

Insurers Take Fall for Workers' Compensation System Flaws

By Michael A.S. Newman

“When sorrows come,” says King Claudius in “Hamlet,” “they come not single spies, but in battalions.” A single bad cause often has a multitude of bad effects. In “Hamlet,” the tragic flaws of the troubled Danish prince result in a stage decked with corpses. In a similar though less dramatic manner, a single ill-conceived law or system of law can have many disparate, simultaneous negative results. California’s workers’ compensation system has long provided a perfect example of this phenomenon.

As The Wall Street Journal editorialized on April 16, “California’s workers’ comp system is one of the most expensive in the country while simultaneously paying some of the lowest benefits.” In April, Gov. Arnold Schwarzenegger pushed through sweeping new legislation to reform the workers’ compensation system. However, advocacy groups have begun lawsuits to challenge the reforms, which are to take effect next year.

Even if the reforms do take effect, the “battalions of sorrows” arising from the state’s dysfunctional system doubtless will continue for quite some time, as the medicine of reform slowly works itself through the system. According to The Wall Street Journal, the state’s workers’ compensation insurance premiums rose 70 percent between 2002 and 2004 to an average of \$5.85 per \$100 of payroll; the national average was \$2.46 in 2004. For many businesses, workers’ compensation insurance is the single greatest expense in its yearly budget. Of course, where businesses face greater costs, they must lower wages, decrease benefits or leave the state, as many have done. Other businesses that would have settled in the state have not done so.

Caught in the middle — between the exorbitantly expensive workers’ compensation system and employers desperate to reduce costs — are the workers’ compensation insurers. On one hand, the law requires a workers’ compensation insurer to pay injured workers; if the insurer fails to do so or does so dilatorily, then the insurer is penalized. On the other hand, an insurer that pays a worker too much or does not work aggressively enough to reduce costs by challenging the claims of injured workers is potentially liable to the employer for the resulting increase in the employer’s workers’ compensation premi-

ums. In this way, insurers have become the scapegoats for the endemic flaws of the state’s workers’ compensation system.

Courts in the state have not been sympathetic to insurers. A line of a dozen state cases arising in the 1990s, starting with *Security Officers Service Inc. v. State Compensation Insurance Fund*, 17 Cal.App.4th 887 (1993), have been used as the basis for employers’ suits against insurers for paying too much to injured workers, for failing to settle workers’ compensation claims quickly, for failing to challenge dubious claims, or for otherwise “mishandling” such claims. The alleged mishandling of workers’ compensation claims does not merely entitle an employer to compensatory damages based on insurer’s alleged breach of the insurance contract; building on *Security Officers*, state courts have permitted employers to bring actions for bad faith against insurers, with concomitant punitive-damages awards.

While the state Supreme Court recently acted to restrict the expansion of workers’ compensation insurer liability in *Jonathan Neil & Associates Inc. v. Jones*, 33 Cal.4th 917 (2004) (holding that punitive damages cannot be awarded where an employer’s premiums rise for reasons unrelated to claims handling), the trajectory of state jurisprudence has been to

render insurers increasingly vulnerable to suits arising from the alleged overpayment of workers’ compensation claims.

Between a workers’ compensation system that has forced insurers to pay enormous amounts to injured workers and case law that permits employers to sue insurers for paying those same sums, insurers have been subject to nearly irreconcilable conflicting forces. Under such circumstances, how is an insurer expected to reconcile its duties to pay injured workers with its duty to keep employers’ premiums down?

The results are not surprising. Many workers’ compensation insurers have become insolvent in the state, and fewer and fewer insurers in the state provide workers’ compensation insurance. Of course, as workers’ compensation insurance becomes less available, premiums have risen still more, only exacerbating the problems with the system. Hopefully, the state eventually will see a halt or at least a lessening of the such problems, when and if Schwarzenegger’s reforms take effect.

In the meantime, we can expect to see the filing of more lawsuits against insurers, whose only real offense is the issuing of workers’ compensation insurance policies in the state.

