

Preconference Workshop 5

Monday, November 7, 9:00 a.m.–4:30 p.m.

WORKERS COMPENSATION

Presented by

William H. Perkins
Instructor
Florida Association of Insurance Agents



A popular introductory course, this workshop provides an overview of construction bond and insurance programs. The day starts with an overview of contract bonds that are commonly used in construction, including when each type of bond is appropriate and what they do and do not cover. Subsequently, experts in general and umbrella liability, builders risk, and workers compensation insurance will examine the coverage provided by these policies. Designed primarily for those who are new to construction insurance, this session provides a foundation for understanding more advanced concepts that will be examined in other Conference workshops. This workshop will review the common types and uses of construction contract bonds; examine the coverage provided by contractors' core insurance policies; identify coverage challenges and make recommendations for filling gaps or modifying problematic policy language; and provide a basis for understanding higher-level concepts presented during the remainder of the Conference.

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William H. Perkins
Instructor
Florida Association of Insurance Agents

Mr. Perkins is one of the presenters for Monday's Preconference Workshop 5, "Introduction to Construction Bonds and Insurance." Before taking his current position as an instructor for the Tallahassee-based Florida Association of Insurance Agents (FAIA) in June 1993, he was an insurance agent for 12 years in Orlando. His teaching responsibilities at the FAIA are concentrated on commercial insurance including teaching the American Institute of CPCU/Insurance Institute of America's Accredited Advisor in Insurance (AAI) and Associate in Risk Management (ARM) programs. Other duties include membership on The Independent Insurance Agents and Brokers of America's Technical Affairs Committee and Florida's Workers' Compensation Appeals Board. He is a graduate of Loyola University of the South and holds the Accredited Advisor in Insurance designation.

Mr. Perkins was named IRMI's Words of Wisdom (WOW) speaker at the 21st IRMI Construction Risk Conference. This is Mr. Perkins's eighth year to speak at the Construction Risk Conference.

Notes

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WORKERS COMPENSATION

William H. Perkins
Florida Association of Insurance Agents

**I. Workers Compensation:
Exclusive Remedy**

- a. Immunity is for me!
- b. Is this a trick question?

II. How Far Does the Coverage Go?

- a. E.T.: The Extraterritorial
- b. Federal jurisdiction

**III. Exemptions:
Who Counts and Who Doesn't?**

- a. Who is covered by workers compensation?
- b. Who isn't covered any why?

**IV. Independent Contractor vs.
Subcontractor**

- a. What's the difference?
- b. So, what's the big deal?

V. So Sue Me! Third-Party Suits

- a. Is this allowed?
- b. Can it be prevented?

**VI. Subrogation:
To Waive or Not To Waive**

- a. Advantages
- b. Disadvantages

VII. Workers Compensation Premiums

- a. How premiums are determined
- b. How costs can be controlled

VIII. Certificates of Insurance

- a. Tool or weapon?
- b. Is it worth the paper its written on?

**IX. Loose Ends:
Questions Looking For Answers**

Notes

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WORKERS' COMPENSATION

Historical Background

The origin of workers' compensation is inextricably tied to the economic phenomenon known as the Industrial Revolution and the law of the day. During this stage of history, the Industrial Revolution was reshaping the agrarian-based economies of many European countries and the United States. Agriculture and its associated commerce formed the financial bedrock of much of the western civilization at the time. However with the advent of mechanization and manufacturing, no longer was the countryside the workplace for legions of workers. Rather the city became home to factories luring former farmers and field workers eager to participate in this new economy. These new factory workers were not adequately trained, if at all, on the hazards of operating equipment which regrettably led to the injuries and deaths of many.

