

WORKERS' COMPENSATION IN MONTANA:
PROBLEMS AND PROSPECTS

by

Donald R. Ferron

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Donald R. Ferron

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4.8.87

Date



Chairperson, Graduate Committee

Approved for the Major Department

4/8/87

Date



Head, Major Department

Approved for the College of Graduate Studies

5-1-87

Date



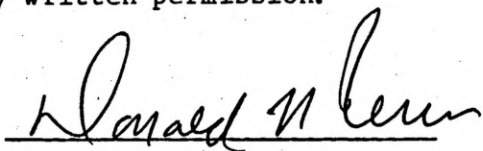
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ABSTRACT

Nineteenth Century English social reformers recognized the need for financial protection of workers injured in industrial accidents. They also realized the need to pass these social costs on to the consuming public, as a legitimate cost of a product. This concept expanded rapidly in Europe, and spread to the United States. In 1915, Montana passed a compensation law, and it has gone through many transformations.

The Montana Workers' Compensation system is in a current state of financial disequilibrium. This state is defined as one in which the benefits and operational expenses exceed the premium income to fund the system.

The legislature has made it mandatory for all employers in the state to provide employees Workers' Compensation benefits. The Compensation Act allows for three funding options:

1. Self Insurance for large companies with substantial financial resources;
2. Purchase coverage from private insurance companies; and
3. Purchase coverage directly from the State Compensation Fund.

This paper identifies regulatory problems. Workers under Plan I cannot be assured that benefit payments would continue if their self-funded employer goes out of business. Nearly all of the Plan II private carriers have left the state because of the unprofitability of writing Workers' Compensation insurance in Montana. The State Fund is in serious financial difficulty. It is possible that they will not be able to meet their benefit payments within the next several years. Employers are complaining that rates in Montana are too high for them to continue in business. To circumvent these problems, some legislative and administrative solutions are suggested.

CHAPTER I

INTRODUCTION

Workers' Compensation is an attempt to provide benefits to workers injured in industrial accidents. It is a no fault system where benefits are triggered by the accident with no regard as to who is responsible for an injury. Workers exchange their common law right of suit against a negligent employer in exchange for benefits paid regardless of fault. This has become known as the "sole remedy" rule. The need for Workers' Compensation was recognized by 19th Century English social reformers. Compensation laws were passed in England and spread to Europe and America. Montana's first compensation law was passed in 1915 and has evolved into an extensive system of benefits.

The Problem and Its Setting

The entire Montana Worker's Compensation system now is in a state of serious disarray. The problem is so serious that the State Fund, which is the major provider of benefits, could conceivably not have the cash to meet these benefit payments by the summer of 1988. It is also seen that most of the private carriers are leaving the state. The self-funded plans have serious regulatory problems, and the future of this option is clouded.

It is the purpose of this paper to determine what the various causes of these problems are and what possible solutions may be in order. Most of the solutions will be legislative and administrative in nature. It is hoped that this paper will be useful to legislators when they consider reform of the Montana Workers' Compensation system. Other business and labor groups, and individuals interested in seeing the system returned to a healthy state may also find the analysis of interest.

To date, a comprehensive study of the Montana Workers' Compensation Act cannot be found. There is virtually no literature on the subject. Most people felt the system was relatively healthy up until 1985, so there was little interest in the topic. Hence the importance of this study.

Methodology

The major research tool was personal interviews with individuals who are currently involved in the Workers' Compensation system. The researcher also had access to considerable financial and statistical data of the State Fund, when he interned with the Workers' Compensation Division during the summer of 1986. Access to the State Law Library helped develop a historical perspective on the Workers' Compensation problem.

A number of questions were asked of each individual, depending upon his background. However, there were two central questions:

- (1) "What do you feel were the causes of the existing financial

problems of the Montana Workers' Compensation system?" The researcher then asked the individuals to rank these causes if they could. The second question was, (2) "In your opinion, what can now be done to return the system to a state of financial health?"

Individuals interviewed were as follows:

1. The current administrator of the Division of Workers' Compensation in Helena, and key staff members;
2. Two of the past administrators of the Montana Division of Workers' Compensation;
3. Managers of the private insurance carriers in the State who had written a substantial volume of Workers' Compensation business in the past;
4. The State Workers' Compensation Judge;
5. Attorneys who specialize in Workers' Compensation cases;
6. One major labor leader in the State;
7. Individuals involved in rehabilitation activities.

Limitations

This study is subjective in nature. It would be difficult, if not impossible, to develop objective methodology to determine the causes of the problems besetting the system. Many of the conclusions reached are based in part on the perspectives of those people interviewed. Also, the solutions proposed are merely suggestions. If they are adopted in some form by the legislature, only time will tell if they are successful.

This paper is organized as follows. The next chapter will deal with the historical development of the Workers' Compensation system and outline the major provisions of the Act. The third chapter identifies the major problems that are causing the financial disequilibrium. The fourth chapter examines some developing problems that could cause further strain on the system. The fifth chapter deals with administrative and legislative solutions to these problems.

CHAPTER II

DEVELOPMENT OF WORKERS' COMPENSATION

Since the early 1980s there has been a great deal of concern about the fiscal health of the Montana Workers' Compensation System. Employers felt the rates were excessive compared to other states, and employee groups expressed concern about the benefit levels and the expense of the delivery system.

