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Introduction

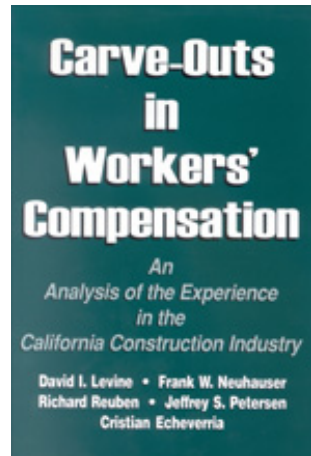
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Carve-Outs in Workers' Compensation: An Analysis of the Experience in the California Construction Industry

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Introduction

Throughout much of the late 1980s and early 1990s, the costs of workers' compensation systems across the country escalated for employers and problems increased for injured workers. Medical and indemnity costs soared, claim frequency increased dramatically, employers alleged fraud by workers and providers, workers complained that benefits were inadequate and often delayed, and both parties were concerned about the increasing cost of litigation. Widespread frustration led to a series of reforms in 1993.

One innovative set of reforms adopted in several states allowed unions and employers to collectively bargain their own workers' compensation system, essentially "carving-out" that arrangement from the statutory system. The parties were allowed to negotiate alternative medical and medical-legal arrangements meant to reduce medical costs. Alternate dispute resolution (ADR) mechanisms were encouraged to speed the legal process and reduce litigation-related expenses.

The carve-out legislation was modeled on a similar experiment in Massachusetts, where Bechtel and the Pioneer Valley Building and Construction Trades Council had a collective bargaining agreement (CBA) governing a single construction project. The Bechtel experience was important because of the apparent success at reducing reported workers' compensation costs, largely by lowering injury rates and reducing litigation (see Table 1.1).¹

In California, the state with the most workers under these agreements, the parties were given substantial latitude in how they set up the program. For example, they could create an exclusive list of medical providers and medical-legal evaluators, and they could create an ADR system to replace most Division of Workers' Compensation (DWC) and Workers' Compensation Appeals Board (WCAB) procedures. These ADR procedures were often accompanied by restrictions on the participation of attorneys. Two constraints remained on carve-outs: the agreement could not reduce compensation to injured workers and the final step of the ADR system had to include the option of an appeal for reconsideration by the WCAB.

Table 1.1 Changes in Pioneer Valley Results when Carve-Out Was Implemented

	8 months before carve-out	8 months after carve-out
No. of claims	38	22
Lost-time claims	11	2
Litigated cases	7	0
Costs	\$480,000	\$220,000
Hours worked	217,117	223,744
Lost-time incidence	10.12	1.78
Rate ^a		
Costs per hour	\$2.21	\$0.98

^a The lost-time incidence rate is the number of lost-time injuries per 200,000 hours worked.

SOURCE: Bechtel Construction Co. (1997).

This volume evaluates the first few years with these novel organizational forms in California. We also draw out lessons for carve-outs in California and other states and for the statutory workers’ compensation system. Importantly, the experience of carve-outs also provides insights into how all employers might want to alter their handling of workers’ compensation claims and, more generally, into ADR programs and decentralization of employment regulation.

CARVE-OUT PROGRAMS IN CALIFORNIA

Within three years of the passage of the legislation, eight carve-out agreements had been reached (see Table 1.2). The largest carve-out covering a single project was an agreement between the California Building and Construction Trades Council, AFL-CIO, and the Metropolitan Water District of Southern California. This was a project labor agreement covering all contractors and subcontractors on a \$2 billion, 5-year construction project to create the Domenigoni Reservoir (East-side Reservoir Project or ESRP). The largest carve-out covering multiple employers involves the 23 local unions making up the state’s International Brotherhood of Electrical Workers (IBEW) and a multi-

Table 1.2 Addendums to Collective Bargaining Agreements that Established Carve-Out Programs Before 1997

Employer(s)	Union(s)	Date of agreement
Signatory's to CBA	S. Calif. Pipe Trades District #16	July, 1994
Cherne Contracting Corporation	Local 250 and S.C. Pipe Trades #16	July, 1994
District 9, NECA	IBEW, 9th District	Oct., 1994
Several contractor associations	So. Calif. Dist. Council of Laborers	Dec., 1994
TIMEC Co.	Intl. Union of Petroleum and Indust. Workers	Jan., 1995
Morrison-Knudsen of Ohio	Contra Costa Building Trades	May, 1995
Signatory Employers	So. Calif. Carpenters (12 Counties)	Dec., 1995
ARB Inc.	Building and Construction Trades (Intl.)	May, 1996

employer group called the National Electrical Contractors Association (NECA), consisting of about 500 contractors. Each individual employer has the choice to sign up or remain in the statutory system.

