

The Liversidge e-Letter

An Executive Briefing on Emerging Workplace Safety and Insurance Issues

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An Electronic Letter for the Clients of L.A. Liversidge, LL.B.

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The Politics of Experience Rating *Rational insurance concepts steamrolled by well played media campaign*

Support for insurance principles underpinning experience rating withering like a dying rose

In a recent *exposé* series running in the *Toronto Star*, a long-trying political assault on experience rating ["ER"] has finally acquired the public relations legs long sought - a total public discrediting of Workplace Safety & Insurance Board ["WSIB" or the "Board"] experience rating ["ER"].

Two recent chapters were published in just the past few days in the *Toronto Star*. On April 5 the story ran under the headline "*When companies get rewarded for mistakes*", and on April 7, "*Workplace safety rebates probed*". On April 8th, the *Star* devoted editorial space to the subject.

Labour asks for a review of experience rating – WSIB Chair agrees – Labour then demands WSIB Chair's firing

In March, following earlier articles on the subject, WSIB Chair Steve Mahoney announced a full review of experience rating. He also immediately implemented an outright suspension of rebates for any company "responsible" for an on-the-job fatality.

On April 9th, in spite of the fast-track actions of the Board's Chair, apparently labour groups immediately turned around and demanded that the Premier promptly fire him along with the entire WSIB Board of Directors.

This story is unfolding at the speed of light.

Everyone is reacting – no one is taking the time to think this through

All the while, a composed scholarly assessment of what is one of the most complex, controversial and yet very effective insurance components of the Ontario workplace safety and insurance ["WSI"] system seems all but impossible. At this very moment, a policy and public relations forest fire is raging out of control. Lost, perhaps irreparably and evermore, is the established reality that experience rating works, and contrary to the themes getting public airing, it does not reward unsafe employers.

The newspaper stories are gripping and compelling and at first blush seem to expose a wide "policy crack"

The human elements of the stories are tragic and gripping. They compellingly relate shocking real human tragedy to what at first blush appears to be a policy crack – allowing companies to receive massive ER rebates, sometimes in the millions of dollars, even though those same employers are responsible for work-related deaths.

The theme of the story is captured in one heart-wrenching real-life example of a 46 year old foreman tragically and horribly burned to death. *The cause?* According to the article - improper training, and the company was successfully prosecuted and fined \$375,000 by the Ministry of Labour. **But, and here is the clincher, the WSIB still issued a multi-million dollar rebate to the employer.**

WSIB Chair Mahoney has decried this practice and has promised to re-work the ER programs siding with the critics. In fact, in the April 7th article, Mahoney is quoted as saying "*this is nonsense*" (giving "bonuses" to such employers) and there "*has to be accountability*".

And, at first blush it appears that the Board's ER program is outrageously flawed and needs to be shut down. But, is this the full story? Can it be that the WSIB administration is so inept as to design such a ridiculous program and let it stand for two and a half decades?

It seems that labour is of the clear view that the Board's recent actions (calling for a review of ER), is a signal of wide-spread ineptitude down at the Board. (It isn't but I must say, the Board has very clumsily managed the recent publicity surrounding this issue.) As noted, labour groups today pulled out all stops and are now demanding the firing of WSIB Chair Mahoney along with the entire WSIB Board of Directors.

Mr. Mahoney has responded with some understandable disappointment on the call for his resignation calling it "grandstanding".

But WSIB response is reactionary and works against its own interests as the insurance moral hazard increases

Steve Mahoney is an outstanding Chair and must remain as head of the WSIB

I am shocked at the calls for Mr. Mahoney's resignation from any quarter. From my direct observations, I have been witness to one of the most dynamic, focused and committed Chair's the place has had (and as readers of **The Liversidge e-Letter** are well aware, I have offered very strong public support for most of the WSIB heads, particularly Mr. Mahoney's immediate permanent predecessor. Readers also know that I have pulled no punches when it comes to critiquing the WSIB). More on the first two years of the *Mahoney Era* in upcoming issues of **The Liversidge e-Letter**.

The debate is getting needlessly heated – it is time to calm it down with some rational and intelligent content

An effective, open and honest debate on the Board's ER program, at the moment, is effectively impossible. This is currently a raging public relations mess, and needlessly so. With the discussion which follows, let me try and introduce some rational policy thought to this wild and out of control free-for-all.