The Montana Workers' Compensation Act (hereafter referred to as the Act) has been a centerpiece of the State's social legislation. In 1909, the State Legislature passed a compensation program, but the law was held to be unconstitutional by the Montana Supreme Court on grounds that it denied equal protection to employers.¹ The court reasoned this law forced employers to give up some of their common law defenses against negligence suits by employees. In 1915, the legislature again passed a compensation law, thereby including a broader class of employees to be covered. This law did pass constitutional scrutiny after another challenge.²

The seeds of our current Workers' Compensation system developed in 19th century England. The problems of an injured worker prior to this time were well stated by William Prosser, thus: "The cornerstone of the English Common Law was the economic theory that there was complete mobility of labor. The supply of work was unlimited, and a workman was an entirely free agent, under no compulsion to enter into

any employment contract. The economic compulsion which left him no choice except starvation, or equally dangerous employment in another job, was entirely disregarded."³

Prior to 1837, an injured workman had no standing in law to recover in a tort action against a negligent employer. In a 1837 landmark case, Prestly v Fowler, this precedent was changed, and injured workers were given legal standing.⁴ Similar legislation was evolving in Western Europe at the same time. By the early 1900s, it became clear that the average injured worker could not compete with the resources of a big employer in the legal arena. If the worker claimed negligence on the part of the employer, the employer could raise the defenses that the employee assumed all risks of the job and that the employer was not responsible for accidents caused by a fellow worker. Under these circumstances, it was most difficult for a worker to get compensation through the legal system.

The idea of workers' compensation spread from Europe to the United States, and in 1911 the State of Wisconsin passed the first successful compensation law. To correct the problems of the old system, a new concept was born, whose essence was a trade-off between the employer and the employee. The employee gave up his common law rights of tort actions in exchange for a no fault system of benefits, which included medical payments and indemnity payments. The employer paid the entire cost of the program, and in turn passed the cost on to the consuming public through higher prices. The cost of industrial injuries was thus to be borne by society and not by the injured worker's family.

Workers' Compensation has been considered in the area of individual state control, and the federal government has very little involvement at this time. By 1920, most states had adopted some sort of Workers' Compensation legislation.⁵ Most of these original laws covered only "hazardous" occupations. Later, the laws were broadened to include almost all classes of employment. The next major step was the inclusion of compensation for industrial diseases.

By the late 1960s, many people in the field recognized that the benefit schedules were lagging far behind actual costs. In 1972, the National Commission on Workers' Compensation Laws met in Washington D.C. and suggested a series of major reforms. In 1973, Montana made a major revision of the Act and included most of these reforms, which brought benefit schedules in line with actual costs.

The Workers' Compensation system is constantly evolving. The current thrust of the Act is to pay actual medical expenses, a major portion of lost wages, and possible loss of future wages because of the injury. In 1915 the average weekly wage allowed was \$10 a week. The current schedule is almost \$300 a week.⁶ This increase dramatically shows how benefits have expanded 30 fold. Most of this evolution has taken place through legislative changes. However, the Montana Workers' Compensation Court and the Montana Supreme Court have also made major modifications through their liberal interpretation of legislative intent.

The Montana Workers' Compensation Court was created in 1975 by the Legislature in response to a scandal involving some compensation settlements.⁷ Prior to this time, settlements were worked out

with attorneys and senior members of the State Fund, with no guidelines or outside review. Now, the Compensation Court has one judge, operating in Helena. The Court is a quasi-judicial body, as it has broad discretion and does not follow the Montana Rules of Civil Procedure. Appeals from this Court go directly to the Montana Supreme Court. There may be a proposal in the 1987 Legislature to add another judge to help alleviate the existing workload.

Major Provisions of the Act

The Montana Legislature has provided three options for employers to comply with the Act:

PLAN I: With the approval of the Division of Workers' Compensation, these employers can self-insure for the benefits and pay claims to injured workers directly. This program is for large employers with substantial financial resources. At the present time about 50 employers are using this option;⁸

PLAN II: An employer can buy Workers' Compensation coverage directly from a private insurance company;⁹ and

PLAN III: An employer can purchase compensation insurance directly from the state through the State Compensation Insurance Fund. Currently, the majority of the Workers' Compensation accounts are under this plan. It is important to note that the benefits are the same for all three plans.¹⁰

Following is a brief summary of the current benefit schedule as provided by the current Montana Code:¹¹

Wage Loss Compensation

Temporary Total Disability: An injured worker would receive 66 2/3% of wages received at the time of injury, subject to the maximum State's Average Weekly Wage (now \$299) for a maximum of 500 weeks.

Partial Disability

An injured worker would receive 66 2/3% of the actual diminution of workers' earning capacity. Maximum payment of one half of State Average Weekly Wage for a maximum of 500 weeks would be paid.

Total Disability

An injured worker would receive 66 2/3% of wage received at time of injury. Maximum of State Average Weekly Wage would be paid. Benefits would terminate when injured worker converts to Social Security retirement benefits, and would be coordinated with Social Security disability payments.

It is important to note that Temporary Total Disability and Partial Disability can be converted to a lump sum benefit. This conversion must be approved by the Workers' Compensation Court.

Medical Benefits

Reasonable medical and hospital services and other approved treatments required because of a work related injury would be paid.

Death Benefits

Death benefits are provided at the same rate as temporary total benefits. Benefits are provided to the surviving spouse for life or

until remarriage. Dependent children can share benefits with a surviving spouse.

Rehabilitation Benefits

The state will provide physical rehabilitation, retraining, education, and job placement. In addition to these services, actual and necessary travel expenses will be paid. During the time of rehabilitation, total temporary wage loss will be paid. The state may contract out these services to private providers.

Occupational Disease Benefits

All diseases contracted in the course of employment are considered occupational diseases. Benefits apply to total disability only and not to a partial disability. Benefits are paid on the same basis as an injury.

Subsequent Injury Benefits

Persons with a permanent physical impairment which restricts their employment may request certification. Once certified, the liability of the certified employee is limited in case the certified person is reinjured. Without this provision, it would be difficult for an injured worker to find other employment, as employers are reluctant to hire people with existing injuries.

Having explained the provisions briefly, attention now must be turned to the major causes of the financial disequilibrium, which is the subject matter of discussion in the next chapter.

FOOTNOTES

¹Lewis and Clark County v Industrial Accident Board, 52 Mont 6, 1910.

