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SECOND INJURY FUNDS IN FLUX; OPPORTUNITIES, CHANGES, AND QUESTIONS

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As policymakers throughout the country grapple with exploding medical costs and the severity of long-term indemnity costs in workers compensation claims, they look to find other ways to lower employer costs so that employers can remain competitive. Debate about cost reduction in many states has focused on the abolition of second injury funds (SIFs) and whether elimination of such funds will help solve the cost problem. Given the complexity of cost reduction, SIFs can appear to be easy targets for savings. But is the bark here worse than the bite?

In recent years, New York, South Carolina, and Georgia have enacted legislation to phase out their respective SIFs. Over 20 second injury funds have closed or “sunset,” leaving about 20 states with SIFs open to claims with new dates of injury. Of these, about 10 have enabling language that creates significant opportunities for employer savings.

Critics of SIFs have cited growing assessment costs and have argued that the Americans with Disabilities Act (ADA) supersedes the social policy need for SIFs. Insurance industry spokespersons join in the debate and assert that private industry can provide reinsurance policies as a replacement. Statistics are scarce and critics are vocal.

While critics' comments have curb appeal, the absence of a constructive, statistically based discussion about the role of SIFs in helping employers, especially small employers, to alleviate the cost of long-term disabilities that have more to do with prior accidents, disease, or congenital conditions than the workplace injury, is telling. Discussion of fund eliminations, especially in the face of the imminent return of so many of our soldiers from Iraq and Afghanistan to the workplace, should give others pause in considering a "solution" that may save little money but leaves large gaps that may adversely affect employers and disabled employees alike.

While many SIFs have closed to future claims, employers should not forget that there is still, by the authors' estimates, upwards of \$40 billion dollars to recover from those funds. Employers and insurers need to be certain that processes are in place to recover those dollars effectively and efficiently. Furthermore, the clock is ticking on several funds, making it imperative that insurers and employers with exposure in those states act *now* to recoup any outstanding recoveries.

This article briefly reviews the history and intent of SIFs and provides an update of major changes with respect to SIFs that have recently closed or been changed by key laws. It will then seek to put the role of today's SIFs in a more modern context. For employers, that context is an era of significant interstate and world competition. As industry's understanding of the nature and consequences of injury and disease, and their relationship to loss of earning capacity, is refined, does it continue to make sense to force individual employers to pay for not only workplace injuries, but for preexisting conditions as well? And if not, how do we change the paradigm?

For many employees, the modern context is how to persuade the employer to assume the hiring risk. For tens of thousands of veterans, this risk includes injuries from war; for millions of others, the risk includes the burgeoning epidemic of medical conditions like diabetes and obesity; and for the growing ranks of older workers, it includes impairments developed over many years in the workplace.

HISTORY AND PURPOSE OF FUNDS

SIFs — also referred to as subsequent injury funds, apportionment funds, or trust funds — are mechanisms that were designed to both encourage

the hiring of and prevent discrimination against disabled workers through an indirect incentive approach. First introduced in the early 1900s, SIFs generally did not take root in any meaningful way until after World War II, when droves of wounded veterans rejoined the work force. In response, most states adopted some version of a fund to help remove impediments to hiring injured vets.

Because workers compensation rates are experience-based, employers were perceived as reluctant to hire employees with preexisting conditions or prior injuries that could potentially exacerbate the cost and seriousness of any subsequent injuries. SIFs offered a mechanism to reduce an employer's exposure in relation to the impact of the preexisting condition. Partial reimbursement added a financial incentive to hiring disabled workers, offering protection to an employer that might otherwise be unfairly burdened by costly claims.

In making payments, funds operate in one of two ways: either by reimbursing the insurer or employer for monies paid or by taking over the claim and making payments directly to the employee. In many states, employers must be able to demonstrate knowledge of a preexisting condition or impairment prior to any work-related second injury. To establish a claim, most funds require a medical opinion affirming that the disability resulting from the workplace injury is greater due to the preexisting impairment than would have resulted from the industrial injury alone. There are also strict requirements about when and how notices of intent are to be filed. Despite these high hurdles, it is often well worth meeting the burden of proof. Second injury claims are often high-dollar claims, many times entailing sums of \$100,000 or more of recovery.

