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# WORKERS COMPENSATION NONSUBSCRIPTION PROGRAMS

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Employers in all states have a number of options for complying with state workers compensation regulations. They can place insurance with an admitted company; they can participate in an association program or group workers compensation pool; or they can qualify for self-insurance. Workers compensation insurance programs can be arranged in a number of ways, ranging from guaranteed cost programs to programs with large deductibles or under qualified self-insurance plans.

In Texas, employers have another choice that is unique to that state. Employers can choose to “opt out” of the traditional workers compensation system instead of providing insurance or qualifying for self-insurance. Opting out of the workers compensation system in Texas is referred to as workers compensation “non subscription.” Employers can simply file an “Employer Notice of No Coverage or Termination of Coverage” form (DWC005) with the Department of Insurance and then establish other ways of addressing the cost of employee injuries. It is notable that out of the 105,000-plus

employers that currently are considered non-subscribers, fewer than 27,000 have actually filed the appropriate notice with the state.

This section offers a summary of the history of nonsubscription, outlines the rights and obligations of employers under both traditional workers compensation insurance and the non-subscription option, provides the framework for a successful nonsubscription program, and analyzes the advantages and disadvantages of each approach.

## History of Texas Nonsubscription

Workers compensation laws were adopted by most states in the early 1900s. Since its inception in 1913, the Texas Workers’ Compensation Act has allowed employers the “non-subscription” option. At one time, Oklahoma implemented changes to its Administrative Workers Compensation Act to allow employers to use an arrangement similar to the Texas nonsubscriber option. However, 2 years later,

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the Oklahoma Supreme Court struck down that state's "opt out" provision. The court ruled it was an unconstitutional "special law" that gave employers the ability to provide inequitable treatment for their injured workers. South Carolina's nonsubscription regulations were withdrawn in 1997. New Jersey also was once cited as an "elective" state for workers compensation. However, the New Jersey Insurance Department currently does not permit any alternatives to the purchase of a standard workers compensation policy other than approved self-insurance programs. So for now, Texas stands alone as the only state that allows an official alternative to workers compensation.

Historically, the vast majority of employers to choose the nonsubscription option in Texas were small businesses that elected to "go bare" and operate without any insurance protection. A count in 2020 indicated there were 105,813 nonsubscribers representing 29 percent of Texas employers with nearly 2 million employees. Almost half of these employed four or fewer employees. A number of very large employers with the financial wherewithal to retain the costs of employee injuries also elected to opt out. Multistate employers have even rolled the nonsubscription exposure into their national workers compensation and employers liability self-insurance programs.

The option began to have greater appeal to a broader scope of employers in the 1980s. The insurance industry was experiencing a hard market cycle, and workers compensation rates were increasing sharply. This provided strong incentive for mid-sized Texas employers to evaluate all of their options, including the option of leaving the Texas workers compensation system.

As a result, the insurance industry began to develop new products for nonsubscription. Among the first was an expanded life and health insurance arrangement providing 24-hour coverage. The death benefit was generally limited to \$100,000, and medical and disability benefits were provided for a maximum of only 24 months. Although such arrangements were adequate for the vast majority of occurrences, a serious accident could still leave an employer facing a significant amount of uninsured damages in excess of policy durations and/or limits as well as employers liability actions.

During this period, several medium and large nonsubscribers combined their efforts to come up with a better plan. An underwriting model was developed for these companies based on their pooled loss information in order to create a more statistically creditable database. The model from the pooled experience of the nonsubscribers produced rates that were an average of 40 percent less than state workers compensation rates. Using these results, a new product called employers excess indemnity insurance was created. It provided a comprehensive policy covering both voluntary benefits and employers liability claims. Forms of employers excess indemnity insurance are still utilized today, along with the original rating model.

The difference between nonsubscriber rates and workers compensation insurance rates have varied over the years, depending on the level of competition and workers compensation rate sufficiency. In 2003 and 2004, the Texas Workers Compensation Commission and the Texas legislature conducted exhaustive research to determine why the workers compensation system proved to be so inefficient and expensive. Some of the findings of the study compared workers compensation costs in Texas to costs in eight other states.

### WORKERS COMPENSATION COSTS IN TEXAS COMPARED TO EIGHT OTHER STATES

- Texas had the highest per-claim cost (\$9,314).
- Texas's per-claim cost was 40 percent higher than the median state.
- The average cost per medical claim increased almost 35 percent between 1999 and 2003.
- The cost of a chiropractic claim in Texas was 363 percent higher than the median state.
- Chiropractic visits in Texas were 101 percent higher than the average state.
- Chiropractors were involved in 13 percent of all cases versus 5 percent in California, the second-highest state.
- Texas had the highest duration of disability and temporary disability.
- Texas injured workers averaged 15 more provider visits than employees in the other states.
- After a lost-time injury, 34 percent of Texas workers did not return to their jobs.