²Shea v North Butte Mining Co., 55 Mont. 522, 1919.

³William Prosser, Law of Torts, 4th Edition. (St. Paul, Minn.: West Publishing Co., 1971), p. 241.

⁴Richard A. Epstein, "The Historical Origins and Economic Structure of Workers' Compensation Law," Workers' Compensation Law Review; 8 vols. (St. Paul, Minn.: West Publishing Co., 1984), 1:47-48.

⁵Revised Codes of Montana, Chapter 96, 1915.

⁶Annual Report, Montana Division of Workers' Compensation, 1981.

⁷RCM 19 & 71, 82A-1016.

⁸MCA, 1985, 39-71-2101.

⁹MCA, 1985, 39-71-2201.

¹⁰MCA, 1985, 39-71-2301.

¹¹MCA 39-71-701 through MCA 39-71-721.

CHAPTER III

CAUSES OF FINANCIAL DISEQUILIBRIUM

A state of financial equilibrium is defined as one where premium income and investment income equal benefit payments and administrative expenses. The State Fund is now in a serious state of financial disequilibrium, with the latter far outpacing the former.

Questionable Premium Modifications

To determine an equitable premium rate, Montana uses about 330 different job classifications. Each classification will have a rate per \$100 of payroll in order to reflect how hazardous that particular job is. Rates will vary from a low of 42 cents per hundred of payroll for clerical workers to \$26 per hundred for loggers. This rate per hundred is multiplied by the employer's payroll in the proper classification to determine the premium paid. Private carriers will generally use the suggested rates or use it as a point of deviation for selected classes of clients. The State Fund developed its own rates with the assistance of the actuarial firm of Coates, Herfurth and England, Inc. (CH&E), based in San Francisco. A New York based organization called the National Council of Compensation Insurance (NCCI) gathers data on losses and paid premiums from most private companies on a nationwide basis. After analyzing this information, this organization publishes suggested rates for each

state. There is a major difference between the rate structures developed by these two. Any state fund should have somewhat lower rates, as it pays no taxes, has no sales commissions, and incurs no marketing expenses. As of July 11, 1986, the average State Fund rate was \$3.19 per hundred, while the average NCCI rate was \$8.27 per hundred of payroll.¹ Most authorities feel that these rate differences should be within a 20% to 25% range.² The current spread in Montana is 259%. There has been an ongoing argument for years as to which rate structure is correct.

The rate structure reflects the mean of the experience data developed. As there is considerable dispersion from this mean, the NCCI wanted to develop a procedure to modify the base premium to reward companies who had good loss experience and encourage those employers with poor loss experience to improve their safety record. (Good loss experience is defined as losses lower than expected, and poor loss experience worse than expected.)

There are several methods used to modify the basic premium. The first of these methods is the experience rating system. The NCCI has developed an experience rating for individual employers who develop an annual premium of at least \$2500 in the previous three-year period, or \$5000 in the previous year. In Montana, both the State Fund and Plan II subscribe to this NCCI experience rating service. Premiums under the \$2500 minimum are considered statistically unreliable. This rating is mandatory for all employers who qualify. The experience period is the three years preceeding the current year. As an example,

in 1986, the experience period would be 1983, 1984, and 1985. This experience rating factor would then apply to 1987 rates. The experience rating factor is first expressed as a ratio of actual losses vs. expected losses; the factor is then reduced to a percentage. This percentage is then multiplied by the basic premium to obtain the net premium. Note that if the actual losses are lower than the expected losses, a rate credit will be developed. If the opposite is true, then a rate debit will be charged.

The expected losses are developed from the actual loss data, modified by a formula that places greater weight on loss frequency rather than on loss severity. The rationale behind this system is that there is a positive correlation between an employer's loss control procedures and the loss experience.³ This, in turn, will encourage employers to expend more resources on loss control, as it will pay them to do so. For 1983, the State Fund experience rating factors ran from .49 to 2.0. Their distribution generally follows a normal curve, with ranges of .96 to 1.25 falling within one standard deviation.⁴ This system has been critized on several grounds. The experience base is rather old and may not reflect current expenditures on loss control. Also, all three experience years are weighted evenly, thereby not reflecting any trends. An improving loss experience over three years would not thus be recognized.

A study done in 1984 by noted researcher Louise Russell, challenges the idea that an experience rating will motivate an employer to expend more resources on loss control.⁵ The thinking has been that loss severity is basically a matter of chance and not really

within an employer's control though loss frequency can be controlled, and loss control measures can reduce loss frequency. Holding severity constant, Russell's study estimates the percentage change in premium costs that a firm can expect by reducing the frequency of accidents by 10%. Assuming the firm has an existing normal frequency, a further reduction in the frequency rate will reduce the premium cost with a firm of 25 employees by less than 1%. A firm with 50 employees would save only about 1.5%. Not until a firm nears 1000 employees could it hope for even a 5% reduction. There are very few employers in Montana with 1000 employees.

Another method of premium reduction is accomplished through the premium volume discount.⁶ If an employer has a net premium after experience rating of at least \$1000, this premium volume discount will apply. Volume discount ranges from 3% to 8%, depending on premium size. The rationale is that at the \$1000 level, certain fixed costs are met, and this adjustment gives fairer treatment to larger employers. However, larger employers have more claims, and the cost of handling claims increases rapidly each year.

Problems with Individual Plans

All three of the options available to employers to provide the statutory benefits to injured workers have serious problems in 1986.

Plan I. In 1985, the legislature expanded the options available under Plan I. Associations of employers are now able to form self-funded groups. As of this date, the Montana League of Cities and Towns (MLCT) and the Montana Association of Counties (MOAC) are the first two groups to set up approved self-funded plans. Both of these

organizations have hired third party administrators to handle claims, investments, and other administrative duties. Both plans have an initial rate structure near the State Fund in order to attract greater participation. The administrators of these programs plan to use sophisticated claims management techniques to keep the benefit payments within the premiums developed by the existing rates. The State Fund claim staff is overwhelmed with its work load and simply does not have enough people to spend the optimum amount of time on each claim. Private carriers generally have adequate claim staffing. A number of other trade organizations are planning to come on line with their own self-funded plan.

