Economic Report:

Effects of Castellanos and Other Recent Court Decisions on Florida Workers' Compensation Costs, Employment and Wages

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August 11, 2016

The Florida Justice Reform Institute (FJRI) commissioned this expert opinion. The FJRI's mission is to fight wasteful civil litigation through legislation, to promote fair and equitable legal practices, and to provide information about the state of civil justice in Florida.

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Summary

The Florida Supreme Court's *Castellanos* decision and two other recent court decisions--*Miles* and *Westphal* -- will have profound effects on ***all Florida employers and employees***.

- Workers' compensation system costs will go up +35.4% in the state and much higher than the NCCI proposed first year rate increase of +19.6%.
- This means an estimated increase of $929 million per year in premium payments for insured employers and a $361 million per year increase in self-insured employers' costs.
- The court decisions will add in total an estimated $1.29 billion per year to employers' costs of doing business in the state.

It also means lower growth in employment and wages.

- A 1.3% point lower growth per year in employment and a 0.7% point lower growth in wages.
- Lower growth in employment translates to a loss of over 106,000 jobs per year in the state.
- Lower growth in wages translates to an average loss of $340 in wage income per year per employee.

I. Overview of *Castellanos* Decision

I have been retained by the Florida Justice Reform Institute (FJRI) to provide expert opinion regarding the impact of the Florida Supreme Court's *Castellanos*[1] decision and two other recent court decisions--*Miles*[2] and *Westphal*[3] -- on the Florida workers' compensation system costs. The FJRI's mission is to fight wasteful civil litigation, to promote fair and equitable legal practices, and to provide information about the state of civil justice in Florida.

NCCI evaluates the combined impact of the three court decisions on costs, and proposes a 19.6% rate increase for new and renewal policies effective October 1, 2016. [4] In my opinion, the combined impact of these decisions on the system costs will be much greater, +35.4%, than the NCCI proposed first year rate increase.

In 2009, I prepared an economic report on the Florida system costs, which was also commissioned by the Florida Justice Reform Institute.[5] It evaluated the effects of attorney fee provisions of SB-50A[6], enacted in 2003, on the Florida system costs in the context of the Supreme Court's *Murray* decision (2008).[7] I believe the analysis and the findings of the report remain

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[1] *Castellanos v. Next Door Co.*, 192 So. 3d 431 (Fla. 2016).
[2] *Miles v. City of Edgewater Police Dep't/Preferred Gov't Claims Solutions*, 190 So. 3d 171 (Fla. 1st DCA 2016).
[3] *Westphal v. City of St. Petersburg*, Case Nos. SC13-1930, SC13-1976, --- So. 3d ----, 2016 WL 3191086 (Fla. June 9, 2016).
[4] NCCI, *Florida Voluntary Workers' Compensation Amended Law-Only Rate Filing Proposed Effective October 1, 2016.*
[5] Helvacian, N. Mike, *Economic Analysis: The Effects of Murray Decision on Florida Workers' Compensation Costs, Employment and Wages, Florida Justice Reform Institute, (March 3, 2009).*
[6] Florida Senate Bill 50A, (2003).
[7] *Murray v. Mariner Health*, 994 So. 2d 1051 (Fla. 2008).

pertinent today for evaluating the impact of the *Castellanos* decision on the Florida system costs.

Prior to the enactment of SB-50A about one in three lost-time claims in Florida involved an attorney representing the claimant. The rate of attorney involvement in lost-time claims had steadily increased from 1994 to 1997, from 19% to 27%. Over the same period, the attorney fees also increased sharply, as did the costs of benefit payments, particularly the costs of lost-time claim benefits, and percentage of claims with a lump-sum payment.[8]

Prior to SB-50A, the claimant attorney fees were on a fee for service basis. The SB-50A changed this provision and based the attorney fees on the concept of benefits secured by an attorney on behalf of his claimant. Under this reform, an attorney representing the claimant could not bill for unlimited hours of service at the customary fees, but had to demonstrate value added or benefits secured on behalf of the claimant. The attorney fee schedule under SB-50A was in fact modeled similarly to an attorney fee paid on a contingency basis.

The *Murray* decision aimed to reverse this key aspect of the SB-50A reform, and revert back to rewarding claimants' attorneys on a fee for service basis. The *Castellanos* decision essentially does the same as the *Murray* decision: reverses the SB-50A reforms on attorney fees, and revives the concept of fee for service that existed in the pre reform period.