Under the common law system developed both in England and in the United States, the injured worker had only one recourse: sue the employer. The worker was faced with the burden of proving that the employer's negligence was the cause of the injury. The employee was to show how the employer failed to provide one or more of the following common law obligations:

1. A safe workplace;
2. An adequate number of properly trained fellow employees;
3. Safe tools and equipment;
4. Rules to ensure the safety of employees; and
5. Warnings of work-related dangers not normally known to workers

This process provided a great deal of protection to the employer and very little to the injured worker. To further compound the employee's chance of recovery, the courts provided additional employer protection with the establishment of three major defenses used by employers. These common law defenses are:

1. The fellow servant doctrine;
2. The assumption of risk doctrine; and
3. Contributory negligence.

Under the fellow servant doctrine, the employer was not liable for injuries to an employee which resulted from the negligence of another employee. The only recourse would be for the injured worker to sue the employee who caused the injury. Under the assumption of risk doctrine, if an employee was injured as a result of an accident which an employee knew was a hazard of the occupation, the worker was deemed to have accepted the risk of such injury and the resulting consequences. Under the principle of contributory negligence, any negligence on the part of the injured worker, no matter how small, negated any liability of the employer. Lastly, the expensive litigation process and the defenses available to the employer made it highly unlikely that a worker would recover at all, much less recover actual losses or future earnings.

Significant reform began in Germany. In 1884, Germany enacted a comprehensive package of compulsory insurance to provide coverage for sickness, accidents, old age and invalidism. The origins of the law was rooted in the socialist philosophy that a large proportion of the misfortunes, sickness, accident and premature aging were social in origin, resulting from forces over which the individual had no control.

Two fundamental differences distinguished the German system from later enactments in both England and the United States. First of all, the German system was more comprehensive, an early version of national health insurance. Secondly, workers contributed funds to the plan, much like Americans contribute to employer sponsored health insurance plans today.

More significantly for Americans was the English law adopted in 1897. The British act differed considerably from the German in that it was more heavily weighted in favor of the employer and based less on the social idealism of the German system. Injuries were covered for accidents "arising out of and in the course of the employment" rather than simply "occurring in the course of employment" as in the German law. Compensation was denied if the injury involved "serious and willful misconduct" by the employee. Detailed notice of injury requirements had to be met before a claim could be maintained.

In 1902, Maryland became the first state to adopt a workers compensation law. Two years later the law was struck down by the courts. New York followed with its' own passage of a workers' compensation law in 1910. The act was limited to certain especially dangerous employments and used the British standard of covering accidents arising out and in the course of employment. This law was later repealed as unconstitutional by the New York Court of Appeals as a taking of property without due process of law. Finally in the states of Massachusetts, Wisconsin and Washington, laws were passed which were later proven to pass constitutional muster. In Massachusetts, the act was much more detailed than New York's law with more liberal worker benefits. Reasonable medical and hospital services were required along with payments for amputations based on a schedule of benefits. In Wisconsin, the employer was permitted to reject the workers' compensation law. If rejected, employers were subject to tort without the benefit of the three common law defenses. Finally, the state of Washington passed legislation which designed a system to provide sure compensation in exchange for the elimination of litigation.

In 1917, the United States Supreme Court settled any remaining doubts by ruling in favor of the validity of workers compensation laws. Seventeen years later, all states had passed workers compensation laws.

While all fifty states and the District of Columbia have workers compensation statutes, no two states laws are identical. Each has drafted and revised legislation which is unique to that state. Each law reflects specific needs or desires of the individual state yet each share some similar tenets of law. For example, one of the basic concepts of workers' compensation law is the employer is responsible for paying benefits to an employee injured on the job, whether or not the employer is negligent. In exchange for this benefit, the employee does not have to sue to receive compensation and some type of immunity protects the employer.

Workers compensation benefits are provided by insurance companies, by qualified self insurers or by state workers compensation funds.

The most common method of providing workers' compensation benefits is through the purchase of an insurance policy. Insurers issue policies which conform to the laws of the state(s) shown on the policy, pay claims and assist in controlling losses. In exchange, the insurer charges the employer a premium for workers' compensation benefits and related services. Self-insurance is another method and is often reserved for larger employers. Because of their size, these employers can accurately predict their losses, set aside funds for the payment of claims and provide suitable loss control and claims handling services without the need of a private insurer.

