

**ANALYSIS OF FLORIDA WORKERS COMPENSATION RATE FILING
PROPOSED EFFECTIVE 8/1/2016**

Overall Proposed Change in Rate Level	17.1%
By Component	
- First-Year Impact of the Florida Supreme Court's Decision in <i>Castellanos</i>	15.0%
- Changes to the Florida WC Health Care Provider Reimbursement Manual	1.8%

NCCI estimates that the cost impact due to the Florida Supreme Court's decision in *Castellanos vs. Next Door Company, et al. (Castellanos)* will result in an overall first-year impact on Florida workers compensation system costs of +15.0%. NCCI proposes that this filing apply to new, renewal, and all in-force policies that are effective on or after August 1, 2016. However, *Castellanos* is also expected to increase overall system costs in the state for all claims occurring on or after July 1, 2009 that remain open or are re-opened¹. Therefore, NCCI expects that a significant unfunded liability will be created due to the retroactive impact of this court decision.

This estimate does not include the following:

- Cost impacts related to the First District Court of Appeal's decision in *Miles v. City of Edgewater Police Department* (April 20, 2016), which addressed claimant-paid attorney fees.
- The entire unfunded liability created in the state due to the retroactive nature of the *Castellanos* decision.
- Unanticipated cost impacts not otherwise reflected in this filing that may emerge over time such as additional stakeholder behavioral changes and interactions with subsequent changes to workers compensation benefits or practices in Florida.

Aside from the unfunded liability, the resultant cost impacts of the above, if any, would be reflected in subsequent Florida rate filings.

Summary of Florida Supreme Court Decision and Resultant Cost Impact

On April 28, 2016, the Florida Supreme Court issued a decision in *Marvin Castellanos v. Next Door Company, et al., (Castellanos)*, No. SC13-2082. The Supreme Court concluded,

"...that the mandatory attorney fee schedule in section 440.34 of Florida Statutes, which creates an irrebuttable presumption that precludes any consideration of whether the fee award is reasonable to compensate the attorney, is unconstitutional under both the Florida and United States Constitutions as a violation of due process."

¹ Note that NCCI's assumptions related to the significance of the unfunded liability are based upon the following filed and approved NCCI Statistical Plan definitions:

Open – Final payment not made

Closed – Company does not expect to make further payments

Reopened – Claim previously reported as closed; now company expects to make additional payments

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The result of the Supreme Court's decision is to eliminate the statutory caps on claimant attorney fees and return Florida to the law as it was prior to July 1, 2009 when claimant attorney fees awarded under the fee schedule were required to be "reasonable."

NCCI estimates that the prospective first-year impact of the *Castellanos* decision will be +15.0% on overall Florida workers compensation system costs.

NCCI has filed for the proposed rates to apply to all policies in effect on August 1, 2016 on a pro-rata basis through the remainder of the term of those policies. Though the *Castellanos* decision was rendered on April 28, 2016, the decision has retroactive impacts on claims open or re-opened from July 1, 2009 (effective date of enacted House Bill 903, which addressed the decision in *Emma Murray vs. Mariner Health Inc. and ACE US*) and forward. Increased system costs which will result from the *Castellanos* decision were not contemplated in the development of workers compensation rates for all policies affected. Because workers compensation ratemaking is prospective only, insurers are not able to recoup premium to cover such unforeseen retroactive system cost increases. Even if the proposed rates are to apply to outstanding policies, a significant portion of the full retroactive impact and unfunded liability remains.

Actuarial Analysis of the Impact of the *Castellanos* Decision

In order to estimate the impact of the *Castellanos* decision on Florida workers compensation system costs, it is necessary to first analyze how the provisions in SB 50A (2003)—specifically those relating to changes in claimant attorney fees—impacted system costs.

The provisions relating to attorney compensation contained in SB 50A were as follows:

- Maintain the "20/15/10/5" attorney fee schedule.
- Alternative hourly fees were eliminated with one exception: an alternative fee of up to \$1,500 may be awarded per accident for medical-only petitions.
- Fees are to be based on "benefits secured" above the offer, only if the employer/carrier makes an offer including attorney fees. Attorney fees are "taxed" against the losing party.