[8] Helvacian, N. Mike and Seth A. Reed, *Compscope Benchmarks: Florida 1994-1999, Workers' Compensation Research Institute (WCRI), (September 2001).*

The 2009 report quantified the effects of the SB-50A reforms on the Florida system costs. First, using data on claims from Florida and four neighboring states, it compared claim outcomes in the pre and post reform periods in Florida with outcomes from the neighboring states. Comparisons include costs of lost-time claims and claim characteristics, such as if an attorney represented the claimant and if a claim closed within 18 months from the date of injury, among many other claim specific information.

Secondly, it used an econometric model that I had developed with Phil Borba of Milliman specifically for Florida claims, published by WCRI (2006), to measure the effects of the model's variables targeted by the SB-50A on the claim costs and frequencies.[9] The targeted variables were percentage of lost-time claims with an attorney representing the claimant, attorney fees and whether the claims closed within 18 months of injury.

The analyses showed that the attorney fee provision of SB-50A was responsible for reducing the Florida workers' compensation costs, -28.6%, in the post reform period. The *Murray* decision would have reversed these cost savings, and *raise* system costs by the exact but reverse amount, +28.6%. This impact on costs far exceeded NCCI's then evaluation of *Murray* and proposed rate hike of 18.6% (2009).

The reform accomplished a number of changes that affected the stakeholders' claim management practices. When attorneys could not add value or were not likely to add value to the case, the claimants did not seek

[9] Borba, P.S and N. Mike Helvacian, *Factors that Influence the Amount and Probability of Permanent Partial Disability Benefits, WCRI, (June 2006).*

attorney representation. This was particularly evident in more costly permanent impairment (PI) claims, where attorney involvement was common before SB-50A, but fell sharply subsequent to the reform.

Secondly, it encouraged employers/carriers to make the best possible first offer in order to minimize the possibility of an attorney involvement, again affecting mainly PI claims. In less severe and less costly Temporary Disability (TTD) claims, the law removed the incentives to attorneys to keep claims open longer than necessary. This helped return the claimants to gainful employment as soon as it was medically possible.

These are indeed desirable outcomes for a self-executing no fault workers' compensation system.

Data analyses underlying the NCCI's recent rate filing corroborate my 2009 quantification of the impact of SB-50A on the Florida system costs. Using more complete and developed data than was available in 2009, NCCI actuaries show that both claim frequencies and costs declined sharply in Florida in absolute terms and in comparison to other Southeastern and Gulf States following SB-50A.

Average pure loss costs decreased in Florida in excess of 32% between pre and post reform periods (NCCI, 2016, Exhibit I). The benefit costs of claims with an attorney representing the claimant declined as well, as much as 27% relative to the other neighboring states (NCCI, 2016, Exhibit II-A). NCCI attributes these cost reductions largely to the attorney fees provisions of SB-50A. NCCI's rate filing attributes a +15% first year rate increase to

Castellanos, in an overall proposed rate increase of +19.6, effective October 1, 2016.[10]

The 2009 report went further and evaluated the effects of SB-50A on Florida employers' costs of doing business in the state. Reducing workers' compensation costs had profound effects on the state's economy in the post reform period. Lower claim costs meant lower insurance premiums for insured employers and lower payroll related employee costs for self-insured employers. The declining costs of doing business in the post reform period had desirable and predictable effects on the state: a flourishing economy with accelerated job growth and higher wages for the employees.

The 2009 report is pertinent and its findings applicable for evaluating the impact of *Castellanos* decision, as fee for service once again becomes the prominent method for compensating claimants' attorneys. *Castellanos* removes the cost containment measures that emerged from the attorney fee provisions of SB-50A. It turns the Florida system back to those practices that existed before the reform, which made the state workers' compensation system among the most costly. The *Castellanos* decision, before considering the effects of the *Miles* and *Westphal* decisions, will increase the system costs by +28.6%, the exact opposite of the measured gains that followed the SB-50A.

[10] In 2008, NCCI evaluating the impact of *Murray* decision on the system costs reported an 18.6% increase in the voluntary rates, somewhat higher than the current evaluation of 15.0%.

II. Other Confounding Court Decisions

The *Miles* and *Westphal* decisions confound the impact of *Castellanos*, and exacerbate Florida claims costs. With the *Miles* decision, the First District Court of Appeal removed certain statutory restrictions on the claimants to enter into payment arrangements with their attorneys. Under this ruling, an attorney's fee could be paid by either the claimant, union representing the claimant, employer/carrier, or some combination of the parties and agents involved. Prior to *Miles*, the employers/carriers were obligated to pay the claimants' attorney fees out of the court approved benefit payments.