In six states the workers' compensation program is administered by the state itself, not private insurers. These six states are Nevada, North Dakota, Ohio, Washington, West Virginia and Wyoming. They are often referred to as the monopolistic states. These monopolistic state funds charge premiums, provide workers' compensation benefits, loss control services and claim payments. Employers in these states must obtain workers' compensation from the state funds.

Purpose of workers' compensation

The underlying principle upon which workers' compensation laws exist is that the cost of industrial injuries, to certain limits, should be borne by society at large or, more accurately, by the consumers of the goods and services provided by particular businesses, rather than by the individual working person. Workers' compensation laws embody this principle by abandoning the common law tort system in which liability is predicted on negligence. Under workers' compensation law, employers have absolute liability to fund prescribed benefits to employees for occupationally incurred injuries, without regard to fault. The recovery of workers' compensation benefits is the injured employee's exclusive remedy. Employees are barred from suing employers for damages for their injuries.

Fundamental to workers' compensation is that benefits are payable because of occupational injuries arising out of and in the course of employment. While the scope of this obligation is very broad, it is also true that not all injuries occurring at work are compensable. For instance, while at work an employee of a retail store was attacked by a robber and was injured, the employee would be eligible for worker's compensation benefits. The injuries arose out of and in the course of employment. In contrast, if the same employee was attacked at work by a disgruntled friend due to a disagreement over unpaid bills, the employee would not be eligible for workers' compensation benefits because the injuries did not arise out of and in the course of employment.

Confusion over eligibility for benefits for injuries arising out of and in the course of employment often surface when employees are involved in accidents while driving to and from work. Some states' laws specifically address this issue and deny eligibility when the worker is driving to and from work if the place of employment is at a fixed location. If the employee is performing a special errand on behalf of the employer either on the way to and from work or during the day after having arrived at work, injuries sustained in an accident are considered arising out of and in the course of employment. Contractors and traveling salespersons are good examples of employees who may have special exposures involving this going and coming rule.

In addition to having eligible benefits arise out of and in the course of employment, injuries must be a result of an accident. This term is normally defined in statute and over the course of time has been the beneficiary of numerous court decisions. Accidents often are characterized as a broken bone, laceration or an injured muscle. These "classic" injuries make up many of the types of losses covered by workers' compensation. Some accidents however, are not as simple nor having a well defined cause or origin. For example, butchers, data entry personnel and dental hygienists can experience carpal tunnel syndrome which is an occupational injury resulting from repetitive action. There is no sudden or unexpected event that caused the injury, yet repetitive action injuries have been shown to be accidents and compensable under workers' compensation.

By requiring employers to guarantee benefits by maintaining insurance or via self insurance, the injured employee is guaranteed certain benefits resulting from accidents arising out of and in the course of employment. These reciprocal guarantees afford the injured worker with the assurance of benefits resulting from an occupationally related injury or death and provide the employer the assurance of tort immunity.

Who is covered by workers' compensation?

To understand who is eligible to receive protection afforded by workers' compensation laws, the definitions of employer and employee found in the specific state's workers' compensation statutes must be analyzed. Often an employer will be defined to include a sole proprietor, partnership or a corporation. As employers, they will not be eligible to receive benefits (although some states make provisions for sole proprietors and partnerships to elect to be covered) under workers compensation, rather they enjoy tort immunity. Employees on the other hand would be persons employed by a sole proprietor, partnership or corporation and thus eligible to receive the benefits outlined in statute. However, there are persons or entities who are hired by employers who are not defined by law as employees. Depending on the state, independent contractors and subcontractors are not defined as employees and as such, they may not require workers' compensation coverage.

