific claim that exceeds a pre-determined amount. Some large nonsubscribing employers might also have large retention levels that allow the company to self-fund a portion of its injury benefits while others might purchase insurance to address less-costly claims. Excess and stop-loss insurance typically offer benefits for all types of workplace injury benefits, including costs associated with employer liability.

Just as there are a number of coverage options available to nonsubscribing employers, nonsubscriber insurance can also offer a multitude of benefits to both the employee and employer.

Nonsubscriber insurance can be obtained to cover costs associated with employee lawsuits that may include the actual damage award (both actual and punitive) and legal fees. Some policies provide legal counsel to the insured while others offer reimbursement costs, enabling the employer to utilize their attorney of choice. Nonsubscriber insurance can also be obtained for medical costs associated with most types of workplace injuries or disease as well as wage replacement, death, disease, cumulative trauma, disability benefits and more.

Workers' Compensation Insurance & Nonsubscriber Insurance - Both workers' compensation insurance and nonsubscriber insurance offer benefits for workplace injuries but the similarities end there.

Nonsubscriber insurance (and the benefits provided by nonsubscriber insurance) is not workers' compensation and should therefore not be represented as a substitute for workers' compensation. In fact, as mentioned earlier it is illegal to represent any other type of insurance as workers' compensation or a substitute to workers' compensation. And while we rarely see attempts to market illegal substitutes, it is important to remember that state law defines a policy as an illegal substitute to workers' compensation if it purports to *“provide the same benefits for either the employee or the employer as are provided by workers' compensation insurance; or limit such employees to a claim for benefits under such policies as the employee's sole remedy against the employer in the event the employee suffers a job-related injury or disease.”*

Claims that nonsubscriber programs are the same or better than workers' compensation are somewhat common however in many instances these representations may only apply to certain benefits rather than the overall scope of the insurance or the program itself.

While it is somewhat natural to compare the benefits offered by nonsubscriber products to those offered by workers' compensation, it is impossible to make an apple to apples comparison. Employers should therefore refrain from making comparisons when presenting or discussing a nonsubscriber program. Benefits offered by a nonsubscriber program should be presented in a clear and concise manner without inferences to workers' compensation, particularly claims that the benefits may be a substitute, replacement, the same as or better than those offered by workers' compensation.

Nonsubscriber products offer a wide-range of valuable benefits to both employees and employers and in many cases employees report greater overall satisfaction with nonsubscriber programs than workers' compensation. Increased employee satisfaction may be attributable in part to increased focus on the prevention of workplace injuries and heightened employee care rather than merely the treatment of injuries, which many feel is the case with workers' compensation.

Workplace Safety - While it may not be included in the nonsubscriber plan, per se, a specially designed workplace safety program is vital to any nonsubscriber program. The National Safety Council reports that on an average day, 14 people are killed and 10,400 are disabled at work making the workplace death toll equivalent to a major airline disaster every two weeks. Job-related diseases cause as many as 60,000 deaths per year and the indirect costs associated with occupational injury claims are 7 to 9 times higher than the actual total paid for medical costs alone.

Because nonsubscribing employers are not protected by exclusive remedy, workplace safety plays a much larger role in controlling costs for nonsubscribers. Many nonsubscribers attempt to ward off occupational injuries by investing large amounts of time and money in programs that are designed to ensure their work environments are safe, staff is properly trained, employees utilize safe work habits, etc.

Fifty-two percent of TXANS' members report having had a safety program as subscribers to workers' compensation but 100% maintain safety programs as nonsubscribers. They also report a 54.58 % overall decline in workplace injuries.

ERISA and Nonsubscription

The federal Employee Retirement Income Security Act (ERISA) wasn't necessarily intended to apply to nonsubscribers specifically but most nonsubscriber plans are categorized as "employee welfare benefit plans" under ERISA. The definition of a "covered plan" is found in Section 1003(a) includes nonsubscriber injury benefit plan. Section 1003(a) states "*any employee benefit plan if it is established or maintained (1) by any employer engaged in commerce or in any industry or activity affecting commerce; or (2) by any employee organization or organizations representing employees engaged in commerce or in any industry or activity affecting commerce; or (3) by both.*"

Various court decisions have also supported ERISA's application to nonsubscriber injury benefit plans. ERISA applies to most private sector employee benefit plans including: (1) pension plans that provide retirement income or defer income until termination of covered employment or beyond, and (2) welfare plans established to provide health benefits, disability benefits, death benefits, prepaid legal services, vacation benefits, day care centers, scholarship funds, apprenticeship and training benefits, or other similar benefits.

