



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Alex Gurza

SUBJECT: SEE BELOW

DATE: October 16, 2012

Approved

Date

10/16/12

SUBJECT: WORKERS' COMPENSATION – ALTERNATIVE SERVICE DELIVERY EVALUATION ANALYSIS

RECOMMENDATION

Approve staff's proposed strategy to re-evaluate the current in-house service delivery model for the Workers' Compensation program and pursue a two year pilot program using a third party administrator (TPA) to handle a portion of claims administration and handle bill review, utilization review and medical case management for all claims as is currently done.

BACKGROUND

The Office of the City Auditor produced a report in April 2009 titled, [*An Audit of the City of San Jose's Workers' Compensation Program*](#), which concluded that the cost of the City's Workers' Compensation program was higher than comparable cities and counties in California. In an effort to address these cost differentials, the Audit identified seven recommendations to contain the costs associated with the Workers' Compensation program as it existed in 2009. Since that report, the City has taken a series of actions to address those recommendations.

At a Council meeting on March 8, 2011, the City Council directed the Administration to develop a comprehensive program to address the total cost of the workers' compensation program and to assist injured employees with receiving appropriate and timely medical care so that they are able to return to work. This direction was the result of the discussion of Council Agenda Item, 3.3, "[Status Report on the Alternative Service Delivery Evaluation for Workers' Compensation Administration and Employee Health Services](#)."

In addition, the [Mayor's June 2011 Budget Message](#), which was approved by the City Council, stated the following:

Workers Compensation Reforms: The Cost of the City's Workers' Compensation Program is higher than comparable California cities and counties. There is potentially \$10-

October 16, 2012

Subject: Workers' Compensation Service Delivery Evaluation Analysis

Page 2 of 15

12 million in savings related to workers compensation reform. In addition, the City Council has approved achieving workers' compensation reforms as recommended by the City Auditor. The City Manager shall accelerate consideration of changes including contracting the entire process to Santa Clara County, which has a much better record than we do.

Contracting Out Opportunities: *The City Manager should review and consider additional opportunities to contract out services to prepare for next year's budget deficit. This review should consider, at a minimum, Real Estate, Park Maintenance, Accounting/Payroll, Fleet Services, and Workers' Compensation.*

It was directed that City Administration provide to the Public Safety, Finance and Strategic Support (PSFSS) committee a Workers' Compensation Reform plan and strategy and to provide monthly progress reports for implementation.

On December 15, 2011, the PSFSS committee approved the [workers' compensation reform plan](#). This plan included exploring an alternate service delivery model. The plan stated that the Administration would be conducting a Request for Proposals (RFP) for alternate service delivery options for workers' compensation program services. It was recommended that rather than asking for a proposal on one component of workers' compensation, the Administration would explore what services responders might be able to provide. Because of the various aspects of the workers' compensation process, there could be a combination of internal City staff and contractors providing these services. The plan, as approved by the PSFSS committee, stated that once the RFP process was completed, a determination would be made on outsourcing all or parts of the workers' compensation process and that this would be brought back to the City Council for consideration.

Per this direction, the Administration developed a Request for Proposal (RFP) for comprehensive workers' compensation services including claims administration, bill review, utilization review, and medical case management. The City currently contracts with a private vendor for bill review, utilization review, and medical case management. Although the three remaining services are already performed utilizing contractual services, these aspects were included in the RFP to allow for vendors who provide for all services to submit a proposal for comprehensive workers' compensation services.

ANALYSIS

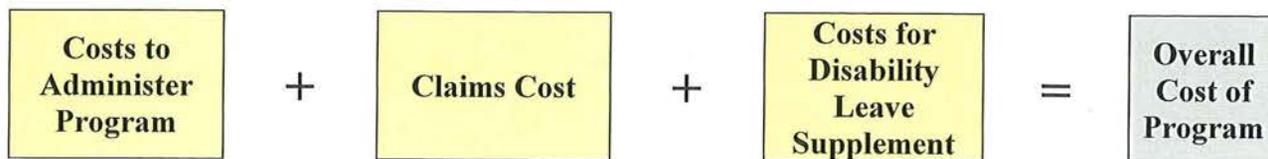
Workers' Compensation Costs

Workers' compensation costs are a significant part of the City's personnel costs. There are three primary components to the total cost of the workers' compensation program, as shown in the following chart:

October 16, 2012

Subject: Workers' Compensation Service Delivery Evaluation Analysis

Page 3 of 15



In Fiscal Year 2011-2012, the City's costs for workers' compensation claims were approximately \$18 million. Approximately 91% of these costs were from the General Fund. In addition to the state mandated workers' compensation benefits, the City provides a Disability Leave Supplement, which cost Departments an additional \$7.5 million in Fiscal Year 2011-2012. Although we are phasing out Disability Leave Supplement with our non-sworn bargaining units, for sworn employees, Disability Leave Supplement (California Labor Code Section 4850) is a state-mandated benefit. It is important to note that this does not include the loss of productivity or any additional costs incurred as a result of employees being off of work due to work related injuries. It also does not include the costs to administer the program.

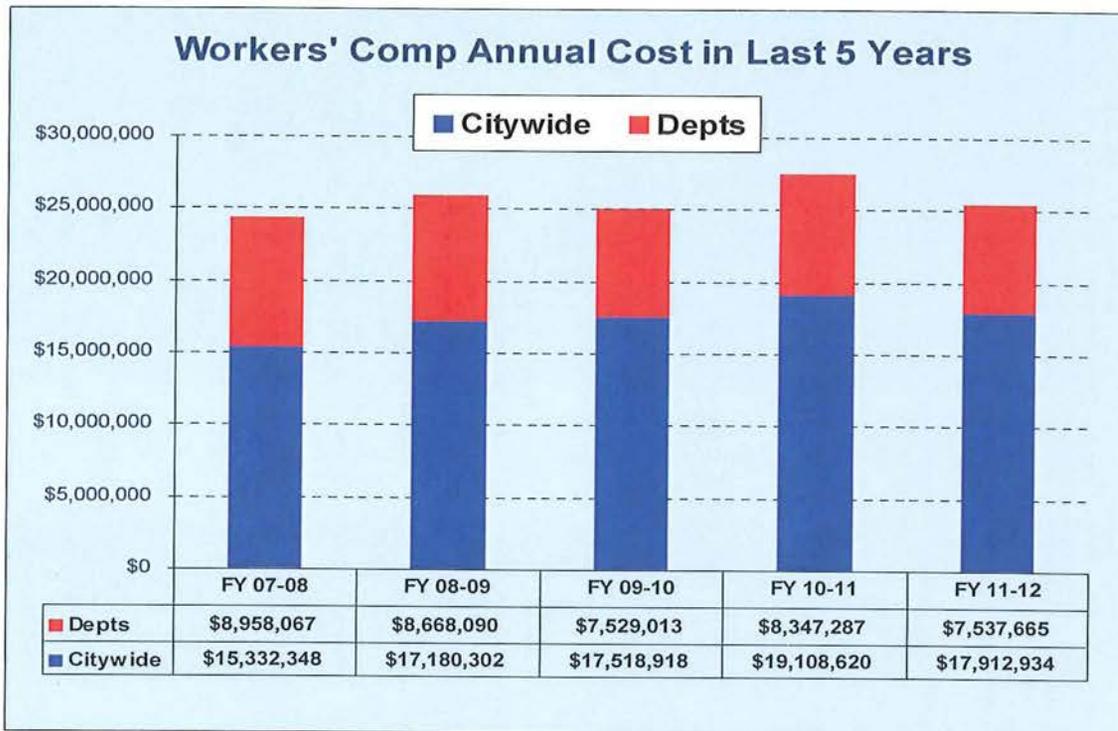
In April 2009, the City Auditor issued an [Audit](#) of the City of San Jose's Workers' Compensation Program. In summary, this audit stated that "In spite of improvements, the cost of the City's Workers' Compensation Program is higher than comparable California cities and counties." This audit contained 7 recommendations, which have been partially implemented.