The Division of Workers' Compensation has the responsibility of overseeing the financial integrity of these groups. This can be a difficult task. Several years ago, the Great Western Sugar Company in Billings filed bankruptcy. The company had elected the Plan I option and had left a number of injured workers with no further compensation payments. Some of these workers have filed a lawsuit against the Division of Workers' Compensation, claiming the Division was negligent in its financial review of its employer. It is difficult for even the most sophisticated financial analyst to monitor the financial health of a company or trade association. If the Division should lose this case, a cloud might descend upon the future of the Plan I concept.

The Division of Workers' Compensation may want to consider at least one person who has had rigorous training in the area of company financial analysis. Someone with a surety bond underwriting

background would be well-qualified. If well-trained people are not hired, one could argue that the Department of Workers Compensation is violating its fiduciary responsibility to workers covered under Plan I. Further lawsuits could lead to abandonment of the Plan I option.

Plan II. At the end of 1985, the private carriers wrote around 52 million dollars of Workers' Compensation premiums in Montana representing about one half of the market.⁷ In early 1986, most of the companies would not write any new business and had advised many of their existing clients that they would not be renewing their policies. The companies cite two major reasons for this action. First, the vast differences between State Fund rates and NCCI rates cause most business to flow to the Fund.⁸ Secondly, the business that the private carriers write has been unprofitable. In 1985, the private carriers paid out \$1.25 in claims and expenses for every dollar in premium(s) taken in.⁹ It is expected that the Plan II writings would be under 20 million dollars by the end of 1986.

Plan III. There have been dark mutterings for years, coming mostly from the private sector, that the State Fund was in poor financial health. The first real sign of trouble came in the State Fund annual report for fiscal 1984. At the beginning of that year, the policyholder's surplus was \$5,547,025. At the end of the year, the surplus was \$352,338. These figures represent a 94% decrease. Later in 1984, CH&E reviewed more current data and concluded that instead of a \$352,388 surplus, there was in fact a deficit of \$23,758,000, as of the end of fiscal 1984.¹⁰ This data prompted the legislative audit group to retain the accounting firm of Peat,

Marwick, & Mitchell (PM&M) of New York to make an independent review. PM&M delivered its report to the State in March of 1986 and also concluded there was a problem. The firm estimated the discounted deficit to be in the 23 to 35 million dollar range and in the 65 million dollar range on an undiscounted basis.¹¹ The undiscounted claims liability is the amount of money it will take to pay off incurred claims as they develop over a period of years. For accounting and actuarial purposes, these claims can be discounted to present value by using an appropriate interest function. This is known as the discounted liability. A group of Workers' Compensation claims that occur in any given year take up to ten years or even longer to mature and finally close out. It takes this long in some cases to determine if injuries are permanent or not. The premium dollars are invested, and it is hoped the principal plus interest will be enough to fund these claims as they develop. Assuming that the State Fund could go to the legislature and get a 23 million dollar appropriation, the Fund could invest this money and over a period of five to eight years have enough money to pay off all the claims as they come due. If there is no money to make this kind of a cash deposit, the claims will continue to grow and become more expensive. PM&M has estimated the undiscounted liability to be in the area of \$65,000,000.¹² NCCI also did an audit and felt the undiscounted liability was almost 87 million dollars, and the discounted liability about 65 million dollars. There are two main reasons for these discrepancies.

The first is the discount factor applied to existing claim liabilities to bring them to present value. A major component of the State Fund balance sheet is an evaluation of incurred, but unpaid, claims by the actuaries and accountants. Estimates are made as to how much will be paid out in the future and in what time frame. These amounts are then discounted to present value. The higher the discount rate, the smaller this reserve amount will be.

Critics of the State Fund claim their current 9 1/4% discount rate is too high, thereby understating their current liabilities. At the time these audits were made, fiscally conservative investments were yielding around 6.5%, and critics feel that such a discount rate would be more realistic.

The second area of disagreement is how to evaluate the amount due on unpaid claims. Different actuarial methods will come up with significantly different answers. Everyone agrees there is a problem, but there are major disagreements as to its extent.

The cash in/cash out demands on the State Fund have been plotted on Figure 1. Note that unless major changes are made, the State Fund could no longer meet its payment demands by mid-1988. The general fund is in no position to bail anyone out; so underfunding has the makings of one of the greatest financial disasters to ever hit the state of Montana.

However, there may be some temporary relief in the wind. With the private carriers leaving the marketplace, there could be 30 million dollars premium(s) flowing to the State Fund. The average claim is paid out in 2.75 years, so considerable investment income