Broadly defined, independent contractors usually furnish their own materials and equipment and are paid based on a contracted price. They do not fall under the direct supervision or control of the employer and are responsible for the final work product. As such, independent contractors can legally do business in some states without having to carry workers' compensation insurance. Caution is recommended when involving an independent contractor because a work related injury may result in a lawsuit seeking to deny independent contractor status and show the injured party as an employee of the general contractor. If successful, this will result in having the insurer pay benefits for which no premium had been collected from the employer. This will result in additional premium due the insurer from the employer when the policy expires. If permitted, it is suggested to require independent contractors to provide evidence of workers' compensation coverage.

Subcontractors are entities working under contract for a general contractor. A general contractor is one who has been awarded a contract and in turn parcels out (subcontracts) parts of the contract to others. These subcontractors perform the work as required by the general contractor. In most states, general contractors are responsible only for the payment of benefits to injured employees of an uninsured subcontractor. If the subcontractor does not carry workers' compensation, the general contractor is then obligated to provide the benefits afforded under the state's workers' compensation law. The individual operating as a subcontractor would not be eligible for benefits as (s)he would be treated as an independent contractor. Again, it is suggested to require subcontractors to provide evidence of workers' compensation coverage.

When proof of insurance is required, it is often in the form of a certificate of insurance. This document provides the basic policy information including:

- Insurers affording coverage;
- Type of insurance (e.g. liability, auto, workers' compensation)
- Policy number(s)
- Effective and expiration dates
- Limits of insurance

Certificates of insurance provide a snapshot view of the coverage provided to the insured. It confers no rights upon the certificate holder nor can it be used to alter the coverage shown on the certificate. Certificate holders who frequently request copies of certificates of insurance are companies doing business with the insured, mortgage holders and loss payees and governmental entities.

Widely used, standardized certificates are published by ACORD, the agency-company organization for research and development located in Pearl River, New York.

Workers' compensation coverage

There are three categories of benefits which may be payable to an injured employee:

1. Medical expenses;
2. Disability; and
3. Death

Workers' compensation pays for all medically necessary remedial treatment, care and attendance by a health care provider for as long as necessary to enable the injured employee to recover. All drugs, medical supplies and devices such as wheelchairs, crutches, and other prosthetic devices are covered. Unlike many health insurance policies, workers' compensation has no coinsurance provisions or deductibles which limit payment. Reimbursement of medical bills are however, based on a maximum fee schedule adopted by the state. Increasingly, many states have adopted a variety of methods in an effort to control the cost of delivering workers' compensation medical benefits. Some states have approved rules that permit employers to select coinsurance options and deductibles and in some cases, states have chosen to institute mandated managed care statutes which further contain health care costs.

Compensation for disability is designed to partially reimburse the injured employee for inability to perform normal work following a compensable injury. The basis for computation of the disability benefits due is a percentage (normally 66 2/3%) of the employee's weekly wage subject to a minimum and maximum amount determined by each state. Payments for lost wages typically are made after a waiting period, usually three to seven days, and depending on the duration of the disability, e.g., more than 21 days, payments are made retroactively for the waiting period. Disability payments are not designed to replace the full wages of the injured employee. The incentive is for the injured employee to return to work as soon as practicable and receive normal wages thereby permitting the discontinuance of disability payments.

There are four specific classifications of disabilities:

1. Permanent total;
2. Temporary total;
3. Permanent partial; and
4. Temporary partial

Permanent total disability cases involve catastrophic-type injuries, which renders the employee unable to perform any work for the rest of their life. Examples of permanent total disability are spinal cord injuries involving severe or total paralysis, amputation of an arm, foot, hand, leg, severe brain or closed-head injury, severe burns over the body and blindness. Due to the severity of loss, disability payments may reflect a higher payment than 66 2/3% of the employee's average weekly wage. Benefits are normally paid for life but depending on the particular state, there may be a coordination with social security benefits factored into the weekly disability amount.

Temporary total disability cases are the most common form of disability. Examples may include concussions, fractures, muscular sprains and strains. These benefits are paid to the worker who is injured and is unable to work at all while recuperating. It is foreseen the injured employee will recover from the accident and return to work after reaching maximum medical improvement (MMI), meaning the date after which no further recovery or lasting improvement can be medically anticipated. Benefit payments are made after the waiting period lasting until MMI has been reached or some other state defined time limitation, which ever occurs first.