When a fund closes or sunsets, the vast majority of costs do not go away. First, there is a long tail of payment on already established claims, which the authors estimate in the sunset fund states to be in the range of 40 billion dollars. Second, the cost of disability previously paid from these funds merely *shifts back to insurers*. In other words, whether the employer pays into a fund or to its insurer, employers must still bear the cost of the disability. In most states where funds were eliminated, there were few statistics to back up the elimination and little debate as to why or whether it is better or worse to shelve funds rather than keep them. For instance, in New York, there was no open debate whatsoever, nor are we aware of any follow-up studies that have analyzed the shifting costs of disability after closure.

THE ADVENT OF THE ADA

In 1990, the enactment of the Americans with Disabilities Act (ADA)

afforded various rights and protections against discrimination to the disabled in the hiring process. These protections were bolstered by state antidiscrimination laws. Many believed that these legal “sticks” would significantly alleviate the problem of discrimination in the workplace. The reality is far less sanguine, because the ADA’s application has been limited by the courts and by the statute itself. For instance, the ADA applies only to employers with 15 or more employees. Because the majority of jobs in this country are created by smaller employers, it follows that the majority of new hires are not protected by the discrimination provisions of the ADA. Discrimination against the disabled in the work force remains a major problem and a social negative for our country. Nevertheless, some observers came to believe that the protection antidiscrimination laws offered to disabled workers rendered SIFs redundant. They did not see that a financial benefit offered by SIFs to the employer through reimbursements of expenses or rate reduction could be an *added incentive* to hire disabled workers. There was little, if any, discussion about how to make second injury fund laws more effective as an alternative to repeal.

Beyond the stated social policy of promoting the hiring of individuals with prior conditions, SIFs serve an additional social function, which is significant but less discussed. In effect, these funds were established as a statutory reinsurance program and as a means by which the burden from certain high-cost claims and conditions would be spread among many throughout the economy. Because both small and large employers will no longer be eligible for any mitigating reimbursements in states that have eliminated funds, they will now bear the full cost of any second injuries, regardless of the significance of prior conditions to the employee’s disability.

FUNDS IN FLUX

Today’s active SIFs, and those that have closed or sunset, differ in detail by state, but they share a common principle of reinsuring costs of industrial accidents in which preexisting impairment contributes substantially to the injured party’s disability. Some of the active state funds with the most recovery potential today include Alaska, Arizona, Louisiana, Massachusetts, Nevada, and New Hampshire. As previously noted, 2007 legislative reform initiatives for workers compensation in New York and South Carolina sunset these funds. Other jurisdictions, such as Florida, Georgia, and Washington, D.C., have funds that have been, or are being, phased out and are in run-off. In most states that are transitioning away from SIFs, recovery opportunities are still available for claims prior to a specified cut-off date.

The following presents a status overview of states that have closed or sunset funds or have changes that have an impact on recovery policy:

New York — In March 2007, New York’s workers compensation reform bill was signed into law. One of the new law’s major provisions was the elimination of the state’s SIF, the New York Special Disability Fund. The Fund was closed to claims with dates of injury after June 30, 2007, and no new claims for reimbursement may be filed, regardless of the date of injury, after July 1, 2010. There are still many gray areas from the new legislation. For example, judges are currently ordering insurers with *pending* SIF claims to make payments for permanent disability into a special fund managed by the State Insurance Fund, known as the Aggregate Trust Fund (ATF), while *established* SIF claims are exempted from this requirement. These orders are currently the subject of intense litigation. Another issue has just been clarified. It is now established, by the opinion of the New York Workers’ Compensation Board, that there is an exception to the deadline of March 13, 2008 limiting reimbursement to medical and indemnity payments made within one year from the date of the request. For claims that have not been established as of March 13, 2008, requests for reimbursement of medical and indemnity payments may be made the later of one year from the date of payment or one year from approval of the claim.