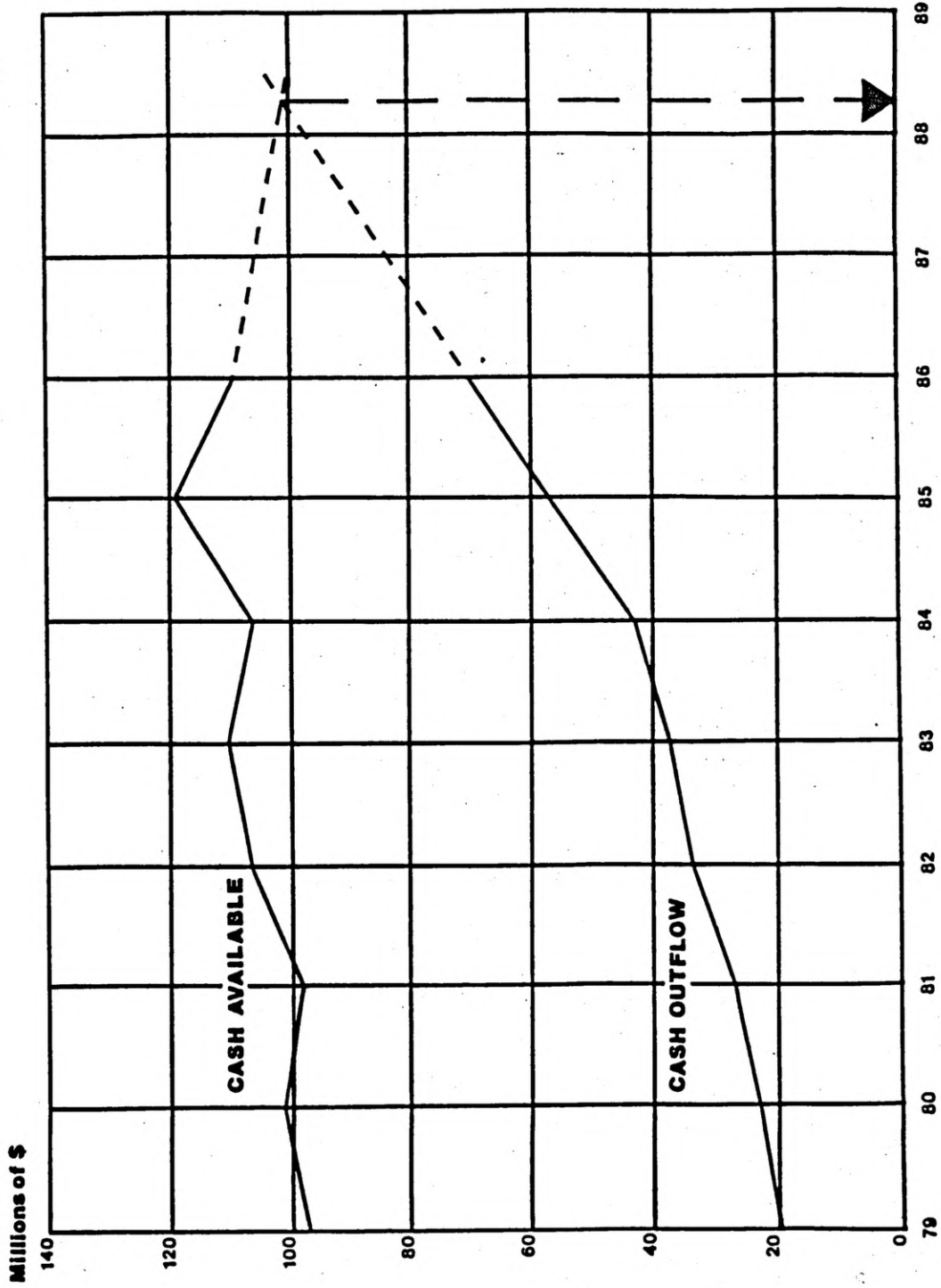


Figure 1. State Fund: Cash Available/Cash Outflow.

could be earned on this new money. But this only creates breathing room; the piper will eventually have to be paid.

Court Decisions

Following is a review of some of the major cases of the Montana Workers' Compensation Court and the Montana Supreme Court that have had a major bearing on the cost of Workers' Compensation cases in Montana.

Coles v Seven Eleven Stores, 1985.¹³ The Montana Supreme Court concluded that the insurer must bear the burden of proof that an injured worker, upon healing, can compete in the open labor market. This ruling creates the need to obtain detailed job analysis and labor market surveys to determine if a return to work is possible. This is a time consuming and expensive process.

Linton v City of Great Falls, 1985.¹⁴ This case established the position that a preponderance of medical evidence is no longer necessary in determining when a worker can return to work. When it is assumed that a worker has been injured, a disagreement then develops as to whether the worker can return to work or not. The insurance company hires several doctors to examine the worker, and they conclude that the preponderance of medical evidence shows the worker is healed. If the worker does not want to return to work, all the worker has to do is find a doctor that will say there exists a medical possibility that the injured person was not healed. He then can continue to claim benefits.

McDonald v Burlington Northern Transport Co., 1984.¹⁵ In this case, the Montana Supreme Court developed a vague and complex formula for settlement purposes. There are continuing debates among claimants and lawyers as just what this formula means, thereby causing even more litigation.

Hafer v Anaconda Co., 1984.¹⁶ This case expanded the concept of the inability of an injured worker to compete in an open labor market. Lack of (court) guidelines have proved troublesome. Experts will disagree as to what the "open labor market" is, thus opening the door to new areas of conflict and litigation.

Willis v Long Const. Co., 1984.¹⁷ As previously mentioned, several types of bi-weekly benefits could be converted to a lump sum settlement. When this was done, the insurer would discount the amount paid to present value. Willis challenged this provision, and the Montana Supreme Court agreed, not allowing any discounting. An example will serve to show the impact of this ruling. If a highly paid worker receives a permanent partial award, the dollar amount could approach \$150,000. Discounting this award at statutory amount to present value reduces the cash payment to \$76,500. It becomes obvious that this ruling has an enormous effect on the amount of money needed to pay benefits.

The 1985 Legislature reacted strongly to this case, passing a law which says these cases can be discounted to present value at a rate of 7%. The law also had a retroactive provision, dealing with cases that were in the pipeline. This retroactive provision was challenged in

Workers' Compensation Court on the grounds that it was a denial of due process and equal protection. The Court ruled for the plaintiff, and the State Fund has appealed to the Montana Supreme Court. The Court has heard the case but is yet to render an opinion.

Stelling v Rivercrest Ranches, 1986.¹⁸ In the event the State Fund would be unable to meet its benefit payments as they fall due, an interesting law could be invoked. MCA 39-71-2326 provides that if the State Fund cannot meet compensation payments, the individual employer pay his own compensation claims. The State Fund would then apply these payments as a credit against the next premium payment due, at 6% interest. Most employers simply could not pay a major claim.