Permanent partial disability involves an injury from which the injured employee will never recover but not serious enough to prevent the employee from working at all. For example, the loss of a finger would qualify as a permanent partial disability in that the injury was permanent in duration but it would not restrict the employee from performing other types of work. The methods in calculating permanent partial disability benefit payments vary from state to state involving both how to determine the amount and duration of benefits.

Lastly, temporary partial disability is a benefit payable when the employee can return to some type of work but cannot perform the usual duties required by the employer. The employee has returned to work performing "light duty" and has not been released by the doctor from treatment nor has maximum medical improvement been reached. Because the employee has returned to light duty, a percentage of the difference between what was being earned at the time of the accident and what the employee is paid after the accident will be payable to the employee. Benefit payments will normally be defined by state statute.

The final category of compensable losses payable under workers' compensation is death benefits. In addition to burial expenses, death benefits pays surviving dependent beneficiaries loss of income benefits based on the deceased's average weekly wage. State statutes define who qualifies as a dependent beneficiary and the amounts payable for burial and loss of income.

How coverage is provided

The most common method of providing workers' compensation benefits is through the purchase of a workers' compensation policy from a private insurer. The policy version commonly used is published by the National Council on Compensation Insurance (NCCI), a national rate and rule making organization. Among the services the NCCI provides for many states include:

- Establishment of manual rules and rates for insurers;
- Classification of risks based upon the type of work performed;
- A special rating program based upon an employers' past experience;
- Administering special insurance plans for risks unable to procure coverage in the regular market.

The policy published by NCCI consists of six parts and Part One of the policy is workers' compensation. Here the policy conforms to the laws of the state designated in the policy's information page. Thus, in preparation of the policy, each state for which coverage is desired should be stated on the information page.

Part Two of the policy, Employers Liability Insurance, covers the insured for liabilities arising out of the injury of an employee in the course of employment that are not in the scope of workers' compensation coverage. Such liabilities include claims often referred to as "liability over" lawsuits. This is when a third party brings a claim against the insured employer because of an injury to an employee who has filed a

claim against that third party. An example would be if an employee lost a finger when operating a punch press and later sued the manufacturer of the punch press because of the injury. The manufacturer subsequently sues the employer claiming it was the employer's failure to provide proper training and supervision of the punch press that resulted in the injury and not the fault of the equipment manufacturer. Other damages covered by employers liability is loss of care and services claims, consequential bodily injury to a spouse or other relative due to the employee's injury (e.g. spouse of killed employee suffers heart attack upon learning of death), and "dual capacity" suits. An example of a dual capacity suit is when the injured employee sues the employer as a manufacturer of a product rather than as the employer of the injured.

Part Three of the policy is Other States Insurance and is designed to automatically provide statutory coverage in a state not named in the policy when an exposure develops under such state's laws. If the exposure is known or expected, it is intended that such state should be listed on the information page. Coverage under Part Three is intended only for the unexpected exposure. Work in progress in another state on the effective date of coverage will not be covered if the state is not listed on the information page.

Part Four outlines the duties of the insured in the event of a loss and Part Five provides that all premiums for the policy shall be determined in accordance with the insurer's rules, rates and classifications. The unit of exposure for which workers' compensation rates are established (with minor exceptions) is each \$100 of remuneration to employees. The term remuneration is defined by NCCI broadly and is not to be understood solely as payroll. Each risk is classified using one or more of the 600-plus workers' compensation classifications maintained by NCCI. The classification process is designed to apply the appropriate four digit code number(s) that best represents the risk according to its operations. Each code number has a corresponding rate per \$100 of remuneration. The rate is multiplied by the premium basis (remuneration) resulting in the estimated annual premium. To determine the accuracy of the estimate, the insurer performs an audit at the expiration of the policy term to determine if additional or return premiums will be necessary. To avoid large additional or return premiums after the audit, it is a sound business practice to ensure the proper use of classifications and accurate premium bases throughout the policy term. Careful monitoring of these factors can assist in controlling cash flow.