In 1997, carve-out employers had over 5,000 full-time equivalent employees (about 1 percent of construction employment in the state) and paid over \$240 million in payroll. The carve-outs had a number of elements in common and some variation. For example, each of these carve-outs established lists of medical and medical-legal providers and vocational rehabilitation providers who could provide services for injuries and illnesses occurring under the carve-out.

All but one agreement (TIMEC Co.) also established ADR systems. These ADR systems start with an “ombudsperson,” a neutral person available to all parties who attempts to avert and/or resolve disputes at an early stage. If this is unsuccessful, the worker may move the matter to the next step, typically formal mediation by an independent, neutral mediator. Two ADR programs used a joint labor-management committee at this point.² If mediation is unsuccessful, the parties turn to an outside neutral arbitrator—often a retired Workers’ Compensation Administrative Law Judge. By statute, the decision of the arbi-

trator may be appealed to the seven-member WCAB (California Labor Code Section 3201.5[a][1]). Ultimately, a decision of the WCAB can be appealed to the civil courts at the Court of Appeals level.

EARLY EVALUATIONS OF THE CARVE-OUTS

While the original DWC reports stated that it was too early to evaluate thoroughly the impact of carve-out programs on the cost of workers' compensation, preliminary results were promising.

At the end of each calendar year, carve-out participants report to the DWC on claims during that year. From 1995 to 1997, these annual reports listed only eight mediations and two arbitrations on over 2,000 claims. The DWC reports suggested that this represented a virtual elimination of disputes under the ADR process.

In addition, the DWC reported that costs to employers in carve-outs were approximately one-half of those experienced by employers outside the carve-out arrangement.

Insurers stated that they were offering employers a workers' compensation premium discount of approximately 5 to 25 percent for participating in a carve-out program. Because workers' compensation costs are typically 3 to 15 percent of wages in construction, these premium reductions were potentially substantial.

At the April 1996 National Conference of the Building and Construction Trades Department, AFL-CIO, a workshop was held consisting of representatives from carve-out programs in California and Florida. These presentations were extremely favorable, although anecdotal, and focused on the following results that had been achieved to date.

- ***Lower injury/claims rates.*** It was felt that, with labor and management working together to achieve common results, greater awareness of safety had been achieved on carve-out construction projects. At the same time, this was the area where the anecdotal evidence seemed weakest and where the evidence seemed most conflicting. On the one hand, it was reported that the number of claims filed on construction projects covered by these programs had declined. On the other hand, none of the presentations could

provide specific descriptions of the types of safety provisions that had been put in place. It was not clear whether reduced claims frequencies could have arisen from favorable selection of employers into these programs or from injured workers being accommodated in such a way that they did not file claims.

- ***More effective medical delivery.*** It was widely reported that the quality of medical care delivered was better under the collectively bargained programs, although there was no health service research data to back up this claim. Anecdotally, two sources of improvement were noted: there was an increased willingness of care providers to participate, as exemplified by the University of California at Los Angeles Spine Center agreeing to become a provider to collectively bargained programs. The Spine Center is reported to be a premier treatment facility that had avoided the workers' compensation field because of all the legal disputes involved. Another example of this increased willingness was the care which at least one program exercised in selecting medical providers it accepts into its program.

Several programs had case managers assigned to see injured workers through treatment and rehabilitation, which much improved the continuity of care. No specific examples were provided to support this claim, and there was no evidence to suggest that these programs were able to establish procedures that routinely enable injured workers to return to employment at an earlier stage.

- ***Virtually no friction in dispute resolution.*** There was unanimous agreement among the existing programs that the dispute resolution system was working very well—better than expected. At the time, no disputes had proceeded to the arbitration stage.
- ***Cost savings.*** Based in part on the experience from Pioneer Valley (see Table 1.1), these programs held out the hope that cost savings of as much as 30 percent could be achieved through fewer claims and greater effectiveness. All of the programs then in operation reported savings significantly in excess of the expected 30 percent. In addition, Florida's rate-setting authority allowed a 15 percent discount off the top of the manual rate in

recognition of the special program features, including the managed care medical networks.

- ***Great satisfaction expressed by employers, workers, and union leaders.*** Union leaders claimed they had not heard a single complaint about these programs from other union leaders or employers and had complete support for the programs from union membership.