The conclusions from the subscription versus nonsubscription study can be summarized as follows.

### RESULTS OF SUBSCRIPTION VERSUS NONSUBSCRIPTION STUDY

Issue/Question	Subscribers	Nonsubscribers
1. Adequacy/ Equity of Benefits	44%	52%
2. Good Value for the Company	48%	65%
3. Ability To Manage Costs	42%	61%
4. Overall Satisfaction	50%	61%

The results of this study led to a complete reform of the workers compensation system in 2005. House Bill (H.B.) 7 legislative reforms focused heavily on all the negative factors that were creating an ineffective and costly system. The legislators eliminated the Texas Workers Compensation Commission and placed its functions under the Department of Insurance. In addition, the state workers compensation act was revised to provide for more accountability and control of the actions of the medical community.

One objection raised by the workers compensation insurance community and organized labor during the reform efforts was that nonsubscription allowed employers to operate outside the system. Nonsubscribers did not contribute to the cost of the system, thereby raising the cost to participants. They argued that participation in the workers compensation system needed to be mandatory to resolve this inequity. The Texas state legislators disagreed and decided not to strip Texas employers of the option to non-subscribe. A separate study conducted by the Texas Association of Responsible Nonsubscribers (TXANS) in 2005 produced the responses from its members listed in the following chart.

RESULTS OF 2005 TXANS SURVEY		
1. Has nonsubscription played a role in increasing or decreasing the number of jobs your company provides?	100% Increased	0% Decreased
2. How do the benefits provided by your nonsubscriber plan compare to those that would otherwise be provided?	50% Better than	50% Less than
3. What percentage of wages are provided to employees for work-related injuries?	96%–100%	6.67%
	86%–90%	13%
	81%–85%	40%
	76%–80%	6.67%
	70%–75%	27%
	< 70%	6.66%

Nonsubscribing employers played a large role in the 2005 reforms. Based on the surveys, nonsubscribers repeatedly reported having better occupational injury experiences, lower costs, and better overall outcomes.

A 2018 biennial report produced by the Texas Department of Insurance, Division of Workers Compensation, on the 2005 H.B. 7 reforms highlighted positive impacts to the affordability and availability of workers compensation insurance for Texas employers. It also touted the effectiveness of certified workers compensation healthcare networks on return-to-work outcomes, medical costs, quality of care issues, and medical dispute resolution. It found that the number of medical disputes decreased by about 84 percent. Between 2005 and

2017, average premiums for workers compensation insurance decreased by 67 percent. The average cost per claim fluctuated during the study period—decreasing significantly from a 2002 peak until 2007, increasing from 2008 to 2011, and then following a decreasing trend after 2011. Return-to-work outcomes improved with a much higher percentage of injured employees returning to work within a shorter period of time. The report also noted that the workers compensation coverage line had been profitable each year since 2004, as measured by the industry’s combined ratios and return on net worth. A separate 2018 survey completed by Texas A&M University and analyzed by the Workers Compensation Research and Evaluation Group indicated improvements in satisfaction with care and health-related outcomes.

## Self-Insurance versus Nonsubscription

Self-insurance versus nonsubscription to the traditional workers compensation system are completely different. However, these two alternatives are sometimes erroneously referred to as if they were synonymous.

### Self-Insurance

Under self-insurance, benefits paid to workers are identical to those mandated by a state’s workers compensation statute, except that such benefits are paid directly by the employer rather than by the insurer. Thus, the self-insured employer agrees to operate within the scope of the state’s workers compensation law and is considered a subscriber for all purposes under the law.

### Nonsubscription

Under nonsubscription, no benefits are due other than those paid voluntarily, by means of a settlement between the employer and the employee, or as a result of a court judgment. In other words, self-insurers are responsible

for benefits required by the workers compensation act. Nonsubscribers, by rejecting the Act, are not legally required to pay any workers compensation benefits. Many nonsubscribers, however, voluntarily use an occupational injury/disease benefit plan to provide medical and wage replacement benefits to their injured employees that match or exceed the benefits prescribed by workers compensation.