Part Six, Conditions, contains the insurer's right to inspect the employer's workplace at any time. The purpose of the inspection is for underwriting reasons and not for safety purposes. The insurer assumes no responsibility for assuming a safe or healthy workplace, although the insurer may make suggestions or simply report various conditions to the employer.

Another method of providing workers' compensation benefits is through self insurance. One expression of self insurance is the grouping of employers, sometimes limited to related industries, willing to pool resources and assets to provide workers' compensation benefits to their collective employees. This approach is often referred to as group self insurance. Alternatively, large individual employers may elect to self insure its' employees however this method is normally reserved for only the largest of employers. In either case, many states permit self insurance and have specific statutes outlining its' requirements.

Rating plans

One method used to affect the employer's workers' compensation insurance premium is using NCCI's experience rating plan. The purpose of the experience rating plan is to reflect the individual risk's past experience in forecasting its' future losses. The two influences analyzed by the plan are the risk's frequency of losses and severity of losses. While the plan considers both types of losses, greater weight is given to accident frequency than to accident severity. Eligibility for the experience rating plan and other rules pertaining to the plan is found in NCCI's Experience Rating Plan Manual and is reserved for em-

ployer's generating the required minimum premium during a specified period as outlined in the plan's rules.

Experience rating is mandatory for all eligible employers and can be described as the use of a mathematical formula comparing the actual losses of the risk during a given period of time, defined as the experience period, to losses which are expected based on actuarial studies of the classifications involved. The result is an experience modification factor which is applied to the policy premium as either a credit or debit and thereby either reduces or increases the final premium of the insured. Because of the incentive of a premium credit, employers with effective safety programs and accident prevention efforts are able to lower their cost of workers' compensation premium when compared to similar risks without good loss control measures. This calculation continues for each year the insured is eligible according to the experience rating plan rules.

Retrospective rating is another method of rating a risk's final premium. Under a "retro" plan, a basic premium is determined, which is an amount designed to provide the insurer with a charge for the insurance and all expenses other than that for adjusting losses and premium taxes payable to the state. To the basic premium is added the losses and expense of adjusting losses and taxes, the result being the insured's final premium, subject to a specified minimum and maximum. Such minimums and maximums may range from 65% of manual premium to 125% of manual premium. If an employer has an effective loss control program, there are opportunities found in retrospective rating to control workers' compensation premium. On the other hand, despite good loss control procedures, injuries do occur and coupled with the uncertainty of the final premium, the insured may not desire the risk sometimes found in a retrospective rating plan.

Case management

Effective loss control procedures and case management can mitigate exposures to injuries and death. The use of experienced personnel, ongoing training, proper equipment, safe work environments, safety conscience employers and employees, incentive programs, effective communication and comprehensive claim analysis collectively form the basis for effective loss control. Today, medical and disability costs are major business expenses and with the increased need for a highly trained and efficient workforce, proactive procedures to prevent losses from occurring allows the employer to divert resources away from treatable work place losses and a reduced employee count to more efficient business practices. But when losses do occur, case management focuses attention on getting the injured employee the proper treatment with the least amount of time away from work. By eliminating delays and unnecessary medical expenses and promoting effective communication among all parties involved, case management lowers the barrier that sometimes exists between the insurer, an employer and an employee when a workers' compensation claim occurs.

Responding to the role as an intermediary between the employee, the medical community, and the employer, the case manager provides advice and direction to the injured concerning the rights and privileges afforded by the workers' compensation law. By coordinating medical care, the case manager reviews the treatment and therapies prescribed by physicians and makes recommendations when necessary to reduce inefficiencies and contain costs. In the end, the goal of the case manager is to facilitate the employee's return to some form of modified work while fully recuperating which hopefully leads the employee returning to their pre-loss employment.