The approximately \$18 million that was spent last year in workers' compensation costs is similar to previous years, as shown in the chart below with the bar noted as "Citywide." In addition to these costs, Departments spent from their own budgets an additional \$7.5 million in Disability Leave Supplement costs as shown in the bar noted "Depts." Although our costs decreased slightly in Fiscal Year 2011-2012, it should be noted that our Citywide workers' compensation costs increased over the previous four fiscal years, with Fiscal Year 2010-2011, being the highest.

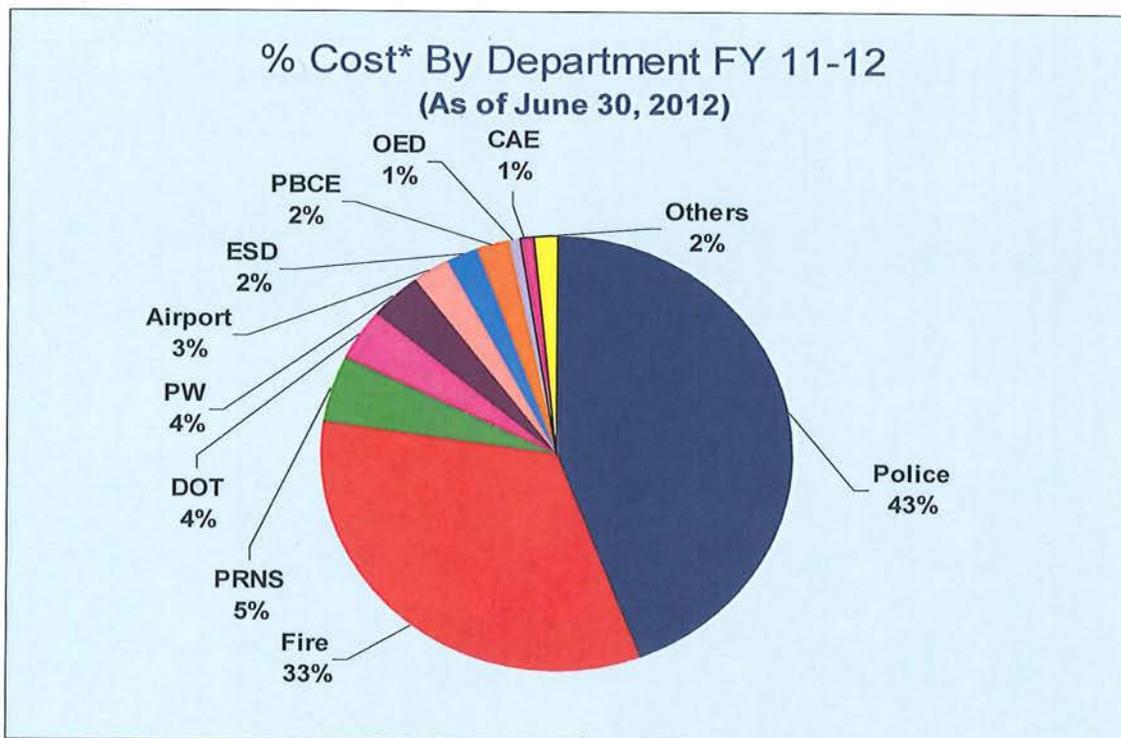
October 16, 2012

Subject: Workers' Compensation Service Delivery Evaluation Analysis

Page 4 of 15



The chart below shows the total costs distributed by Department for Fiscal Year 2011-2012. As noted in the chart, the highest workers' compensation costs are in the Police and Fire Departments, which together comprise approximately 76% of the City's total workers' compensation costs.



When analyzing the cost incurred per claim, the City Auditor's audit on Workers' Compensation also noted that San Jose's cost incurred per claim was significantly higher than other agencies, as shown in the chart below.

Exhibit 5: Average Incurred Cost per Claim – 7/1/04 through 6/30/07



Source: California Institute for Public Risk Analysis.

Given the high costs of workers' compensation, the funds spent out of the General Fund and the areas for improvement identified by the City Auditor when comparing San Jose to other agencies, it is understandable that there is a focus on workers' compensation reform as an area for cost containment. The goal is to reduce the overall cost of the program and not only in the area of claims administration.