WSIB cancelled ER rebates for companies "responsible" for a workplace fatality

The Board announced on March 10, 2008, "*effective immediately, if a company is responsible for a workplace fatality, they won't be eligible for a rebate from the WSIB that year*". And, over the next 12 months, the Board plans on revamping the entire ER system and is opening it up to a full review. My guess is that whatever comes out the other end will bear little resemblance to what we have now.

Responding to the "pushback" from business groups (except there hasn't been any yet – this process just started), Mahoney said, "*The answer I gave them was, 'Are you telling me that we should continue to pay bonuses to companies that are responsible for killing workers?' That is ridiculous*".

The Board has acted with dispatch changing what would seem to be an indefensible practice

Sticking to the public relations arena, the Board gets an A⁺. No one can argue with the potency of the public message. A "policy crack" appears to have been identified in the media, the Board immediately responded, and at the same time, the WSIB deservedly seems to warrant kudos for being tough as nails to unsafe employers who disregard their employee's health and safety.

And, any critic will be sidelined as somehow being soft on unsafe workplaces, a position of course, no right minded person would hold. *Surely, no one can support unsafe employers getting massive rebate returns from the very WSIB that is getting tough on unsafe workplaces?*

So who can argue with the Board's approach? Well, I can and do

Contrary to being a fast-track, thoughtful and considered solution to a pressing policy problem, while I fully understand the message that is being sent, and have very high regard for Mr. Mahoney's unqualified commitment to the health & safety of Ontario's workers (which is unmatched), I am afraid that I must categorize the Board's response as a well-intended, but misplaced knee-jerk reaction. **This just has not been thought through.**

Through its actions the WSIB has increased the "moral hazard" of workplace safety insurance

In actuality, the Board will unwittingly increase the *moral hazard* (more on that later) of workplace safety insurance and set in motion a mechanism that will work against the very goals being sought. As incentive measures are lost in the workplaces that may well need them the most, it is workers that will ultimately suffer as a result of what I consider to be a very short-sighted and "quick-fix" response.

The Board's initial response may not pass legal muster

The legality of the Board's new "policy" is also questionable and most certainly will be put to the test. More on this in future issues of **The Liversidge e-Letter**. But for starters, the "new policy" has a powerful *de facto* retroactive effect that may not stand-up to judicial scrutiny. And, the express words of the *Workplace Safety & Insurance Act* ["WSIA"] just might get in the way of the Board's plans as well.

As powerful as the Board is, it is not the all powerful Oz and still must conform to the rule of law.

It may come as a surprise to some that the Board just cannot do *anything* that it wants. *There are legal constraints*. Not many, to be true, but *some* nonetheless.

If the Board wants to scrap ER altogether – that it can do *albeit*, prospectively. If it wants to change ER in a rational, open manner that respects the governing words of the empowering statute (the WSIA), well, that it can do too. [But, a convention has been long established for the Board to openly consult with respect to ER program design changes before the fact.]

The Board can't snap its fingers and retroactively impose new taxation rules on Ontario employers.

A case undoubtedly will arise involving a large, safety conscious employer that does not fit the profile of an unsafe employer placing its workers at risk. So, expect this to one day proceed to the courts if necessary (if it is not settled at the Appeals Tribunal first). [But, that of course, will be years away, and the "new" yet to be developed policy will be in effect, so the final effect of any court case, no matter the result, from a policy development perspective, will be negligible].

A comment on the Board's changes – What does "responsible" mean?

As far as I can tell, and although I have vigilantly tried to seek clarification, it seems that Board officials themselves

have a hard time understanding exactly what its policy means. Recall that the Board announced “*effective immediately, if a company is responsible for a workplace fatality, they won’t be eligible for a rebate from the WSIB that year*”.

So, in the context of ER accountability, just what does the word “responsible” mean?

I tried to find out. In a notice found on the WSIB website [at www.wsib.on.ca], “**Important Information about Your Experience Rating Program**”, the WSIB requests stakeholders to call the **Prevention Contact Centre**. I called the number. The very friendly and courteous person who answered said they didn’t have the authority to answer the question. I was referred to the Board’s External Affairs department, who did have the authority (although it took more than a week to get back to me with the answer).

So, what does “responsible” mean in the context of the announcement? Does this mean that in every case where a death occurs that the deceased’s employer will immediately be ineligible for an otherwise accrued ER rebate? *Well, . . . no, not exactly*, I was told.