### **Workers Compensation Subscriber Exposures**

The intent of the workers compensation system is to provide benefits on a “no-fault” basis to employees who suffer work-related injuries. There is no need for an injured employee to prove employer fault in order to receive benefits. Employers that participate in the system (subscribers) agree to provide reimbursement for work-related injuries in exchange for employees waiving their common law rights to sue their employers. Employees are entitled to reasonable and necessary medical expenses, as well as their loss of earning capacity, subject to state prescribed limits. Indemnity payments for an injured employee’s lost wages are set at a percentage of weekly wages, subject to limits on the maximum weekly benefits and on the length of time such benefits must be paid. Medical payments for injured workers are not capped, but most states have medical fee schedules that healthcare providers must follow for treatment of workers compensation claimants. These workers compensation subscriber exposures are faced by businesses that buy traditional workers compensation insurance (or self-insure the exposure).

Every state’s workers compensation law includes an exclusive remedy provision stipulating that the benefits prescribed in the act are the sole remedy for an injured employee. However, most state laws allow suits for work-related injuries if the employer has failed to either purchase workers compensation insurance or obtain authorization to self-insure.

Employees who are exempt from workers compensation laws (such as domestic workers or seasonal farm workers) also can sue employers for on-the-job injuries. Further, many states allow suits against an employer if it can be shown that an employee’s injury was intentionally caused by the employer, or if the employer’s actions involved gross negligence. Under these egregious circumstances, most states deprive employers of three common law defenses.

- The employee assumed the risks of the employment.
- A fellow employee caused the injury.
- The employee’s negligence contributed to the injury.

### **Workers Compensation Nonsubscriber Exposures**

Employers that elect nonsubscription can have a much greater risk of employee injury lawsuits. When a nonsubscriber is sued by an injured employee, the employee must prove that the nonsubscriber was negligent. These workers compensation nonsubscriber exposures allow plaintiff employees to allege many different types of negligence.

#### **Potential Damages under Nonsubscription**

Employers choosing to nonsubscribe face the potential for tort liability, including the possibility of paying punitive damages to an injured worker.

#### ***Tort Liability***

Employers that have opted out of the workers compensation system are liable in tort for employee injuries. Accordingly, if any of the standard pleadings (or similar allegations) can be successfully proven in court, a plaintiff employee may have a cause of action not only for “economic damages” (e.g., lost wages, medical expenses), but for “noneconomic damages” as

### STANDARD PLEADINGS IN SUITS AGAINST NONSUBSCRIBERS

- Failure to supervise the job
- Failure to furnish a safe place to work
- Failure to communicate adequately to the employee how to safely perform the work
- Failure to instruct, train, and supervise the employee
- Failure to inspect for safety hazards
- Failure to furnish the employee with proper tools and equipment to perform the work
- Failure to supply adequate and competent fellow employees
- Failure to establish and enforce safety rules and regulations
- Failure to warn employees of dangers inherent in the work
- Failure to protect employees from criminal acts by third parties
- Failure to inform employee that employer does not provide workers compensation, thereby constituting fraud and misrepresentation

well (e.g., pain and suffering, emotional distress). Since noneconomic damages are not a part of benefits payable under state workers compensation statutes and because they are theoretically unlimited in amount, nonsubscribing employers face much greater potential liability than do employers that subscribe to workers compensation.

#### ***Punitive Damages***

As in traditional tort claims, the plaintiff employee may also have a case for an award of punitive damages. Punitive damages are subject to the Texas Civil Practice and Remedies Code, which limits their recovery to an amount equal to the greater of (1) two times the amount of any economic damages awarded plus an amount equal to any noneconomic damages awarded up to \$750,000, or (2) \$200,000. An intermediate court of appeals has determined that the cap on punitive

damages is applicable to nonsubscribers (*Beverly Enters. of Tex., Inc. v. Leath*, 829 S.W.2d 382 (Tex. App. 1992)).

In contrast, punitive damage awards are not recoverable under the traditional workers compensation system unless an employee is killed as a result of a subscriber's gross negligence.

#### **Defenses Available under Nonsubscription**

Employers that elect nonsubscription give up the three common law defenses listed above. Once proven negligent in causing an injury, the only defenses available to nonsubscribers are the following.

- The injury was intentionally self-inflicted by the employee, or
- the injury occurred while the employee was in a state of intoxication.

However, the Texas Supreme Court has indicated that employees are held to a comparative responsibility standard, meaning that in a suit against a nonsubscriber, an employee's damages could be reduced by the extent of their own fault in causing the injury.

### **Mitigating Potential Damages under Nonsubscription**

To reduce their exposure to employee injury suits, many nonsubscribers attempt to have their employees enter agreements adopting company policies to submit such suits to binding arbitration under the Federal Arbitration Act, thereby precluding employees from suing their employers. Thus far, the legality of such practices remains intact. Following the lead of employers all across the United States, nonsubscribers are also applying these agreements and policies to federal employment claims such as those brought under Title VII and the Americans with Disabilities Act, as well as wrongful discharge claims.