Workers' Compensation Program

The main objective of the City's workers' compensation program is to assist injured employees in returning to work through appropriate and timely medical care. The City is currently self-insured and self-administered. The Human Resources Department- Health and Safety Division administers the Workers' Compensation Program. The program's budgeted staff is 9 Workers' Compensation Claims Adjusters, 2 Senior Workers' Compensation Claims Adjusters, 1 Principal Account Clerk, 4 Support Staff and 1 Division Manager.

The Health and Safety Division of the Human Resources Department currently provides claims administration services while bill review, utilization review, and medical case management are handled by contractual services. The following is an explanation of these different components:

- **Claims Administration-** Providing workers' compensation claims administration services for medical, indemnity and future medical claims. Adjusting Workers' Compensation claims professionally, meeting all state laws, rules and regulations. This service is currently handled by in-house staff.
- **Bill Review-** Reviewing medical provider bills for appropriateness of fees charged utilizing the California Official Medical Fee Schedule. Using computer assisted bill review capabilities in order to determine and apply the appropriate network discounts from selected PPO's. Reviewing bills for discounted rates. This service is currently handled by through contractual services.
- **Utilization Review-** Providing prospective (pre-certification), concurrent and retrospective utilization review services to determine whether aspects of a patient's care and requested medical treatment and/or services is medically necessary and appropriately delivered. This service is currently handled through contractual services.
- **Medical Case Management-** On a selected case-by-case basis, providing telephonic case management and/or nurse case management involving on-site visits with the injured employee. This service is currently handled through contractual services.

Legal services are also an important component of the workers' compensation process. Legal services are handled by the City Attorney's Office, and it has performed a separate service delivery evaluation for legal services.

As found by the City Auditor, the City's workers' compensation costs are much higher than other jurisdictions. While there is not one particular reason for this, as has been directed by the City Council, the Administration is pursuing various avenues that could potentially reduce costs.

It is not uncommon for other jurisdictions to have a Third Party Administrator (TPA) handle their claims administration. In a survey conducted of the largest five Bay Area Cities, four of the five use a TPA for all claims administration. The City/County of San Francisco, however, uses a TPA for a portion of their claims and in-house staff for a portion. The following chart outlines the findings of this survey:

AGENCY	Which aspects of workers' compensation services are provided by a Third Party Administrator, if any?	Does the same Third Party Administrator handle all aspects?
City of Fremont	100%	Yes, the same provider handles all aspects.
City of Hayward	100%	Yes, the same provider handles all aspects.
City of Oakland	100%	Yes, the same provider handles all aspects.
City of Sunnyvale	100%	Unbundled
City/County of San Francisco	Partial claims administration, bill review, utilization review, case management	Unbundled; 66% of claims-in house; 33% TPA

Medical Provider Network

One other component of the City's workers' compensation reform plan was exploring the possibility of developing a Medical Provider Network (MPN).

Currently, when an employee is injured, they can go to any doctor. An MPN is an entity or group of health care providers set up by an insurer or self-insured employer and approved by Division of Workers' Compensation (DWC's) administrative director to treat workers injured on the job. Under state regulations, each MPN must include a mix of doctors specializing in work-related injuries and doctors with expertise in general areas of medicine. MPNs are required to meet access to care standards for common occupational injuries and work-related illnesses. The regulations also require MPNs to follow all medical treatment guidelines established by the DWC and allow employees a choice of provider(s) in the network after their first visit.

Many TPAs have established their own MPNs or have one available to their client. Alternatively, TPAs can establish an MPN specific to the City of San Jose. This is an important component of the reform plan and one component that can be achieved more quickly with the use of a TPA compared to the City establishing one on its own. If the City proceeds with the pilot or complete outsourcing we will work with the selected TPA to utilize an MPN for all claims.