The NCCI rate filing does not quantify the effects of *Miles* decision on the system costs, although the amended rate filing does state that the *Miles* decision is likely to put "additional upward pressure on system costs."

In my opinion, the *Miles* decision is likely to increase disputes between claimants and the employers/carriers, increasing litigiousness in the system above the current levels. Without the statutory restrictions on fee payments, more claims are likely to be filed for ambiguous cases, which may or may not be compensable under the workers' compensation statutes, and/or for types of injuries that are difficult to ascertain as work related. For example, the frequency of claims for back injuries and occupational diseases are likely to increase relative to claims filed for acute work injuries.

At this time, I am also unable to quantify the impact of *Miles* on system costs because of data limitations, but merely assume that there will be a small but significant 1.2% increase in the system costs (see table below, page 12).

Recently, on June 9, 2016, the Florida Supreme Court issued another opinion, *Westphal v. City of St. Petersburg*, Case Nos. SC13-1930, SC13-1976, --- So. 3d ----, 2016 WL 3191086 (Fla. June 9, 2016), and struck down as unconstitutional a statutory limit of 104 weeks (two years) of temporary disability (TTD) payments. The statute setting the 104 week limit was enacted back in 1994. With this ruling, the court revived the limit of 260 weeks (five years) of TTD payments that existed before the 1994 statute.

The NCCI rate filing does consider the impact of the *Westphal* ruling on the system costs, and proposes a 2.2% increase in the rates attributed to the *Westphal* decision.[11] The proposed increase is in addition to the 15% increase in the rates attributed to *Castellanos*. The NCCI evaluations do not consider "additional stakeholder behavioral changes or interactions that may result in changes to workers compensation benefits or practices."

The *Westphal* ruling, however, will result in additional behavioral changes and affect the stakeholders' practices as they implement new strategies to manage claims. With regard to the claimants' behavior, the *Westphal* decision will induce some claimants to stay out of work longer than otherwise necessary to achieve either full recovery or to reach maximum medical improvement (MMI). This is more likely with a claimant that may not qualify for Permanent Total (PTD) disability benefits at the onset of the

[11] See NCCI Amends Pending Florida Workers' Compensation Rate Filing to 19.6% (June 30, 2016). In an earlier analysis, NCCI estimates the effects of the *Westphal* decision as having 2.6% impact on the system costs.

disability, and may not be willing to accept a Permanent Impairment (PI) rating and a lump-sum benefit payment before reaching MMI.

With a five year limit, the claim adjusters and risk managers will have greater urgency to settle claims to avoid longer payments of TTD benefits. This means larger impairment benefit offers to settle claims. Moreover, a claim that could have closed with just TTD benefits could now become a PI claim, as adjusters and risk managers make an impairment offer to close the claim. In these situations claimants will likely need attorneys to negotiate the settlements, which in turn will increase litigation, increase frequency of costly PI claims relative to TTD claims, and increase claim costs.

I have not independently quantified the effects of the *Westphal* decision on the system costs. In my overall assessment (below), I merely use NCCI's rather conservative 2.2% impact on the proposed rate increase attributed to *Westphal*. The NCCI rate filing also proposes a 1.8% increase in the rates due to changes in the Florida Health Care Provider Reimbursement Manual. This increase is also included in my overall cost assessment without an independent evaluation.

III. <u>Overall Effects on System Costs</u>

The table below (page 12) summarizes overall effects of the court decisions on the Florida system costs. The first column shows the NCCI's proposed overall first year rate increase of 19.6% and the effects of each court decision -- *Castellanos* and *Westphal* – on the rates. Column 2 shows my assessment of the court rulings on the system costs, and the effects of each ruling on the costs. I use the NCCI's evaluations of *Westphal* and changes in the Florida Health Care Provider Reimbursement Manual.

As stated earlier, the *Castellanos* decision will fully reverse the cost savings that resulted from SB-50A, and increase the system costs +28.6%. The *Miles* and *Westphal* decisions will confound the effects on system costs, but their effects in my opinion have not yet been fully quantified. For my overall evaluation below, I use the NCCI's quantifications of *Westphal*, a 2.2% increase in the rates, and assume that the *Miles* decision will increase costs by a mere 1.2%.