Insurers and employers have a significant amount of work to do in light of the reform to obtain the recovery of the billions of dollars of claims incurred but not yet accepted by Special Funds.

South Carolina — In July 2007, the South Carolina Legislature made important changes to the state’s SIF statutes as part of the reform of its workers compensation system. Included in the legislation are guidelines for the sunseting of the South Carolina Second Injury Fund as of July 1, 2013. Between the law’s enactment last year and the upcoming date for closure to new claims, the types of claims that would be considered were narrowed to instances where the second injury essentially affected the same body part as the prior injury or condition. Legislation stipulated that no claim will be considered for reimbursement for an injury that occurs on or after July 1, 2008. For claims that occurred prior to that cutoff, an employer, self-insurer, or insurer must notify the SIF of a potential claim by December 31, 2010, and must submit all required information for consideration by June 30, 2011.

Florida — The Florida Special Disability Trust Fund is closed to claims with dates of injury on or after January 1, 1998. However, the Fund remains very active with many lifetime reimbursement claims still open.

Georgia — The Georgia Subsequent Injury Trust Fund is closed to claims with dates of injury on or after July 1, 2006. If notice of a potential claim has been previously filed or if the notice deadline of 78 weeks of payments has not yet passed, there is still time to submit a new claim to the Fund for review. If notice was filed prior to July 1, 2006, then the statutory deadline before which the Fund must *accept* the claim is July 1, 2009, which means that it will want all evidence submitted well in advance of that date.

Washington, D.C. — Although the Washington, D.C., Fund is closed to claims with dates of injury on or after April 16, 1999, the Fund will still accept new claims for dates of injury before that date if the insurer's claim is still open.

The following states have active funds that saw some changes in 2007:

Louisiana — The Louisiana legislature recently enacted changes to its SIF statute. The prior statute stated that the thresholds from July 1, 2004, through July 1, 2007, would be \$25,000 medical and 130 weeks indemnity. At the end of this period, thresholds were scheduled to decrease to \$5,000 medical and 104 weeks indemnity. However, the legislature recently postponed the decrease for two more years, leaving the current thresholds in place for dates of injury between July 1, 2004, and July 1, 2009.

Massachusetts — Pending case law will affect recovery in Massachusetts. The courts have ruled that there is no statute of limitations for claims with dates of injury between December 10, 1985, and December 23, 1991, and an appeal is pending decision before the Massachusetts Supreme Judicial Court. The Massachusetts Workers Compensation Trust Fund continues to be very slow in resolving and processing many claims and is significantly more litigious than other state funds.

OPPORTUNITIES STILL EXIST

With the prominent news of fund closures, many employers and insurers are under the mistaken assumption that few or no SIF recovery opportunities exist. Nothing could be further from the truth. States in which

material recovery opportunities exist (reimbursement states) currently disburse approximately \$600 million a year. For instance, a single claim for reimbursement in New York alone could be worth more than \$300,000 over the life of the claim.

States that take over payments to employees (rather than reimbursing insurers after they have made the payments) account for another estimated \$200 million a year in disbursements.

The author's experience shows that 15 percent to 25 percent of the opportunities are missed. This leads to the conclusion that the industry is leaving \$120 million to \$200 million in recoveries on the table.

Here are examples of recoveries that have been found in "sunsetting" states:

- **Washington, D.C.** — A forensic audit revealed an old, open file with potential SIF relief. The file was perfected for recovery, and within a year, a reimbursement was obtained, totaling almost \$500,000. In addition, indemnity on the claim, estimated to be worth another \$315,000, will continue to be reimbursed by the Fund for the life of the claim. The 17-year-old file had never been identified as a potential SIF claim before it was reviewed. Total recovery: over \$800,000.
- **Florida** — A review of files with older dates of injury demonstrated that files with dates of injury prior to the cut-off date of closed jurisdictions can still have value. A file was discovered where many years prior, the insurer had begun to pursue a SIF claim but dropped the claim under the assumption that the closure of the Fund meant that recovery was no longer possible. When the file was examined, it became apparent that the Fund had raised an improper legal defense to the claim. Using this argument, a claim was filed, and within months it was settled with a reimbursement in excess of \$200,000.
- **New York** — A review of files was performed in light of the Fund's imminent closure. A 12-year-old claim was discovered that had been rejected by the Fund for lack of sufficient medical evidence but was thought to have potential despite that obstacle. Additional evidence was obtained, and within six months, the Fund accepted the claim. The initial reimbursement to the insurer was over \$184,000 with an estimated \$224,000 in future recovery. Total recovery: over \$400,000.

THE MODERN CONTEXT

A significant percentage of workers today have impairments due to prior injury, disease, or congenital conditions that risk extending their time out of work when they suffer an industrial injury. The authors' work across the country shows that 50 percent of workers with long-term disability have preexisting impairments and that, for as many as half of these workers, their preexisting impairments significantly contribute to their disability.

The California legislature appears to have understood the harmful economic impact of this nonindustrial disability on employers when it voted in 2004 to radically change the law relative to long-term disability. Under the new law, employers are held liable for only the long-term cost of disability that is *directly* due to the employment accident.

Some industry observers find that this approach may be too harsh on employees. Nevertheless, no one can debate that, at the very least, the change was grounded in consideration of employer cost and fairness as to where that cost should lie, as well as how to keep jobs alive in California.

Another major social consideration today is the more than 200,000 injured veterans — many profoundly wounded — who will be returning to the work force after serving in Iraq and Afghanistan. According to Department of Defense statistics, 20 percent to 40 percent of those deployed at various points have been “citizen soldiers,” Reservists or National Guard, who will be returning to employers, many of which are legally bound to reemploy them as per the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA). At the close of 2006, more than 200,000 veterans had been treated at Veterans Administration medical facilities and more than 100,000 had been granted disability payments. Informed observers project that the number of disabled could eventually reach as high as 400,000 service members if the 20 percent rate of disability to discharge holds up.

Although the insurance industry is quite capable of designing reinsurance products to offer in place of abolished SIFs, the cost must still be borne by individual employers, either through their primary insurance policy or through a reinsurance policy. To our knowledge, no study exists as to whether or not the friction costs of an efficiently managed SIF are more or less than the built-in profit and broker costs that are added to insurance and reinsurance in the absence of SIFs.

When considering change, there are really only three options or variations thereon.

- The first option is to leave the burden of long-term workers compensa-

tion disability costs on individual employers. This policy is furthered by closing SIFs.

- The second option is to apportion the burden between employers and employees. This option is, in essence, the California model.
- The third option is to distribute, at least in part, the cost among all employers within a state. This is, in essence, what SIFs do.

Looking at these three options begs the question as to whether or not the time is right to debate if workers compensation should be limited to temporary wage replacement, with just one universal system utilized for long-term disability through Social Security. Significant friction costs could be reduced through the elimination of inefficient dual payment systems, potentially saving employers billions of dollars.

Obviously, there is great urgency for employer action in any state with a SIF that has sunset or is in the process of sunseting. Yet finding the opportunities requires the counsel of experts who understand the nuances of the law and the opportunities for legal challenges. In both active and sunseting states, recovery is a worthwhile pursuit. Every employer pays or has paid for the reinsurance of SIFs, but not every employer takes advantage of maximum recovery.

CONCLUSION

We do not advocate the position that one method of approaching distribution of the cost of long-term disability is right and another is wrong. What we do advocate for is thoughtful, statistically backed decisions reflecting today's realities. We know that no one should ignore the realities of our returning veterans or the hardships of our small employers. SIFs should, at least, be considered as providing a fair process to help address the needs of both parties. Finally, we know that employers must take proactive and timely steps to ensure full recovery of their rights, even in states that have already chosen to sunset SIF statutes. Opportunities abound for significant recovery in both closed and open SIF states, but in many jurisdictions, such as New York, there is a need for immediate action.

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