### **Nonsubscriber Obligations**

In Texas, nonsubscriber obligations include a requirement to file an Employer Notice of No Coverage with the Texas Department of Insurance and make certain that all current and new employees are advised that the employer is a nonsubscriber. Such notice to employees must be prominently displayed in both English and Spanish. Failure to comply with these requirements could result in fines. Nonsubscribers are not exempt from reporting lost time injuries to the Department of Insurance. Most nonsubscribers use the current Occupational Safety and Health Act reports to avoid filing duplicate reports with state and federal agencies.

### **Potential Obstacles for Workers Compensation Nonsubscribers**

Almost any Texas employer, regardless of size, may become a nonsubscriber. Yet, given the potential obstacles for nonsubscribers,

employers should consider this option only after careful study. Certain types of firms may not be good candidates for nonsubscription.

#### **DIFFICULT-TO-INSURE EXPOSURES UNDER NONSUBSCRIPTION**

- Jones Act liability
- Industries with catastrophic loss potential
- Contractors (required to furnish evidence of workers compensation coverage)

Firms that are required to furnish evidence of workers compensation insurance to third parties, notably contractors or subcontractors, will find it difficult to become nonsubscribers. In the event of injury or death, employees of the contractor/subcontractor could be construed as employees of a general contractor or project owner, which might ultimately impose unexpected workers compensation obligations on the general contractor or owner. However, employees of subscribers have often taken workers compensation benefits from their employer and then sued all of the other contractors, subcontractors, and owners involved in the project. Specific contractual arrangements can overcome many such potential problems.

### **Elements of Effective Workers Compensation Nonsubscriber Programs**

A nonsubscriber program is subject to the proverbial "weak link in the chain." Effective nonsubscriber programs must contain all the necessary elements, and each element must have the requisite components. When working in harmony, the system can produce optimum results. If any element or component is missing or not functioning on par, the results will be less than desirable over time. Also, favorable results do not necessarily prove a program is



optimal. As demonstrated by the latest round of hurricanes, any risk management program's effectiveness or lack thereof can be defined by a single event. The fact that the event has not occurred is no assurance that the program will respond favorably. Faulty programs can incur costs that far exceed the upfront "savings" created by element or component short cuts. An optimum system balances costs with potential risks to achieve long-run stability in results. The critical elements of the optimum nonsubscription include the following.

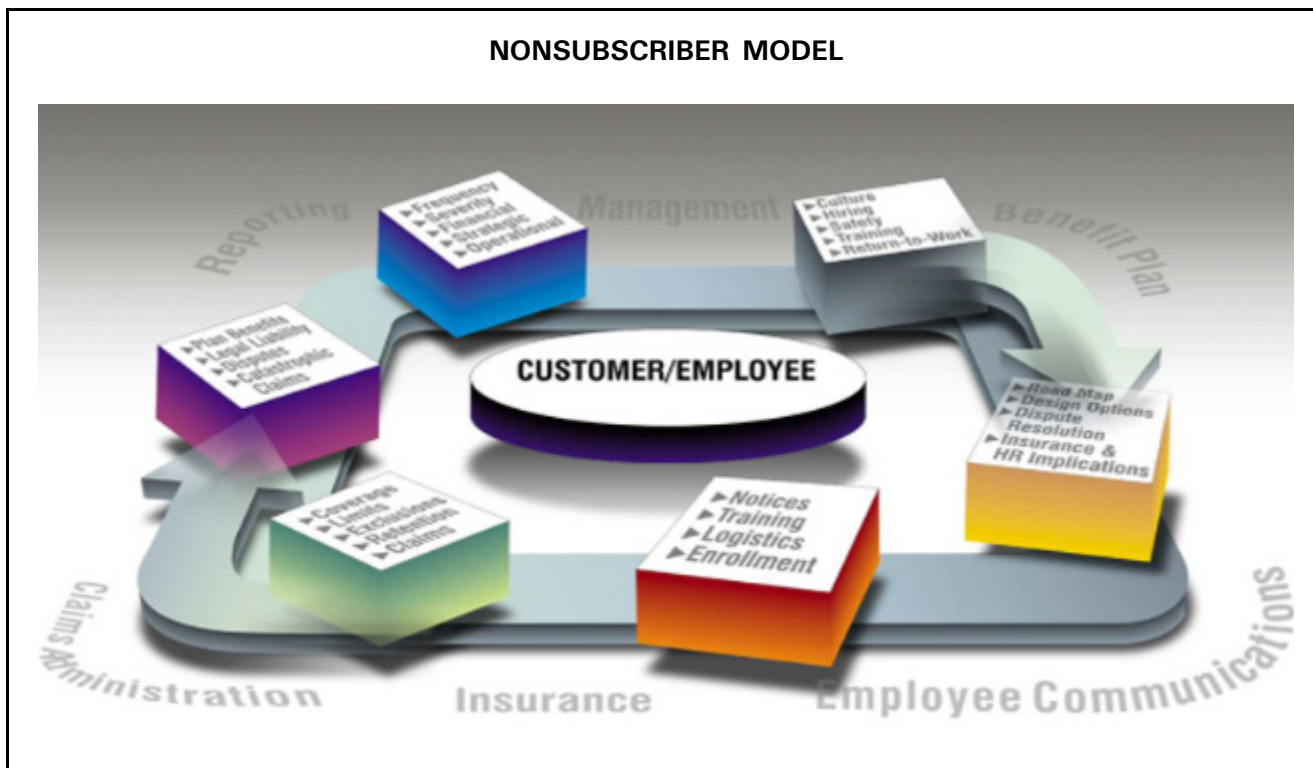
- Management
- Benefit Plan
- Employee Communications
- Insurance
- Claims Administration
- Reporting