Request for Proposals

Per Council direction, the Administration developed a Request for Proposals (RFP) for a comprehensive workers' compensation cost containment program including claims administration, bill review, utilization review, and medical case management. The City currently contracts with a private vendor for bill review, utilization review, and medical case management. Although the three remaining services are already performed utilizing contractual services, these aspects were included in the RFP to allow responders to bid for bundled or unbundled services.

The RFP was released on March 20, 2012, with a due date of April 30, 2012. The City reserved the right to accept an offer in full, or in part, or to reject all offers. The RFP process is close to completion and if the service delivery recommendation is approved, the contract award recommendation will be brought back to Council.

One benefit to using a TPA is that because claims administration is their core competency they have instituted best practices, technology advances, and other ways to contain costs that may not be resources available to in-house staff. For example, there is a TPA that has developed an application that provides injured employees information, such as reminders on doctor appointments and forms via electronic avenues. This ensures consistent communication with an injured employee. Using a TPA will also provide a reduction in the number of claims handled by an adjuster, which can allow an adjuster to spend more time on individual claims, thus allowing for better service.

The potential benefit of having one provider provide all workers' compensation services (bundled services) is efficiency and communication. A pilot program where one provider provides all workers' compensation services allows the Administration to test whether or not bundling the services with one provider leads to improvements in efficiency and communication.

TPAs typically have legal services that their clients can choose to use as an alternative to in-house legal services or legal services contracted by that client. However, how to provide legal services is within the purview of the City Attorney.

Alternative Service Delivery Options

City staff has identified three possible service delivery options for the comprehensive Workers' Compensation program. Since bill review, utilization review and medical case management are already outsourced, the options being considered are related to using a TPA for claims administration. These three options are:

1. Continue providing claims administration in-house and pursue a contract for continued outsourcing of bill review, utilization review, and medical case management.
2. Outsource all claims administration to a Third Party Administrator (TPA) providing 100% of the Workers' Compensation services.

3. Institute a two year pilot program where a TPA provides 40%-50% of the Workers' Compensation claims administration services as well as all bill review, utilization review and medical case management. Through coordination with the Departments, the Administration would select specific departments whose claims would be handled by the TPA for a two year period and re-evaluated thereafter. A service delivery evaluation would be conducted after the two year period as part of the evaluation of the pilot program.

Through the analysis of the costs and benefits of the three alternative service delivery strategies, as described below, Alternative #3 is the Administration's recommended strategy.

Cost Benefit Analysis

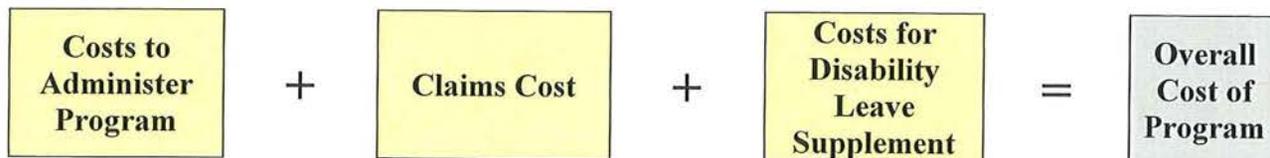
Below is an annual cost benefit analysis of the three options being considered related to claims administration.

#	Major Considerations	100% In House Staff	100% Claims Administration by TPA	2 Year Pilot Program 40-50% Claims Administration
1	Estimated Annual Cost	\$2,010,000	\$2 - 3.5 Million	In House: <u>\$1,110,000*</u> TPA: <u>\$900,000</u>
2	City Savings in Long Term	\$0	Unknown	Unknown
3	City Staff Affected by Reorganization	0 FTEs	17 FTEs	8 FTEs (all but one is vacant or will be vacant shortly, resulting in NO layoffs, one bump within same class)

* The personal services savings related to the recommended elimination of 8.0 vacant positions, if this pilot is approved, includes \$273,000 of fixed retirement costs. Due to the minimum annual required contribution to the Federated Retirement System, the fixed cost will be built into the 2013-2014 budget.

NOTE: The estimated savings noted above are preliminary estimates and may change after contract is negotiated with selected vendor.