Oh, so I asked then there will be circumstances where a worker is tragically killed while in the course of employment, and the claim is perfectly allowable, and yet the company may still receive its ER rebate? *Well, yes, maybe, depending on the circumstances* I was told.

In fact, this is as an official a statement as I could get. The Board advises that “*the circumstances of each case will need to be considered and there may be extraordinary circumstances where the principle of merits and justice means that the rebate should not be withdrawn*”.

I was told that “*there is no documented list*” but certain motor vehicle accidents may be exempt.

I am going to return to this idea in future issues of **The Liversidge e-Letter**, but what is strikingly clear is that the Board has not thought this through very well at all. Frankly, while I am entirely supportive of the “merits and justice” template to be applied to all WSIB decision-making, how in the world will WSIB decision-makers make those determinations case-by-case when no one even knows what “responsible” really means? This is going to be a right mess.

Just what is experience rating supposed to achieve?

Since this debate seems to be right off the rails, let me see if I cannot help it back on the tracks with a novel idea – how about a rational policy assessment of experience rating? As readers know, even with its flaws and warts, I remain an ardent supporter of ER. ***But what at its core is ER designed to achieve?***

As I have outlined before [in the March 26, 2004 issue of **The Liversidge e-Letter**, “**Experience Rating Reform: The Concepts**”] ER deals with the management of “moral hazard” in workers’ compensation insurance, which is the “*resulting tendency of an insured to under-allocate to loss prevention after purchasing insurance*”.

This is how I described ER four years ago:

While the provision of replacement income to disabled workers is arguably the core objective of any workers’ compensation program, ***the prevention of injury and disease has always featured prominently as a design objective, and increasingly this role is gaining importance***. Professor Weiler, in his 1980 study into the Ontario workers’ compensation scheme, maintains that an essential design feature of the workers’ compensation plan must be to prevent injuries, and even though the program is no-fault, it has preserved an incentive for prevention through the provision of experience rating.

The theory (behind experience rating)

The underlying economic theory under-pinning experience rating is straight forward – higher costs internalized by employers for injuries should translate into workplace safety expenditures to the point where “*the marginal cost of reducing injuries equals the expected marginal benefits*”. Weiler acknowledges the power of the funding mechanism to operate as a “useful lever” to encourage accident prevention, on the simple theoretical foundation that it makes sense to have costs paid directly by employers rather than through the general revenue fund as it is “*employers who usually are in the best position to institute safety measures in their workplaces*”. Weiler explains that experience rating modifies collective liability in a positive manner, building on the theory that “business reacts to economic incentives”. Economic theory advances the thesis that experience rating is efficient because “it causes employers to take socially desirable preventative actions to reduce work accidents”

Does experience rating theory work in practice?

This of course, is the crux of the debate – *does ER work?* The short answer: Yes. But, don’t take my word for it. There has in fact been a study on the effects of the Ontario WSIB’s ER program entitled, “**Assessing the Effect of Experience Rating in Ontario: Case Studies in Three Economic Centers**”, (June 2005, Institute for Work and Health, IBM Business Consulting Services), which notes: ***Our research indicates that NEER functions well, encourages prevention and contributes to positive workplace health and safety practices***. Nearly three-quarters of all managers across all three sectors state that NEER is influencing them to develop safer workplaces. ***The large majority of employees state that they are being encouraged to report accidents and incidents and are being offered suitable modified and early return to work if injured***.

LAL addressed ER last year in front of legislative committee

Last year at just about this time, I appeared before the *Standing Committee on Government Agencies* when it was examining the WSIB. ER was under fire by those now demanding the resignation of WSIB Chair Mahoney.

In my comments to the Committee, I noted that in the area of injury prevention, experience rating is but one tool in a larger arsenal of tools. I suggested that “***You can’t do it absent a regulatory framework; you can’t do it absent a prosecutorial model; you can’t do it absent certain expectations and guidelines***”.

I understand why the debate has been derailed – the WSIB has been sending mixed messages

Three years ago, in the May 16, 2005 issue of **The Liversidge e-Letter**, when the ER question was again heating up, I suggested that the Board's approach to ER was getting confused between several over-arching themes: employers paying their "fair share"; incentives and the business case model; and an emerging "*social obligation focus*", which I explained in this fashion:

I also suggest that there is concurrently a new philosophical slant emerging with respect to occupational health and safety, and this is the "moral" or "social obligation" focus. This gives rise to the question, "*Why should a company be rewarded for doing the right thing?*".