With the cost increases attributed to *Miles* and *Westphal*, changes in the health care provider reimbursements, and the 28.6% cost increase attributed to *Castellanos*, I believe overall system costs in Florida will increase +35.4%.[12]

Summary of Proposed Chages

	NCCI Proposed Rate Change	Effects on System Costs
Overall Effects	**19.6%**	**35.4%**
Castellanos Decision	**15.0%**	**28.6%**
Westphal	**2.2%**	**2.2%**
Miles	**0.0%**	**1.2%**
Health Care Provider Reimburments	**1.8%**	**1.8%**

[12] The figure of 35.4% is derived in the following manner: *Castellanos* 28.6%, *Westphal* 2.2% (NCCI's evaluation), *Miles* 1.2% (my conservative assessment), and provider reimbursements 1.8% (NCCI's evaluation). The total impact 35.4% = ((1.286 x 1.022 x 1.012 x 1.018) – 1) x 100.

IV. Effects on Employers' Costs, Employment and Wages

The increase in workers' compensation costs will have profound effects on Florida employers. For insured and self-insured employers alike, the workers' compensation premiums and costs will go up on average 35.4%. This means an estimated $929 million per year increase in the premium payments for insured employers and a $361 million per year increase in claim costs for self-insured employers. [13] The court decisions in total will raise employers' costs of doing business in the state by an estimated $1.29 billion per year.

The higher workers' compensation costs are similar to raising the employers' payroll taxes, a proportional tax that is directly levied on an employer's payroll. The exact cost would depend on the employer's industry and payroll by occupational classifications, with a greater cost impact falling on employers in the high risk industries and occupations: for example, construction and manufacturing occupations and industries.

Unlike an increase in the payroll taxes, however, the employers' higher insurance premiums or claim costs is not a source of revenue to the state, but a source of income to the claimants' attorneys. The claims data I analyzed in 2009 indicated that under a fee for service a greater percentage of lump-sum benefit payments (about 42% of the benefits) would go to the attorneys

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[13] The composition of total written premium for 2015 – preliminary-- is as follows: $2.625 billion private carriers (source: NAIC Annual Statement), and $1.020 billion estimated combine premium of individual and group self-insured employers (source: NCCI). Premium increases are calculated as follows: $929 million=0.354 x $2,625 for insured employers, $361 million = 0.354 x $1,020 for self-insured employers, and total employers' cost $ 1.290 billion = $929 million + $361 million.

representing the claimants than under the SB-50A attorney fee provisions (about 40%).

A 35.4% increase in employers' costs will also affect the state's employees and their wages. With rising labor costs, the employers' demand for labor will decline, putting downward pressure on the growth rates of employment and wages.

To put this in perspective, an employer with $3,000,000 payroll and a workers' compensation insurance premium of 5% on the payroll ($150,000) will experience a $53,100 (+35.4%) increase in its insurance premium.[14] For this employer, such an increase could mean reducing its workforce by one person, or giving smaller raises to employees, and/or forgoing hiring one additional employee. The premium increase could be twice as large for an employer in the high risk industry with a similar size payroll.

In the aftermath of SB-50A -- 2003 through 2007 -- the average employment growth in Florida was nearly twice as great as the average growth in four neighboring states, 2.8% per year and 1.5% per year, respectively. Similarly, average annual wage growth in Florida exceeded the wage growth in neighboring states, 3.4% per year on average over the same period versus 2.7% average annual increase in the neighboring states. A similar but reverse impact on the business costs would mean a loss of over 106,000 jobs per

[14] Calculated as $53,100 = 0.05 x 0.354 x $3,000,000.

year in the state, and an average loss of $340 in wage income per year per employee.[15]

V. Data and Methodology

The 2009 report analyzed panel data --cross section data-- of lost-time claims, their costs and characteristics from NCCI's Detailed Claim Information (DCI) database, and frequency of Permanent Impairment and Temporary Disability claims from NCCI's Financial Data. The claims were for injuries that occurred before the SB-50A reform (January 2000 through the first half of 2002) and after the reform (from the second half of 2004 through December of 2006). The panel data includes a variety of claimant and claim characteristics: ages and genders, types of injuries by part of body, occupations, and information on an attorney representing the claimant and if the claim closed within the time of evaluation, 18 months from the time of injury.

The analysis compared the claim variables over the pre and post reform periods in Florida and in four neighboring states in the region: Georgia, Alabama, Mississippi and Louisiana. The claims data on the neighboring states for the same periods are used as a control when evaluating the effects of SB-50A in Florida.

I then used an econometric model for Florida that I had developed with Phil Borba of Milliman at WCRI for evaluating the effects of various

[15] The calculations are as follows: loss of employment in the state, 106,409 = ((1.028/1.015)-1.0) x 8,308,100 covered employees in Florida; and, loss of wages, $340 = ((1.034/1.027)-1) x 52 x $958 average weekly wage of covered employees in Florida. The data source of employment and average wage is the U.S. Bureau of Labor Statistics, Table 3, Covered establishments, employment, and wages by state, fourth quarter 2015.

independent variables on the model's two dependent variables -- claim cost and likelihood that a lost-time claim will become a permanent impairment claim.