There are multiple aspects to the overall cost of the workers' compensation program:



The goal is reduce not only the number of claims, but the overall costs of work related injuries. This cannot be analyzed by only focusing on the costs of adjusters, whether through a TPA or in-house staff.

One component of the City's workers' compensation costs include the costs of Disability Leave Supplement (DLS), which is a benefit that provides payments that are beyond workers' compensation benefits. The supplemental benefit has been eliminated for four non-sworn bargaining units and has been reduced to three months for the other five bargaining units. Complete elimination of DLS will be a subject of the upcoming or continuing negotiations with these five bargaining units. However, DLS benefits for sworn Police and Fire are mandated by State law. Therefore, there are minimal savings left to achieve in this area, absent a change in State law.

While the costs to administer the workers' compensation claims portion of the program using a TPA can be more than the costs of using in-house staff, a pilot program will allow the City to compare the effectiveness of using a TPA in reducing the overall claims cost and therefore, reducing the overall cost of the program. This is the reason the Administration is recommending a pilot program where a portion of the claims are administered by a TPA at the lowest possible cost and a portion remains in-house. This pilot program will be used to evaluate whether or not the overall claims cost can be reduced by using a TPA, and this information will be used in the determination of whether or not to use a TPA for 100% of claims administration or go back to using in-house staff for all of claims administration.

It should be noted that in the pilot project alternative, there will be no layoffs of City employees since there are currently enough vacant positions or positions that will be vacant shortly that could be eliminated. There would be one employee who would bump within the same classification.

Bill Review, Utilization Review and Medical Case Management

As noted above, bill review, utilization review and medical case management are already handled through contractual services. The City has a contract with Mitchell Corporation that extends through December 31, 2012. There is a per service fee in the contract with Mitchell that varies depending on the service.

Under the Administration's recommendation, the TPA will handle bill review, utilization review and medical case management for all of the City's workers compensation claims and claims administration for 40-50% of the City's claims, as described above.

COST SUMMARY/IMPLICATIONS

If the City Council approves this two-year pilot, as part of the contract award for the pilot program, it will be recommended to delete eight positions in the General Fund effective January 1, 2013: 1.0 Senior Workers' Compensation Claims Adjuster position, 5.0 Workers' Compensation Claim Adjuster II positions, 1.0 Sr. Office Specialist, and 1.0 Office Specialist II position; and (2) to modify the 2012-2013 Human Resources Department budget by shifting approximately \$450,000 in resources from the personal services appropriation to the non-personal/equipment appropriation to provide funding for the contract. As part of the development of the 2013-2014 Base Budget, approximately \$900,000 will be reallocated from personal services to non-personal/equipment in the Human Resources Department budget to cover the estimated annualized cost of the contract.

POLICY ALTERNATIVES

Alternative #1: Continue using in-house staff for claims administration and contractual services for bill review, utilization review and medical case management

Under this alternative, in-house staff will continue to be used for all claims administration and the Administration would bring back an award for a contract for continuing contractual services for bill review, utilization review and medical case management.

Key Benefits

- Maintains City staff.
- Maintains direct oversight of claims administration.

Key Issues

- There will be no change to the costs, efficiencies and communication to employees of the current workers' compensation program by using a TPA and therefore no way to assess whether or not a reduction in costs and better efficiencies and communications can be achieved through the use of a TPA.

Alternative #2: Contract with a Third Party Administrator (TPA) for 100% of claims administration

Under this alternative, 100% of the claims handled by in-house staff would be handled by the chosen TPA.

Key Benefits

- Cost savings: By fully contracting with a TPA, the City would not receive additional savings in the form of a reduction in personnel costs due to the similar costs of using a TPA vs. in house staff, however, it is expected that using a TPA could reduce the City's overall cost of the workers' compensation program by reducing the City's overall costs per claim.
- Process Improvements: The expectation will be that the TPA will be able to provide more time per case, apply best practices and efficiencies, and thus be able to save in overall workers' compensation costs by effectively managing a claim so that employees are returned to work as soon as possible. The TPA may have access to technology that is not cost effective for the City to procure, whereas a TPA may use streamlined processes and tools for all of their clients. These process improvements will also ensure that better service is provided to the injured employee.
- Alignment with Key City Policies: Contracting with a TPA will serve the City's interest in increasing the service level to injured employees and at the same time, reducing the overall cost.