While this is a powerful philosophy, it is one that runs in absolute conflict with the underlying philosophy behind ER, that is, that self-interested employers will adjust their behaviour to maximize their business interests, and which introduces a "business case" approach to workplace safety and insurance.

With respect to the "social obligation" focus, there is theoretically no limit on the investment pertaining to occupational health and safety, whereas, the self-interest model caps investment at the maximum potential benefit that can be realized. However, the "social obligation" model opens the door to the very type of insurance "moral hazard" (the under-allocation to loss prevention after the purchase of insurance) that gave rise to experience rating in the first place.

My advice to the WSIB (then and now): Figure out what ER is expected to achieve

Three years ago, I strongly encouraged the Board to figure out what exactly it seeks to achieve with its ER program. Actually, that has been a theme that I have been proposing for years and years now, getting nothing more than "*ho . . . hum*" type responses from the Board.

The events of the past few days profiled in the ER debate add fuel to my long observed trait that the Board doesn't respond unless it is publicly pushed. Well, I don't want to say, "*I told you so*" (but I did).

This recent ER controversy was entirely avoidable

All of this recent controversy was entirely avoidable. Three years ago, I suggested that the ER program be revamped with a hybrid incentive and "best practices" approach. This is what I said then:

Readers may recall that the NDP, in their workers' compensation reforms of 1995, included "best practices" provisions and linked those to experience rating. While those statutory reforms were never rendered operational, the clear intent was to allow for a "compliance audit" so that rebates would not be automatically provided to an employer unless they also pass the "compliance audit".

Many readers (those with very long and good memories) will recall that in 1995, employers outright rejected the "best practices" concept and it never was implemented.

Three years ago it was clear to me that the design of ER had to bend or it risked being snapped (and it appears this was pretty much proved right). I saw considerable merit in a *modified and limited* "best practices" model. Had the Board

adopted this model proposed three years ago, there likely would have been no controversy today. This is what I said:

A better alternative – return to "first principles"

ER is an "incentive" program. While negative stimuli (penalties, surcharges and audits) may mildly influence behaviour, certainly the potential for gain is far greater with a positive inducement versus the threat of penalty. That is the founding principle behind ER. **I do not, however, disagree entirely with the concept of "best practices".** Being governed by "best practices", by definition, suggests something positive. **A "best practices" approach, responsibly administered in a way that buttresses the positive inducement aspects of ER, may be worthy of consideration.**

Here is my simple proposal: Provide an opportunity for surcharged employers to reduce or eliminate their ER surcharges by submitting to, and passing, a compliance and Workwell type audit. The benefits are clear and obvious: employers performing not as well as expected will have an opportunity to improve their situation, and the Board would be able to channel resources where they will provide a maximum return – to those employers that need the most assistance.

At the end of the day, below par performance will create a motivational opportunity for improvement. **A win-win.**
Where do we go from here? What is the best thing the Board can do right now?

As I have said, the Board's immediate response (cancelling rebates for employers "responsible" for a fatality) was, in my very respectful view, short-sighted and inspired less by a thoughtful and sustainable policy solution and more by an immediate and urgent public relations storm.

Setting aside for a moment that the Board's "policy" may not stand up to legal scrutiny, it will actually undercut the very levers available to deliver higher standards of worker safety, the very goal being sought!

A far more intelligent approach is to build on the tools available, not pointlessly cast them aside. In the suggestions and ideas I set out three years ago lay the opportunity for a way out of this frazzled mess.

There is a better way that meets everyone's needs: The Board's, employers and workers

Here is a better way, which preserves the core elements of ER, demands perpetual incremental improvement, all the while addressing the program's shortcomings:

In any case (not just fatalities) where there is either a serious injury or a safety prosecution, the Board will initiate a thorough "best practices" audit of that firm before issuing any rebate. The Board will grant an ER rebate for that year or any future year, only if there is demonstrated change and a clear renewed commitment to worker safety by the firm. The Board will also use this process to allow surcharged employers to recoup surcharges.

This approach takes the hysteria out of the debate, **demand**s improvement, and compliments the Board's highly touted ***Road to Zero*** campaign. I encourage the Board, employers and workers to get behind this new way, this better way, and make Ontario a safer place to work.