As we stated before, most nonsubscriber plans are categorized as "employee welfare benefit plans" as defined in Section 1002(1): "*Any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (a) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services, or (b) any benefit described in Section 186(c) of this title (other than pensions on retirement or death, and insurance to provide such pensions).*"

A properly designed benefit plan can serve the mutual interest of both employers and employees. For employers, one of the more favorable aspects is its mission to protect interstate commerce. Specifically, Section 1144(a) provides, "*Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title.*" In other words, ERISA preempts or supersedes most state laws that relate to the provision of benefits thereby making an ERISA plan subject to federal law. ERISA precludes employers with plans in multiple states from

being subjected to a myriad of state laws and regulations and we will explain later how the preemptive nature of ERISA can also benefit nonsubscribing employers.

There are some exceptions to the plans that are governed by ERISA. Section 1003(b) defines excepted plans as: certain governmental plans, church plans, plans established outside of the United States, un-funded excess benefit plans as defined in Section 1002(36), health insurers and plans that are "*maintained solely for the purpose of complying with applicable workmen's compensation laws or unemployment compensation or disability insurance laws.* While at first glance it may appear that nonsubscriber plans could be defined as a plan that is designed to "*comply with applicable workmen's compensation laws,*" Texas nonsubscriber plans are not maintained "*solely for the purpose*" of complying with workers' compensation laws therefore they are not excepted.

Because ERISA is a very broad law that encompasses almost any "plan, fund or program that provides medical, surgical or hospital care or benefits, or benefits in the event of sickness, accident or disability," virtually any plan (whether it is intended to be a plan or not) can fall under the auspices of ERISA. For this reason it is important that an employer be very careful about verbal or written statements that relate to the provision of employee benefits. Courts have ruled that an ERISA plan exists, "if a reasonable person could ascertain its intended benefits, its benefit procedures, its beneficiaries and the source of its funding." Therefore if an employer provides benefits but does not have a written benefit plan, the employer may still be subject to ERISA, especially as it relates to requirements for paying claims, fiduciary responsibilities, reporting procedures and more.

ERISA does not replace workers' compensation so the benefits of an ERISA plan should not be overstated. Representations that an ERISA plan offers benefits equal to or greater than those provided by workers' compensation should be avoided.

ERISA plans do not protect nonsubscribers from state negligence claims (also referred to as tort claims). In other words, ERISA will address claims brought under the plan but employees of nonsubscribers can also assert negligence/tort actions in state court.

ERISA wasn't enacted to give nonsubscribing employers control when addressing occupational injuries. To the contrary, ERISA was enacted to protect the interests of plan participants and beneficiaries and to provide penalties for employers that abuse the rights of their employees. Therefore it is important to consider the law's intent during the preparation of any ERISA plan.

Free ERISA Plans

Employers should exercise caution when accepting a "free" plan that accompanies an insurance policy, particularly a liability policy. While there is certainly nothing inherently wrong with these programs, plans offered with insurance can (in some cases) adversely affect the policy terms or scope of coverage and may contain obsolescence clauses that void the plan if the insurance policy lapses or expires.

It is also important for employers to refrain from using plans that have been designed for another company or to operate with another insurance policy. Because of the relationship between the plan

and any associated insurance, both should be designed to compliment one another. The plan should be considered (and amended, if necessary) if the insurance policy changes. If an employer elects to accept a plan with an insurance product, it should **always** be reviewed by a legal professional not associated with the insurance. In addition, ask the people selling the policy if (and how) the ERISA plan will affect the terms of the insurance.