In general, the analyses of the *Castellanos* decision contained in this filing reflect changes in system costs and other metrics between pre- and post-SB 50A time periods ("pre-reform" and "post-reform"). Experience emerging subsequent to the implementation of SB 50A has revealed significant decreases in workers compensation costs—even after adjusting pre-reform values for the expected impacts incorporated in NCCI's SB 50A rate filing (e.g., adjusting pre-reform losses to the current benefit level). The changes to the claimant attorney compensation provisions contained in SB 50A are credited with accounting for a material portion of these decreases. Thus, in general, NCCI is relying on the changes observed between the pre-SB 50A reform period (an hourly attorney fee system) and the post-reform period (a legislated, mandatory attorney fee schedule system) for the changes that are expected to occur due to the *Castellanos* decision—although the changes would occur in the reverse direction.

A summary of NCCI's actuarial analyses of the *Castellanos* decision and its impact on workers compensation system costs is described below. In general, NCCI analyzed the changes in overall benefit costs between the pre- and post-reform periods using NCCI's Financial Call data for both Florida and Florida relative to other states. In addition, NCCI's Detailed Claim

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Information (DCI) data was analyzed to estimate the changes in average claim costs for claims with a claimant attorney over these same time periods.

Recognizing that data for 2003 includes a mix of pre- and post-reform data, this year has been excluded from NCCI's calculations in order to avoid distortions. As the impact of SB 50A's attorney fee change was realized over several years, NCCI used 2005 and 2006 as the post-reform time period in these analyses. This two-year time period allows one to both observe how the impact of the attorney fee changes emerged over time and necessarily avoid the impact of events that occurred beginning in 2007, such as the Great Recession.

Estimated Change in Overall Benefit Costs based on Financial Call Data

Based on premium, loss, and claim count information contained in the Florida 1/1/16 approved workers compensation rate filing, NCCI calculated changes in overall benefit costs for Policy Years 2000 to 2002 (pre-reform) and Policy Years 2005 and 2006 (post-reform) using NCCI Financial Call data evaluated as of 12/31/2014. NCCI then analyzed the observed changes in overall benefit cost levels for both Florida and the surrounding region between the pre- and post-reform periods. The results of the analysis are described below.

The starting point is Florida policy year claim frequency and total (indemnity plus medical) average benefit costs from the Florida 1/1/2016 approved rate filing. The premium and benefit level change adjustment factors embedded in these values are then adjusted to remove the impact of the attorney fee component of the SB 50A pricing². Further, the premium used in determining the claim frequency values is further adjusted to remove all expense-related components. This step is necessary to facilitate a meaningful comparison between the observed changes in Florida and those in the surrounding region. The product of the adjusted claim frequency and average claim severity is divided by \$1M in order to estimate Florida's average pure loss cost in both pre- and post-reform years. NCCI performed similar calculations to estimate the average pure loss cost for the group of southeastern states (Alabama, Georgia, Louisiana, Mississippi, North Carolina, South Carolina, and Tennessee) as well as a subset of regional states that abut the Gulf of Mexico (Alabama, Louisiana, and Mississippi). The "Gulf states" region was specifically recognized as sharing some similarities with Florida.

During the analysis, the pre-reform period was defined to both include and exclude Policy Year 2000. The average pre- and post-reform pure loss costs for Florida and the surrounding regions were calculated. The Florida figures show that the average pure loss cost level decreased significantly in the state between the pre- and post-reform time periods—an observed decline between 32.1% and 34.1%.

Even after adjusting for approved rate level changes subsequent to the effective date of SB 50A, NCCI recognizes that observed changes in overall benefit costs after SB 50A may have resulted from influences unrelated to changes in attorney fees. Therefore, changes in overall benefit costs observed in regions surrounding Florida were also examined.

As mentioned above, Florida's average pure loss cost decreased in excess of 32% between the pre- and post-SB 50A time periods. This is approximately 25% MORE of a decline than observed in the southeastern states region. Florida's 25% decline in average pure loss cost

² The provision for the attorney fee change contained in the SB 50A rate filing needs to be removed since the *Castellanos* decision will extinguish both the quantified and unquantified impacts resulting from the elimination of hourly fees in SB 50A.

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over and above that observed in the southeastern states region is likely attributed to several factors—not the least of which is the change in the attorney fee provisions contained in SB 50A.

Of the seven states in the southeastern region, all three of the jurisdictions that border the Gulf of Mexico exhibited the most dramatic decreases in average pure loss cost level between the pre- and post-SB 50A time periods. As a region, these three states' average pure loss cost declined approximately 23%. Even though this is a notable percentage decline, it is still far less of a decline relative to the pure loss cost decline observed in Florida over this same time period.

This analysis focused on the magnitude of the decline in Florida's pure loss cost (pre- to post-SB 50A) over and above that observed in the surrounding regions. These results indicate that returning to the hourly-based attorney fee environment that existed pre-SB 50A could increase overall Florida workers compensation system costs between 13.8% and 37.5%.