Graham v Tree Farmers, Inc., 1981.¹⁹ The Montana Supreme Court in this case seems to limit "normal labor market" to the immediate area in which the injured worker lives. That is, an injured worker would not have to take a job he was qualified for in the next town.

Attorney Fees

The cost of litigation and related maintenance costs of the Workers' Compensation Court represents a significant transfer cost to the system. Based on information provided by the claims department of the State Fund, it was estimated that these transfer costs were be in the area of 8 million dollars in fiscal 1985.

One of the most troublesome areas of these litigation costs is attorney fees. Montana has one of the most, if not the most, lucrative attorney fee schedules in the United States for Workers'

Compensation cases. Most cases are taken on a contingency basis. For basic representation, the fee is equivalent of 25% of the award, not including any direct payment to medical providers. If the case is appealed to the Workers' Compensation Court, the fee is 33%. If the action is then appealed to the Montana Supreme Court, the fee rises to 40%.

Workers' Compensation cases are unique, and it is not at all clear that they lend themselves to the contingency fee structure. The contingency fee system does allow people with limited resources to have their day in court. The large fee percentage is justified on the basis that it is needed to cover expenses in cases attorneys do not win. However, the chances of losing a Workers' Compensation case are very small. All a claimant needs to do is establish a work-related injury and the system is triggered. Fault or legal responsibility are not at issue. Most of the litigation centers around how much compensation is to be paid and in what manner.

Author Larson, a respected legal authority in these matters, states that, as in other types of litigation, the attorney fee should come from the successful claimant's award.²⁰ Yet the Montana Supreme Court has developed a unique "net award" concept in Wight v Hughes Livestock Co., 1983.²¹ This concept states that an intact award must be preserved for the claimant and that the insurance company must pay the successful claimant's attorney fees in addition to the full award. This concept has proven to be a bonanza to the plaintiff's bar. For example, Swan v Sletten Construction Co. 86-85, an attorney fee of

\$205,520 was awarded.²² In Willis v Long Const. Co. a fee of \$147,000 was awarded.²³

In 1985, the Governor appointed a panel to study some of the problems of the Montana Workers' Compensation system. This group also recognized the problem of attorney fees. The panel stated, "Under current law, an assessment of attorney's fees is automatic if a claimant is successful before the court. This appears to be an unduly harsh penalty against an insurer in cases involving a bona fide dispute where an insurer raises legitimate defenses. The practice also raises the cost of the employer's insurance."²⁴

Lump-Sum Payments

The basic structure of benefits is payments on a bi-weekly basis. Such a schedule is designed to help the injured worker meet basic living expenses as they come due. The other option is to work out some type of a single, lump-sum payment. There was concern by regulators that many workers would not have experience in handling large sums of money, would spend it quickly, and then would be without further benefits. There was also concern that a lump-sum payment is too speculative for people with long-term injuries. The lump sum may not be enough, or too much.

The general problems of this option are well expressed in Arthur Larson: "In some jurisdictions, the excessive and indiscriminate use of the lump-summing device has reached the point at which it threatens to undermine the real purpose of the compensation system. Since compensation is a segment of a total income insurance

system, it ordinarily does its share of the job only if it can be depended upon to supply periodic income benefits replacing a portion of lost earnings. If a disabled worker gives up these reliable periodic payments in exchange for a large lump sum of cash immediately in hand, experience has shown that, in many cases, the lump sum is soon dissipated and the worker is right back where he would have been if Workers' Compensation had not existed. The claimant's attorney finds that it is much more convenient to get his full fee promptly out of a lump sum than out of a weekly payment."²⁵

Larson's comments have proven to be correct in Montana. The rising demand for lump-sum settlements caused the 1985 Legislature to raise the presumption against lump-sum conversions. In spite of this Act, the requests for lump-sum settlements continue to grow. In almost every case of a permanent partial or permanent total disability, there is a request made to convert the bi-weekly benefits to a lump sum. Most of these requests are justified on the basis that the injured worker will buy some small business or start a new one. The State Fund's claims examining staff suspects that the success rate of these ventures is small; the staff is hoping to do a study in this area now. The Division of Workers' Compensation feels they have an obligation to see that lump sums are awarded properly. If they are not, the injured worker may spend the lump sum improperly and end up in the welfare system.

It has been suggested that lump-sum payments be done away with entirely in order to eliminate these problems. This may not be the answer. There are some cases in which a lump sum conversion is in the

best interests of the injured worker, such as buying a small business. The answer may lie in a more stringent review of these requests by the Workers' Compensation judge.

Use of Dividends

Since 1978, the State Fund has returned \$19.8 million dollars to policyholders in the form of dividends.²⁶ A surplus of funds to be paid out in dividends can develop for several reasons:

1. The rates were too high, and the dividends represent a return of an overcharge of premiums;
2. Loss experience has not fully matured, and a potential surplus may simply be temporary funds needed to pay out future claims; and
3. The basic rate structure was correct, but good loss prevention activities on the part of policyholders caused an overall reduction in the accident rate, developing surplus funds.

The State Fund has a statutory obligation to operate on a "break even" basis.²⁷ As surplus funds built up in the Fund's coffers in the late 1970's, it was difficult to determine which of the above options was responsible for the surplus. If it had been one or three, dividends could safely have been paid. Even if the cause had been number two, the State Fund may very well have been directed by the legislature to pay out the surplus as dividends, since it could have been argued that the Fund was operating at a profit. As it turned out, the payments of dividends were a financial disaster. Had the dividends not been paid, the current deficit would be much smaller.