AREAS OF CONCERN ABOUT COLLECTIVE BARGAINING

There was also a growing body of criticism and concern about aspects of the carve-out program (Moscovitz and Van Bourg 1995; Ozurovich 1995). The concern centered around five areas:

- ***Inadequate due process.*** It was alleged that ADR might weaken the legal rights to due process by denying workers access to legal representation and the ability to collect information through discovery or deposition.
- ***Reduced benefits.*** It has been suggested that the use of limited medical networks reduces choice of physician by workers and may result in reduced quality of medical care.
- ***Distribution of savings.*** It has been suggested that employers will not pass on anticipated savings to workers. The distribution of savings is particularly problematic on projects with defined time frames and little opportunity for multiple, consecutive, CBAs.
- ***Continuity of treatment and adjudication.*** Perhaps the most important and least considered concern has to do with continued coverage for long-term disabilities. CBAs are time-limited, while partial or total permanent disabilities and certain temporary disabilities may extend well beyond the limits of these agreements. Further, the disabled worker may cease to be a member of the bargaining unit covered by the agreement. Finally, many disabilities result from cumulative exposures over long periods of time,

where many employers inside or outside a particular agreement retain partial responsibility for these cases.

- ***Unnecessary risk to unions and employers.*** It has been suggested that these programs may place unions at risk of legal liability for failure to provide fair representation to each member (for instance, by denying the current system's right to due process or by limiting benefits). It also has been suggested that these programs may jeopardize the employer's immunity from civil action filed by employees that are provided for in the current system.

OUTLINE OF THE BOOK AND RESEARCH METHODS

We begin in Chapter 2 by giving some important background information on the reasoning behind the development of carve-outs and how the carve-out structure fits within the framework of current institutions. We describe the important characteristics of the workers' compensation system and the particular characteristics of the construction industry and how those have influenced the development of carve-outs. An overview of carve-outs in California is then presented in Chapter 3.

This study utilized a number of methods to evaluate carve-outs. We reviewed the CBAs and surveyed the ombudsmen for all California carve-outs. The survey covered their background, training, and duties, among other issues (Chapter 4).

We chose two carve-outs for intensive case study because they represented two very different models. The ESRP carve-out was a very large project with a single owner (Metropolitan Water District) and more than 200 contractors and subcontractors and all crafts unions (Chapter 5). The NECA/IBEW agreement was a multi-employer carve-out with a single union covering electrical contractors employing union electricians throughout the state (Chapter 6).

Within each category (large-project and multi-employer carve-out), we chose the carve-out with the most members and longest history. This sample selection rule increased our respondents' experience and yielded more data. At the same time, because we chose our sample

partially on the basis of its success in getting started, these two projects may not be representative of all carve-outs.

We interviewed representatives of all the interested parties at each carve-out: the ombudsman, employers, employees, union, workers' compensation insurer, arbitrators, mediators, and lawyers. At the ESRP we included the project owner as well as local, state, and national representatives of the building trades. At the NECA/IBEW we included representatives of NECA, the employers' federation. We read all written materials we could identify for each carve-out, including the PLA (at ESRP), the CBA, handouts from the ombudsmen to injured workers explaining the carve-out, injury reports, other reports by parties to the agreements, and standard correspondence from insurers to injured workers.

We performed site visits using pairs of researchers. The ESRP visits were from May to August in 1997; the NECA visits were from June to September in 1997. All interviews were recorded and transcribed and the entire research team read all interviews. Most interviews involved follow-up phone calls (or occasionally faxes or e-mails) to clear up specific points or to ask follow-up questions.

At each case study site, we asked the ombudsperson to identify workers who had disputes that had resulted in filings for mediation or arbitration. The workers were chosen based upon suggestions made by the ombudsperson. The ombudsperson first contacted the workers to get approval for our interview. Thus, the sample of workers we interviewed was biased towards those individuals who had "tested" the system. We did not interview any workers who did not have a dispute or whose dispute was rapidly and successfully handled by the ombudsperson.

Because the point of the ADR is to avoid mediation, our informants are an unrepresentative sample. That is, these employees in some sense represent the failures of the ADR system to avoid a formal dispute. Thus, they provide one extreme bound of the problems that ADR might cause. (The other bound involves injured employees who did not know they had rights to compensation.) The intent of interviewing these employees was not to find out the experience of the representative injured worker, but to find out the worst-case experience of employees for whom ADR was not leading to a rapid resolution of their dispute.

Finally, we analyzed quantitative data from the first two to four years of experience of the NECA/IBEW carve-out (Chapter 7). We examined a number of important outcomes including indemnity, medical, legal and medical-legal costs, injury rates, and dispute frequency.

We conclude with a summary and with recommendations for changes to carve-outs, to the statutory system, and for future research (Chapter 8).

Notes

1. Bechtel indicated in discussions with the authors that they had been unsuccessful at recreating the success of the Pioneer Valley project at other large construction projects in subsequent years. However, Bechtel felt none of these later projects included all of the unique characteristics of the Pioneer Valley project simultaneously.
2. These were the Pipe Trades and Cherne programs. However, the ombudsperson for the Pipe Trades recommended a mediation stage to replace the committee. In the subsequent round of negotiation, the Pipe Trades addendum was amended to replace the committee with a mediation stage.