Estimated Change in Average Claim Costs for Attorney-Represented Claims based on DCI data

The *Castellanos* decision is expected to have the largest impact on the average cost per case for claims with claimant attorney representation. Therefore, an additional analysis was performed which specifically focused on that portion of overall benefit costs. NCCI's DCI data as of a fifth report was used in conjunction with NCCI's Workers Compensation Statistical Plan (WCSP) data to estimate average claim costs (including claimant attorney fees) for claims with attorney representation. DCI data enables a separate analysis of claim information for claims with attorneys—allowing one to focus on the subset of claims directly impacted by a change in attorney fees.

NCCI calculated indemnity and medical total average claim costs for claims with claimant attorney representation, respectively, for the pre- and post-SB 50A time periods. The individual DCI claims were linked to the WCSP claims database in order to incorporate the incurred loss amounts from the WCSP data into the analysis³. In this way, the impact of the SB 50A attorney fee changes can be analyzed based on the same data contained in the annually-approved Florida rate filings. The average claim costs are adjusted to the current benefit level using values from the Florida 1/1/2016 approved rate filing and to remove the impact of the attorney fee component of the SB 50A pricing.

NCCI calculated changes in average total benefit costs for attorney-represented claims between years 2000 to 2002 (pre-reform) and years 2005 to 2006 (post-reform). Savings of more than 25% have been observed. As the *Castellanos* decision will effectively return Florida's attorney compensation structure to the pre-SB 50A, hourly fee-based system, it also indicates a return to the pre-SB 50A level of attorney-represented claim costs. Hence, the potential first-year impact of the *Castellanos* decision on overall workers compensation benefit costs is estimated to be between +15.0% and +16.1%, which is the ratio of pre- to post-SB 50A average claim costs with attorney representation multiplied by the proportion of total claim costs that have claimant attorney representation during the post-reform period (43.6%⁴). Note that these estimated cost impacts do not reflect any impact on overall system costs due to changes in lost-time claim frequency, which would be expected as a result of the *Castellanos* decision.

³ Approximately 80% of the claims were linked between the DCI and WCSP databases. For the remaining claims, the DCI-reported incurred values were utilized.

⁴ Based on DCI and WCSP data.

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In order to limit the impact that individual large claims may have on the analysis, an additional supplemental analysis was performed. The largest one percent of claims based on reported DCI total incurred losses was excluded. These results indicate that returning to the hourly-based attorney fee environment that existed pre-SB 50A could increase overall Florida workers compensation system costs between 16.7% and 18.1%.

Claimant Attorney Fees and Loss Adjustment Expenses

Claimant attorney fees are included in the indemnity loss data reported to NCCI, and defense attorney fees are included in the loss adjustment expense (LAE) data reported to NCCI. Therefore, since claimant attorney fees are included in the data on which all of the above-discussed cost estimates are based, no separate cost impact for claimant attorney fees has been included in this filing.

As *claimant* attorney behavior changed post-reform, there was a corresponding change in behavior related to *defense* attorneys. For example, there is qualitative input that as claimant attorneys worked fewer hours on cases and agreed to quicker settlements, defense attorneys also worked fewer hours on cases and earned reduced fees. The post-reform reduction in defense attorney costs has been reflected in the LAE component of the approved Florida workers compensation rates. The LAE component is a ratio of expenses to losses. It is anticipated that the *Castellanos* decision will result in both increased expenses and increased losses. At this time, NCCI expects that both will generally increase at the same rate. As such, no change to the current LAE provision is being proposed in this filing.

NCCI estimates that the update to the Florida Workers' Compensation Health Care Provider Reimbursement Manual (FWCRM) to the 2014 Medicare level, effective July 1, 2016, will result in an overall average Florida workers compensation system cost impact of +1.8%.

Summary of Changes

Senate Bill 1402 ratifies the Florida Division of Workers' Compensation updates to the FWCRM for professional health care providers, effective July 1, 2016. The prior FWCRM, which became effective 2/4/2009, is based on 2008 Medicare Conversion Factor and Resource Based Relative Value Scale (RBRVS) geographic-specific reimbursement levels. The revised FWCRM is based on 2014 Medicare Conversion Factor and RBRVS geographic-specific reimbursement levels. Note that the Maximum Reimbursement Amounts in the prior and revised FWCRMs are limited to no less than the MRAs published in the 2003 FWCRM. The changes impact reimbursements for physician services as well as Category 1 hospital outpatient services.