Time to Update Your Workers' Compensation Expense Allocation Models

INTEGRO
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By Jim Bacon

Background
A recent California Supreme Court decision has reversed two lower court decisions, significantly impacting the Workers' Compensation arena. Consequently, risk managers, CFOs and General Counsel of companies who are considered employers in California, need to revisit their Workers' Compensation allocation models.

In *Prachasaisoradej v. Ralphs Grocery Co*, the plaintiffs argued that an employer cannot reduce an employee's earnings to cover Workers' Compensation costs (LC 3751). The lower courts ruled employers are <u>not</u> allowed to include Workers' Compensation expenses in the calculation of bonus or incentive pay. In August 2007, the California Supreme Court did an "about-face" on that position, and it decided that employers were, indeed, permitted to reduce earnings to cover such costs. [i] Now, employers will need to use Workers' Compensation expense allocation to facilitate cost reduction.

Impact
The 2003 ruling required California employers to stop incorporating Workers' Compensation results when calculating bonus or incentive pay for both exempt and non-exempt employees. Many employers altered their models to comply with the law, and in doing so they may have downgraded their Workers' Compensation cost allocation models. The latest California Supreme Court ruling presents an opportunity to evaluate your risk management cost allocation model and maximize its potential benefit while bringing the highest value to your organization.

Integro's Position
Workers' Compensation expense allocation models are most effective when they impact behavior and equitably distribute the expense throughout the organization. An organization's best practice is providing financial incentives and placing responsibility for Workers' Compensation management with those employees who affect outcomes.

Allocation methodologies differ greatly by industry, but the core elements of an effective model are as follows:

- Equitability of expense distribution
- Impact on outcomes
- Ease of understanding
- Ease of management

Integro is available to assist you with an evaluation of your current allocation methodology and models. We have developed an industry-pioneering allocation model based on the combined input from our actuaries, brokers, and risk consultants. Our model addresses the expense associated with all aspects of your risk programs, and we customize it to maximize effectiveness for your unique organization.

Jim Bacon, Principal, operates from Integro's San Francisco Office. He provides technical advice to clients regarding the identification, assessment and mitigation of casualty risk. His expertise includes the design, evaluation and implementation of service programs that support claim management, loss prevention, information management, and other risk related programs.

About Integro

Integro is an insurance brokerage and risk management firm dedicated to serving the insurance and risk management needs of complex institutional risks. Integro has offices across North America, as well as, in Bermuda, London, and Stockholm. Its headquarter office is located at 3 Times Square, 9th Floor, New York, New York, 10036. 1-877-688-8701. www.integrogroup.com

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[i] The California high court's decision in *Ralphs* has been the subject of many a law firm's written reports and litigation updates. For a detailed description of the case and the decision, please see a sampling of such law firm reports at these websites:

- *Morgan Lewis: http://www.morganlewis.com/pubs/LEPG_CASupremeCourtUpholdsSomeCompPlans_LF_31aug07.pdf*
- *Jackson Lewis: http://www.jacksonlewis.com/legalupdates/article.cfm?aid=1185*
- *Epstein Becker & Green, P.C.: http://www.ebglaw.com/showclientalert.aspx?Show=7337*
- *Nixon Peabody LLP: http://www.nixonpeabody.com/publications_detail3.asp?ID=1987*