## Management

Nonsubscription allows management to integrate employee occupational injury benefits with other health and welfare benefits, operational, and managerial issues. The key management components for the employer are as follows.

- Setting the culture
- Hiring responsibly
- Implementing a comprehensive safety program
- Providing effective employee/new-hire training programs that are results oriented and documented
- Creating a return-to-life program for a seriously injured employee

Most nonsubscribing managers benefit from improved productivity, enhanced employee





morale, and reduced frustration for the employee receiving benefits. They also realize the need to focus on the employer-controllable factors of a safe workplace, hiring, training, work practices, return-to-work, and caring for the injured employee.

## **Benefit Plan**

The benefit plan is the road map to success. It creates the framework for benefit administration and employee/employer protection. The benefit plan must comply with the Employee Retirement Income Security Act (ERISA) and US Department of Labor (DOL) requirements. The claim procedure is considered reasonable only if the plan contains both of the following.

- Administrative processes and safeguards designed to ensure and verify that benefit claim determinations are made in accordance with governing plan documents
- Plan provisions have been applied consistently with respect to similarly situated claims, DOL Regulation 2560.503–1(b)(5)). No exceptions!

The quid pro quo for ERISA protection from open-ended litigation is consistent plan administration within the benefit plan for all eligible employees. No exceptions!

### ***Benefit Plan Design Considerations***

The following list describes the components and characteristics of a benefit plan design.

- Employers should take the time to understand the issues and elections required to build a plan that fits their specific needs.
- The injury plan must provide adequate benefits for the majority of injuries sustained by employees.

- The plan must comply with ERISA reporting, disclosure, administrative, and fiduciary requirements.
- The plan becomes the first choice for claim settlement, but it must also coordinate with a clearly defined negligence defense strategy.
- The plan must provide insurable benefits. The benefit limits, durations, and amounts must be reasonable and generally accepted to receive consideration from underwriters.
- The plan must be administration-friendly. DOL regulations effective the second plan year on or after January 22, 2001, significantly impact the administrative process. The plan administrator must clearly specify circumstances that may result in disqualification, ineligibility or denial, loss, forfeiture, suspension, offset, reduction, or recovery of plan benefits. If you do not adhere to the requirements, then adverse benefit decisions will not be upheld and the plan administrator could face a breach of fiduciary duty.
- To steer clear of trouble, the plan must clearly specify eligibility for benefits, requirements to qualify for benefits, requirements to continue receiving benefits, the procedure to review any adverse benefit decision, the procedure to appeal an adverse benefit decision, and a dispute resolution methodology. The regulations provide for the employee to bring suit to determine plan issues. The claim regulations effective the first plan year beginning on or after July 1, 2002, but not later than January 1, 2003, require shorter time frames for accepting or denying a claim, increased time frames for appeals, new procedures for appeals, and independent review of adverse claim decisions. The plan administrator has the

duty to justify their actions with factual documentation.

- This regulatory atmosphere creates the need for the plan administrator to have as detailed a road map as practical to spell out in writing the plan provisions that will be called upon to contain benefit/claim abuses.
- The plan must also dovetail with the nonsubscriber insurance coverage, limits, and policy exclusions. For instance, if, within your plan design, you allow for preexisting conditions, then your insurance policy should provide that coverage as well.
- Lastly, the plan must be coordinated with human resources policies, procedures, and your employee handbook.