The model's parameters statistically measure and test the effects of each independent variable on the two dependent variables, controlling for claim and claimant characteristics. Various hypotheses regarding stakeholders' behavior may be stated, measured and statistically tested. These include the effects of variables that were targeted by the statutory reform – attorney representation of the claimant, attorney fees, and duration from time of injury to claim closure. I used the econometric model parameters to quantify the impact of the targeted variables on claim costs and frequencies.

This analysis indicated that the Florida workers' compensation costs declined, -28.6%, following the SB-50A reforms of the attorney fee provisions. The *Castellanos* decision in reversing the reform provisions will have the exact reverse effect of SB-50A, raising the system costs by the same percentage, +28.6%, without including the effects of the *Miles* and *Westphal* decisions. The *Miles* and *Westphal* decisions will exacerbate the effects of *Castellanos* on claim costs, raising the overall increase in the system costs to +35.4%.

VI. **Conclusion**

I believe the three court decisions – *Castellanos*, *Miles* and *Westphal* – will have profound effects on Florida workers' compensation claim costs and employers' costs of doing business in the state. In my opinion, the combined impact of these decisions will be to raise employers' insurance costs and claim costs by +35.4%, much greater than the NCCI proposed first year rate increase of 19.6%.

My opinion is primarily based on an economic analysis and report that I prepared in 2009, which was also commissioned by the Florida Justice Reform Institute. The report evaluated the effects of attorney fee provisions of SB-50A (2003) on the Florida system costs in the context of the Supreme Court's *Murray* decision (2008). The analyses and the findings of the report by and large remain the basis for my opinion today for evaluating *Castellanos*' impact on the Florida system costs.

The *Castellanos* decision essentially reverses SB-50A reforms on attorney fees, and revives the concept of fee for service that existed in the pre reform period. Prior to the enactment of the SB-50A Florida workers' compensation costs were among the highest in the nation, driven largely by increasing incidence of claimant attorney representation, attorney fees and attorney driven benefit costs.

The SB-50A based attorney fees on the concept of benefits secured by an attorney on behalf of his client -- the claimant. Under this reform, an attorney representing the claimant could not bill for unlimited hours of service at the customary fees, but had to demonstrate value added or benefits secured on behalf of the claimant.

The reform altered the behavior of the stakeholders – claimants, employers/carriers, and claimant's agent attorneys -- in the way they practice claim processing and resolution. The 2009 report shows that the attorney fee provision of SB-50A was responsible for reducing the Florida workers' compensation costs in the post reform period -28.6%.

Data analyses underlying the NCCI's recent rate filing corroborate my evaluations of the impact of SB-50A on the Florida workers' compensation system costs.

Two other recent court decisions –*Miles* and *Westphal* -- confound the *Castellanos* decision and exacerbate costs in the Florida system. With the *Miles* decision the First District Court of Appeal removes certain statutory restrictions on the claimants to make direct payment arrangements with their attorneys.

With *Westphal*, the Florida Supreme Court struck down as unconstitutional the statutory limit of 104 weeks (two years) of temporary disability payments that was in effect since 1994. The court revived the limit of 260 weeks (five years) of temporary payments that existed before the 1994 statute.

While the effects of these two decisions are not yet quantified, they will fundamentally alter the way stakeholders practice claim resolution process and exacerbate the impact of *Castellanos* on costs. The combined effects of the three court decisions will raise the Florida workers' compensation costs 35.4%.

Summary Conclusion

The three recent court decisions – *Castellanos, Miles and Westphal* -- will have profound cost impact (35.4%) on all Florida employers, both insured and self-insured employers alike. A 35.4% increase in the overall claim costs will mean the following:

- The premiums will go up by an estimated $929 million for the insured employers, and the claim costs will increase by an estimated $361 million for self-insured.
- The combined impact of court decisions will be to raise Florida employers' costs of doing business in the state by an estimated $1.29 billion per year.

The state's 8.3 million employees and their wages will also be affected. With rising labor costs, the employers' demand for labor will be lower than without the cost increase, putting downward pressure on demand for employment and wages.

Using the experience in the aftermath of SB-50A (2003 through 2007) as a guide, the effects on the employees will be the following:

- The average employment growth in Florida will be a 1.3% point lower per year, and average annual wage growth in Florida will be a 0.7% point lower per year.
- These translate to a loss of over 106,000 jobs per year, and average wage loss of $340 per year per employee.