Subsidy

The State Fund recently agreed to lower the compensation rate for loggers. The logging industry is a powerful political force, and the Montana Loggers Association successfully argued that it was unable to compete with Idaho, whose compensation rate was considerably lower than Montana's. Because logging is a significant factor of the economy of western Montana, the Division of Workers' Compensation was sympathetic to this position. As a state agency, it felt that it had an obligation to help this ailing industry. Such a move will increase the deficit of the State Fund by at least 1 million dollars a year. This figure is a State Fund in-house estimate.

This move has not passed unnoticed by other trade groups. Several are organizing now, ready to ask for similar concessions for their members. Almost every group can make a case that its compensation rates are "high" by some standard, and each group will demand relief. This area will be a very difficult one for the State Fund Administrator on where the line on rate concessions be drawn.

Thus there appears to be several reasons for the current financial disequilibrium. These are additional problems that need to be considered as discussed in the next chapter.

FOOTNOTES

¹Interview with Dan Glenney, actuary and underwriter for Orion Financial Group, Helena, Mont., July, 1986.

²Interview with Ray Conger, a leading compensations expert in Montana from Missoula, Mont., July 1, 1986.

³ABC's of Experience Rating, National Council on Compensation Insurance, 1984.

⁴Information provided by State Fund employees, July, 1986.

⁵Louise Russell, Workers' Compensation Task Force Report, Vol. VI, 1985.

⁶"Pam 5" Pamphlet by Division of Workers' Compensation, 6/1/85.

⁷Montana 1985 Stastical Figures, published by Independent Insurance Agents of Montana Inc., July, 1986.

⁸Annual Report, 1984, Division of Workers' Compensation.

⁹"Montana 1985 Statistical Figures", published by Independent Insurance Agents of Montana, Inc., Helena, Mont., 1986.

¹⁰Ammendment to 1984 Annual Report of Division of Workers' Compensation.

¹¹Peat, Marwick, and Mitchell, Report to Legislative Auditors Office, 1986.

¹²Ibid.

¹³42 State Report 1238.

¹⁴WCC #8412-2784.

¹⁵41 State Report 1307.

¹⁶41 State Report 1403.

¹⁷41 State Report 2050.

¹⁸WCC 8412-2757.

¹⁹385 P2 283.

²⁰Arthur Larson, The Law or Workers Compensation; 7 vols. (New York, New York: Matthew Brenden, 1985), Sec. 82:71.

²¹Wight v Hughes Livestock Co., 38 St. Report 1632 (1981).

²²Swan v Sletten Construction Co., 41 St. Report 1899 (1984).

²³Willis v Long Const. Co. 41 St. Report 2050 (1984)

²⁴"Workers' Compensation Advisory Council, Recommendations for changes in the Montana Workers' Compensation System" p. 9, (1986).

²⁵Arthur Larson, The Law of Workers' Compensation; 7 vols. (New York, New York: Matthew Bender, 1985), Sec. 82:71.

²⁶Division of Workers' Compensation Annual Reports, 1978 through 1984.

²⁷MCA 39-71-2304.

CHAPTER IV

FUTURE PROBLEMS

A review of cases before the Montana Supreme Court shows some of the attempts to expand benefits under the Act. Additionally, some of the precedent setting actions outside Montana may further exacerbate the problem.

Mental Stress

Several years ago, California allowed "mental stress" as a compensable claim under its compensation system. It is hard to imagine any job that does not involve some degree of mental stress. Stress can manifest itself in many ways, accompanied by a spectrum of physical symptoms. It can be very difficult to establish a causal relationship between physical problems and job induced stress. At what level is stress considered disabling? This concept could exponentially increase the number of claims the system is trying to absorb.

Montana has consistently denied these types of claims as compensable. The leading case is Erhart v Great Western Sugar Co. (1976).¹ The Court ruled that mental stress is not a compensable injury because there was not a "tangible happening of a traumatic nature." All it takes is one Montana Supreme Court Decision covering stress claims to make new law in Montana. It would seem reasonable

that the plaintiff's bar will continually press this issue and if the Montana Supreme Court were to adopt the California position, the costs would be that much more.

Industrial Disease

One of the fruits of current developments in environmental science is the growing realization of how many workers are exposed to toxic substances. Insurance analyst Albert J. Millus estimates that only 5% of existing occupational disease potential claims are being compensated.² The current system cannot deal with the claims that will be developing in the next decade. One need only look at the problems of the Johns Manville Co. that it took a Chapter 11 bankruptcy to protect its assets against millions of dollars of lawsuits filed by people who claimed they were injured by inhaling asbestos fibers.

Many of these claims take years to develop. Who is financially responsible for a worker who changes employers within the same industry four or five times over a long period? Who bears the responsibility when a company changes its Worker's Compensation carrier several times over a twenty-year period? How does one compensate a worker who developed lung cancer, having smoked two packs of cigarettes for thirty years, and worked at a job where he inhaled toxic fumes for twenty years? It will take a monumental effort of cooperation between industry, labor, and government to solve this problem.

Attack on Sole Remedy Rule

To date, the Montana Supreme Court has upheld the sole remedy doctrine. However, one justice does appear to favor the rescission of this doctrine.³ Assuming a worker is injured by a defective power press, this novel legal theory holds that the injured worker can collect full compensation benefits and then sue the manufacturer of the power press under a products liability theory. Industry analyst Johnathan M. Weisgall reports that 42% of product liability claims result from this type of claim.⁴ The most common thrust of this theory is that an employer should be punished for "gross negligence" in failing to provide a safe workplace. California and Massachusetts will allow up to a 100% surcharge on benefits if the employer has been guilty of "gross negligence." How does one separate "gross negligence" from "ordinary negligence?" If this theory is adopted in Montana, it could add another layer of costs.

Effect of Future Rate Increases

The theory behind the compensation system is that the employer pass on the compensation costs to the public, who consume the goods or services. This is a reasonable proposal. However, that most businesses in Montana have a fairly elastic demand. If compensation costs represent a significant cost item, additional rate increases will drive up the cost of the product, thereby reducing demand. This process could cause worker layoffs, which our current Montana economy can ill afford.