The vast majority (97 percent) of nonsubscriber injuries are administered to a rapid and satisfactory conclusion within the benefit plan. Less than 1 percent of claims are open at the 2-year point.

## **Employee Communications**

Upon benefit plan rollout, you can reinforce the positive benefits provided to employees and their families by the occupational injury program. For new hires, working safely and being protected from the economic setback of an occupational accident and interrelated messages are important. The state-required notice postings (English and Spanish) can be supplemented by postings that explain the benefits provided by the company and what to do in the event of an accident.

## **Insurance Coverage**

Nonsubscriber insurance policies fall into two classes.

- Limited policies (accident policies—medical, loss of wages, and accidental

death and dismemberment, and employers liability policies)

- Comprehensive policies—designed to cover claims for benefits under the benefit plan and losses sustained that are above or beyond plan benefits and actions for damages brought at common law. The coverage provisions, limits, exclusions, conditions, definitions, and deductibles vary widely. These policies continue to evolve as the insurance market expands and contracts due to market conditions.

Insurance is available from both admitted insurers and excess and surplus lines insurers. The policies are underwritten based upon the employer's operations and claim history. Underwriters have tightened the ERISA benefit plan and claim administration requirements in recent years. For example, many underwriters are no longer allowing employers to administer their claims.

## **Claim Administration**

In general, the administration of nonsubscriber claims has three components.

1. The administration of benefits offered in the benefit plan
2. Protection from negligence actions
3. Protection from employment status actions

The administration of claims under the benefit plan is on a "no-fault" basis. The plan administrator will determine if benefits are due based upon the coverage, limits, and exclusions.

There is no regard to employment status (part-time or full-time, job title or classification, length of employment, or likelihood to return-to-work) when the injury occurred. There is no "favorable" treatment or "exceptions to the rule." The plan benefits must be administered

“in the best interest of the plan participants.” This is normally not a problem, as 90 percent of employees filing claims are honest and eager to return to work. The troublesome 10 percent create the problems that must be contained within the plan provisions. For these claims the administrator must walk the fine line of respecting the claimant’s rights, while stopping or at least minimizing abuse. In most cases this is accomplished by clear communication of the contested issues to the claimant and clear alternatives to the abusive behavior.

For the small percentage of claims where damages exceed those provided in the benefit plan, the employer is separated from the plan and its attendant fiduciary obligations. Any “settlements” with the employee are outside the plan and are therefore beyond or “in addition” to the plan benefits. In a lawsuit for workplace personal injuries, Section 406.033 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, the employer might need to address such allegations as those listed in “Standard Pleadings in Suits Against Nonsubscribers.” The defenses and other considerations that might come into play in nonsubscriber negligence actions arise from the responses to various questions.

- Is this action subject to arbitration?
- Was the employee’s injury the fault of the employer or solely because of the employee’s negligence?
- Were the employee’s acts and/or omissions the primary cause of the injury?
- Did the employee fail to follow rules/instructions?
- Does the “simple tool rule” apply?

- Was the employee’s injury the result of an avoidable act?
- Did the employee’s injury occur while intoxicated?
- Did the employee’s injury occur in the course and scope of employment?
- Was the employee’s injury self-inflicted?
- Did the employee’s injury actually occur at work?
- Has the statute of limitations expired?

Note that nonsubscribers frequently receive offsets for damages paid prior to trial such as the following.

- Medical expenses
- Wage replacement
- Dismemberment benefit
- Death benefits

The settlement of an employer liability claim for damages beyond the benefits paid under the benefit plan will be based upon the same criteria as any third-party liability claim: the degree of negligence and degree of damages. After this assessment, the settlement negotiations can move forward with an offer of compensation outside the benefit plan and with a complete and total release of nonplan liability received in return. When settling a claim, there are five important considerations.

- Is it the right time?
- Is the amount fair?
- Is the employee making an informed/voluntary decision?
- Is the agreement in writing?
- Is the employee releasing all potential claims?

In the event a settlement cannot be reached, the matter can be moved to mediation and then arbitration if a pre-injury arbitration agreement was in place. Absent the employee's pre-injury agreement to arbitration, the employer will probably have the right to defend a Texas state court action to determine the issue. Depending on the insurance policy and the self-insured retention, the liability claim may be defended by the insurer.

## Reporting

The minimum claim reporting system will provide for the reporting of claims statistics and the measurement of results. The components addressed are as follows.