The following is a list of some of things an employer might consider when evaluating an ERISA program:

- Does the plan meet the company's specific needs?
- Does this plan conflict other employer plans?
- Does the plan modify the insurance benefits and if so, how?
- What provisions can or cannot be modified?
- Will the plan be updated or amended as needed and if so, at what cost?
- What happens to the free ERISA plan if the policy is changed or cancelled?
- Is the entity providing the free plan responsible for filings and regulatory requirements?
- Who pays for what services (benefits provided by the plan may not necessarily covered by the insurance policy).
- Can the employer designate providers or does the plan require the use of certain providers? (*i.e. medical, legal, third party administrators, mediators, etc.*)
- What action does the plan require if the insurance carrier fails to honor claims? *Some programs purport to limit/circumvent liability, prevent lawsuits, etc., which may or may not be valid. If you encounter such claims, get assurances in writing.*
- Does the plan require some form of alternative dispute resolution?

Regulatory Requirements

Nonsubscribing employers are subject to certain state and federal regulatory requirements. To name a few: all lost time injuries, occupational diseases and work-related fatalities must be reported to the Texas Workers' Compensation Commission. An annual statement regarding the company's status as a nonsubscriber must also be filed with the TWCC and certain nonsubscribing employers may also be subject to certain filings regarding their nonsubscriber plan with the federal government.

Monitoring a Nonsubscriber Program

Nonsubscribing employers must engage in on-going efforts to monitor their nonsubscriber program. This may include constant reporting and analysis of losses, claims, benefits, etc. either by company personnel or third-party professionals. Nonsubscription is not a static program but rather on going and ever changing, which requires constant monitoring.

Deciding to Nonsubscribe

One of the final issues to consider in a study of the feasibility of nonsubscription is presenting the program to the workforce. Regulatory requirements govern the timing associated with introducing a new nonsubscriber program, which equates to timing the process so that both the regulatory

requirements and the internal roll out are coordinated with one another. After the program is complete the process of introducing it to the workforce should be carefully planned. The employer must file notice of its change to nonsubscriber status with the State of Texas and if the company is dropping a workers' compensation insurance policy, specific requirements regarding carrier notification also apply. Specific posting notices that inform employees that the employer has elected to operate as a nonsubscriber must also be posted in the workplace.

Review

The State of Texas maintains a generally elective workers' compensation system meaning that the majority of the state's private employers can elect to purchase workers' compensation insurance or operate as nonsubscribers. Although Texas is frequently cited as the only state where employers can opt out of workers' compensation no state has 100% employer or employee participation under workers' compensation.

In terms of legal liability workers' compensation bars employees from seeking recovery with limited exception. While employees of nonsubscribers, on the other hand, can assert a cause of action against their nonsubscribing employer for negligence but the employee must successfully prove that the employer's negligence caused the injury.

A comprehensive workplace safety program can serve not only to reduce workplace injuries but it may also serve as a defense against negligence claims. Nonsubscribers also have other methods of mitigating liability and only a small percentage of all nonsubscriber claims are ever litigated. Many nonsubscribing employers voluntarily develop a comprehensive nonsubscriber injury benefit program that falls under the auspices of the federal Employee Retirement Income Security Act or ERISA, which governs the employer-provided benefits made available to employees that sustain an occupational injury.

To support the success of a responsible nonsubscriber, the employer must be willing to commit the necessary resources to ensure the success of its nonsubscriber program. Although a nonsubscriber program might save a company from paying high workers' compensation premium costs, the company should not elect to "opt out" if it is not fully prepared to implement a comprehensive nonsubscriber program.

The mission of the Texas Association of Responsible Nonsubscribers (TXANS) is to help nonsubscribing employers succeed at caring for injured employees by working with both Texas nonsubscribers and the industry professionals that support nonsubscriber programs. TXANS also maintains an active government affairs program that strives to preserve the option to nonsubscribe in Texas for those nonsubscribing employers that choose to operate responsibly.

Regardless of whether your company is a nonsubscriber or considering the option, TXANS has resources available to assist you. More information regarding TXANS and the option to nonsubscribe in Texas is available on TXANS website, www.txans.org.

Questions may also be directed to info@txans.org or (512) 477-7357.