Underground Economy

Another problem of rate increase is a growing underground economy. Discussions with people involved in the general construction trades in Montana, make it clear that as labor costs rise, a growing number of twilight contractors who operate outside the law can be found.⁵ Compensation costs are a major item to this industry. They carry no liability insurance, do not pay unemployment insurance, and do not carry Workers' Compensation coverage. Because of their reduced overhead, they can underbid those legitimate contractors who do comply with the law. As compensation costs rise, more of these twilight contractors will spring up. The injured workers of these illegal contractors will have no coverage.

As no one has control of the Supreme Court outside the court itself, one could only hope for less expansionary opinions. Other than that, some possible legislative and administrative solution that could lead the system toward financial equilibrium are presented in conclusion.

FOOTNOTES

¹169 Mont. 375.

²Albert J. Millus, "A Haunting Nightmare," Best's Review, July 1986, p. 39.

³Letter from Justice Frank B. Morrison, Jr. to Wayne Schile, editor of the Billings Gazette, dated January 20, 1986.

⁴William A. Miller, "Product Liability in the Workplace," Workers' Compensation Law Review, 7, (1983), p. 321.

⁵Interview with Clair Daines and Everett Egbert of Bozeman, Mont., July, 1986.

CHAPTER V

LEGISLATIVE AND ADMINISTRATIVE SOLUTIONS

Before addressing specific solutions, the key problem areas should be reviewed: Montana Courts have expanded benefits beyond legislative intent. This is an area beyond control of the legislature or the Division of Workers' Compensation. However, positive changes can be made in the area of excessive attorney fees, political pressure from trade groups asking for subsidies, payments of dividends where there was no surplus of funds, and Plan I companies that become insolvent.

In the light of the above, this chapter will address some of the legislative and administrative reforms that could restore the system to financial equilibrium. To do nothing is to court financial disaster. To bring the income/benefit ratio of the fund into balance, either benefits would have to be reduced or premium income significantly raised. As the latter is unlikely, given the current status of the Montana economy, the following alternatives are suggested.

Legislative Solutions

1. Some of the current benefit levels are in need of reexamination. As mentioned earlier in this paper, the surviving spouse of a worker killed in an industrial accident can be eligible

for lifetime benefits. This causes a great deal of uncertainty in quantifying what the benefit will be. A better approach may be to award a single lump-sum payment. For example, the amount could be based on the average face amount of life insurance policies in force in Montana. This, or a similar index could be developed from data provided by the State Auditor's office.

A second step is the 500 week maximum benefit schedule. The legislature may want to reexamine the possibility of reducing the number of weeks, keeping in view the savings to the system without losing sight of possible adverse impact on the injured worker.

2. Changing the level of proof involving medical evidence in disputed cases is yet another matter for study. All that is needed to trigger benefits in some cases is a medical possibility, rather than the preponderance of medical evidence. This latter approach would be more equitable, and reduce payment of unwarranted claims.

3. The creation of an arbitration unit to resolve the claim disputes should be helpful. This unit would not be under the control of the Division of Workers' Compensation, but under the direction of the Department of Labor. This should help insure impartiality. This indeed would create another layer of bureaucracy and some expense, but the amount of money saved by getting grievances resolved without litigation should far outweigh the costs. This arbitration system would be mandatory, and no one would be permitted to proceed with legal action without exhausting this process.

This type of arbitration procedure has been used successfully by the Montana medical community in reducing the amount of malpractice

litigation. This approach should go a long way in fulfilling the legislative intent of having a Workers' Compensation system that is not burdened by excessive litigation.

This unit would function as follows: An injured worker reports the injury to the employer, and the employer's insurance carrier contacts the employee. If the worker feels unfairly treated by the insurance carrier, an appeal will be filed to this arbitration unit at no cost to the worker. The cost of this arbitration procedure would be funded by assessments against the State Fund, private carriers, and self insurers. If the claim has merit, the staff will attempt to resolve the matter with the insurance carrier. If the worker is still unhappy with the result, the proceedings can then move the Workers' Compensation Court. The findings of this unit will be admissible as evidence in any other court proceeding.

Administrative Solutions

1. All State Fund dividend payments must be stopped until the Fund is solvent. The past payment of dividends drained over eighteen million dollars out of policy holders equity. The argument that payments of dividends increase loss prevention activities is questionable.

2. Consider discontinuing any rate credits based on experience modification plans. This would provide much needed additional revenue to the State Fund. After the Fund becomes solvent, consideration could be given to reinstate this program.

3. Subsidies in the form of rate reductions must be carefully assessed and not encouraged. There is tremendous political pressure to make these concessions. If a subsidy is allowed to one group, it becomes very difficult to deny others. These subsidies can cost the State Fund millions of dollars in lost revenue.

4. Increase the training level of individuals responsible for reviewing Plan I companies. It takes considerable skill to detect a financially faltering company. A persuasive argument can be made that the Division of Workers' Compensation has a fiduciary responsibility to the workers of Plan I employers to make sure that benefits will not be terminated because of a business failure.

5. The Administrator of the Division of Workers' Compensation has the statutory power to exercise tighter control over attorney fee schedules. As the amount of litigation in Montana creates an excessive drain on the system, the Administrator should exercise his authority judiciously in this area.

6. It is important to step up enforcement activities against uninsured employers. As our underground economy grows, so does the number of injured workers who have no benefits available.

In attempting to restore the system to equilibrium, there is an equity issue to be addressed. Currently an injured worker with a permanent partial disability is locked in at the benefit level at the time the award is made. What is justly due the worker ought not be lost sight of. The legislature may want to consider adding a Cost of Living Adjustment (COLA) to the benefit schedule to rectify this

inequity, thus balancing the demand for the fund's financial integrity with the welfare of the injured worker.

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