- Claim frequency
- Claim severity
- Financial results
- Administrator actions
- Administration history
- Strategic issues
- Operational issues

Through the tracking of actual claims data, the risk/hazard profile of an employer's operations can be defined. The data can be used to benchmark results and provide the insight necessary to improve under-performing units. The occupational injury reporting methodology and format can be designed to fit with the employer's financial and operational reports. A claim/benefit history can be developed and documented to support fiduciary obligations. Care must be taken to ensure that medical and personal information about an individual claimant is not compromised.

## Advantages of Nonsubscription to Texas Workers Compensation

A number of important benefits can be derived by becoming a nonsubscriber to the Texas workers compensation system.

### NONSUBSCRIPTION ADVANTAGES

- Reduction of frivolous and fraudulent claims
- Short-term cost savings
- Elimination of insurer administrative costs
- Additional incentive for safety
- Reduction of internal administration costs
- Possibility of improved employee satisfaction

### Reduction of Frivolous and Fraudulent Claims

There is little doubt that the workers compensation systems in virtually all states are riddled with nonmeritorious claims. Although such activities can probably never be completely eliminated, nonsubscription allows the employer—rather than an insurance company—to control the process of paying and settling claims. (Subscribers commonly complain that workers compensation administrative procedures do not permit the employer to even be heard at hearings because insurers control the defense in such proceedings.) Under nonsubscription, however, where employers are in charge of the claim settlement process, employees are discouraged from making trivial or bogus claims to which an insurer, particularly an insurer on a deductible or some other type of loss-sensitive rating plan, would be more prone to acquiesce.

### Short-Term Cost Savings

Considering that the types of insurance coverage purchased by nonsubscribers are substantially less costly than workers compensation insurance, nonsubscriber employers will realize an immediate reduction in costs. Additionally, nonsubscribers can derive cash flow benefits because, under such programs, medical

and income loss benefits do not always begin as quickly as they would under the regular workers compensation system. This is especially true if a settlement must be negotiated or if a claim is litigated. Under both circumstances, claims may not be resolved, and payment may not be made for some time after the actual date of injury.

### **Elimination of Insurer Administrative Costs**

By avoiding the workers compensation system entirely, nonsubscribers are not required to bear the so-called frictional costs buried within insurance premiums—that is, agent’s commissions, residual market loadings, insurer overhead and profit, premium taxes, and insurer services. Such items encompass about one-third of the cost of workers compensation coverage.

Admittedly, frictional costs are contained within excess indemnity policies and the other types of insurance available to nonsubscribers. However, because these costs are derived from a smaller premium base, they will be lower than if they were contained in a standard workers compensation premium.

### **Additional Incentive for Safety**

Given the possibility of catastrophic claims, organizations that opt out of the traditional workers compensation system have more incentive to operate safely than those that do not. It is imperative that nonsubscribers establish a safety and loss control program if one is not already in place. In addition to their effectiveness in controlling injuries and resulting costs, a written safety program is a key element in defending against allegations of negligence as well as in preventing the occurrence of negligence. Ultimately, the added incentive for safety that is provided by nonsubscription will accrue to the employer’s benefit from a cost standpoint. Of course, safer workplaces also benefit employees by reducing the number and severity of injuries and improving employee morale.

### **Reduction of Internal Administration Costs**

Employers that nonsubscribe may realize savings because internal administration of a traditional workers compensation program involves payroll audits, premium allocations, negotiating insurance policies, and administering claims in conjunction with the insurer. While it is difficult to measure the true dollar impact of these activities, they nevertheless add to the costs of participating in the workers compensation system.

### **Improved Employee Satisfaction**

Studies have shown that employees of nonsubscribers are more satisfied with their injury benefits than employees of subscribing companies.

## **Opting Out of the Workers Compensation System: Disadvantages**

Despite the benefits of nonsubscription as outlined above, employers that choose this option are also subject to a number of possible difficulties.

### **NONSUBSCRIPTION DISADVANTAGES**

- Potential catastrophic liability
- Deterioration of employee relations

### **Potential Catastrophic Liability**

As noted above, employers who opt out of the Texas workers compensation system lose three important common law defenses when a claim is brought against them by an employee for a work-related injury or illness.

- The employee assumed the risks of the employment.
- A fellow employee caused the injury.

- The employee's negligence contributed to the injury

Absent an intentionally self-inflicted injury or intoxication at the time of injury, an employee need only prove that the injury occurred on the job and that the employer was somehow negligent in causing that injury for the employer to be held liable for damages. However, it should be noted that in *Texas Workers' Comp. Comm'n v. Garcia*, 893 S.W.2d 504 (Tex. 1995), the Texas Supreme Court decided that an employee's claim against a nonsubscriber is subject to the statutory comparative responsibility system in the Texas Civil Practice & Remedies Code. Under the statutory scheme, an employee's collectible claim should be reduced by the percentage of their own negligence that caused the injury. The court's language indicates that a nonsubscribing employer has the same defenses available that the employer would have if a third-party plaintiff sued the company for damages associated with a faulty product or unsafe premises, for example. Thus, given the protection afforded by the combination of insurance coverage and the comparative negligence standard noted in the Garcia opinion, nonsubscriber firms appear to have considerable protection against catastrophic claims.

#### ***Exposure to Noneconomic Losses***

As indicated in "Nonsubscriber Exposures," there are numerous allegations an employee can raise to prove that the employer was negligent in causing an injury. This is especially true in the event that an employee comes before the court with a serious injury. Under such circumstances, an employer not only could be liable to pay medical and lost time benefits but, more importantly, could be responsible for pain and suffering and punitive damages. Since there are potentially no limitations on pain and suffering awards, nonsubscriber employers are subject to catastrophic liability exposure unless they purchase insurance coverage with adequate limits.

#### ***Exposure in Multiple Claim Situations***

Employers are especially vulnerable to potentially uninsured catastrophic claims in situations involving multiple employee injuries or deaths. For instance, consider an event like the 1991 chicken processing plant fire in North Carolina in which a number of employees died or suffered injuries due to the building's locked fire exits. If the employer were a nonsubscriber, it is likely that the employees would have been able to prove negligence. Under such circumstances, possible judgments could have been expected to exceed even substantial excess indemnity coverage limits. If those deceased employees' families could show that the deaths were the result of gross negligence, the families could also recover uncapped punitive damages in a lawsuit involving a similar incident in Texas even if the employer were a subscriber.

#### ***Deterioration of Employee Relations***

One benefit of workers compensation insurance is that it can reduce the potential for an adversarial relationship by distancing employers from the claims settlement process. An insurer or third-party administrator can act as a buffer between the employee and the employer on difficult claims. If employees experience poor treatment in the handling of their claims, the blame is shifted away from the employer.

If a nonsubscriber takes a more hands-on approach to claims administrations, claimants can have reason to direct their dissatisfaction at their employer, thus harming employee relations. This risk can be mitigated by establishing a good plan for compensating injured workers and by communicating the specifics to all employees.

#### ***Mandatory Arbitration Provisions***

Another issue associated with the deterioration of employee relations under nonsubscription is the fact that a number of nonsubscribers require employees to sign mandatory

arbitration agreements. Such agreements bar employees from suing employers for work-related injuries and instead limit them to arbitration proceedings in the event of a dispute. Some businesses have gone even further by implementing mandatory arbitration corporate policies that unilaterally impose arbitration on all employee-employer disputes. Although the enforceability of mandatory arbitration provisions has withstood most legal challenges, such provisions could be perceived by employees as overreaching by employers.

## **Workers Compensation Nonsubscription Conclusion**

Experience and numerous research studies have reinforced what employers already know about the components of successful cost containment for work-related injuries.

1. Safety is the number one issue. No accident is the best possible outcome.
2. Immediate reporting of accidents and prompt emergency treatment is critical.
3. Treatment of injuries by specialists that are outcome driven enhances results.
4. A fair and flexible return-to-work program (and return-to-life plans for seriously injured employees) are highly beneficial.
5. A benefit administration system that monitors and positively impacts the actions and compliance of injured employees and medical providers pays for itself.

6. Programs with significant retentions can produce substantial savings.

7. Professionally administered benefit plans with specific appeal, mediation, and arbitration instructions allow even difficult claims to be handled effectively with minimal adversity.

A number of organizations have successfully operated as nonsubscribers for many years. Given their experience, such firms have no desire to return to the traditional workers compensation system. They feel that the absence of insurer intervention afforded by nonsubscription permits a higher degree of control over the claims management process. Nonsubscription facilitates their equitable treatment of employees with legitimate work-related injuries, while allowing them to control medical costs and contest frivolous and bogus claims.

A number of factors should be weighed when assessing the option of becoming a nonsubscriber to the Texas workers compensation system. This alternative must be evaluated from both quantitative and qualitative vantage points. Risk managers should consider the nonsubscription option not only in terms of its "hard dollar" impact but also its effect on employee morale and customer relations. Indeed, nonsubscription is not a viable option for all employers. However, given the possibility that workers compensation costs could once again rise to levels that many firms found unaffordable (as they did in the late 1980s), businesses should seriously contemplate this alternative after carefully evaluating the issues discussed here.



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