Key Issues

- Staffing Impact: As 17 FTEs comprise the Workers' Compensation Health and Safety Division of the Department of Human Resources, the employees in this Division would be directly affected by the complete outsourcing of the Workers' Compensation program. However, there are 7 current and anticipated vacancies within the workers' compensation in-house staff, and therefore 10 employees would be actually impacted through complete outsourcing. The Human Resources Department and the City has many vacancies open for the potential placement of impacted employees.
- Lack of Internal Control: A TPA will need monitoring to ensure that the City is receiving the most cost-effective service. In addition, the City would be losing direct supervision and oversight of the claims administration team. However, a communication system would be established to ensure that Administration could receive timely information on the program. Reporting by the TPA would be a key component in monitoring the TPA's performance and the costs of the program.

Should the Council approve moving forward with this service delivery option, staff would develop strategies to lessen the impacts of these program changes.

Alternative #3: Pilot program to assign 40-50% of the claims administration to TPA for specific departments

This alternative is the recommended alternative and would keep a portion of claims administration services in-house. The Administration would identify specific departments whose employees' claims would be handled by the TPA as a two year pilot program. This could be done to ensure that there is an overall benefit, including a cost benefit, to having a TPA handle the claims administration and is similar to how the City/County of San Francisco handles their claims administration.

Key Benefits

- Test Period: A pilot program allows for a testing period to evaluate whether using a TPA actually reduces the overall costs and effectiveness of the workers' compensation program, without necessitating a decision to completely outsource claims administration. The pilot will allow the Administration to engage with those Departments who use the TPA to receive feedback on using that TPA for analysis in forming a recommendation of whether to go back to using 100% in house staff or move completely to using a TPA for claims administration. We would work with the TPA to set up clear performance measures and targets. Employees whose claims are handled by the TPA would also be surveyed to assess the performance of the TPA.
- Cost savings: By using a TPA for a portion of claims administration, the City would not receive additional savings in the form of reduced personnel costs to the Human Resources Department, however, it is expected that using a TPA could reduce the City's overall cost of the workers' compensation program.
- Process Improvements: The expectation will be that the TPA will be able to provide more time per case, apply best practices and efficiencies, and thus be able to save in overall workers' compensation costs by effectively managing a claim so that employees are returned to work as soon as possible. The TPA may have access to technology that is not cost effective for the City to procure, whereas a TPA may use streamlined processes and tools for all of their clients. These process improvements will also ensure that better service is provided to the injured employee.
- Alignment with Key City Policies: Contracting with a TPA will serve the City's interest in increasing the service level to injured employees and at the same time, reducing the overall cost.

Key Issues

- Staffing Impact: 17 FTEs comprise the Workers' Compensation Health and Safety Division of the Department of Human Resources, and a portion of the employees in this Division would be directly affected by the pilot program. Since there are currently or will be enough vacancies shortly within the workers' compensation in-house staff, only one filled position

would actually be impacted, but would result only in a bump within the same classification. There will be no layoffs of employees.

- Lack of Internal Control: A TPA will need monitoring to ensure that the City is receiving the most cost-effective service. In addition, the City would be losing direct supervision and oversight of the claims administration team. However, a communication system would be established to ensure that Administration could receive timely information on the program. Reporting by the TPA would be a key component in monitoring the TPA's performance and the costs of the program.

Should the Council approve moving forward with this service delivery option, staff would develop strategies to lessen the impacts of these program changes.

EVALUATION AND FOLLOW-UP

In the Council approves the recommendation, the next steps in the process will complete the RFP process and allow staff to bring back to the Council an award for a contract. At the same time and prior to any contract being finalized, outreach will be conducted with stakeholders and, the Administration will meet with the affected City employee bargaining unit, if requested.

At the end of that two year period, based on the pilot program, the Administration will do a full Service Delivery Analysis and bring that forward to the City Council for consideration.

Key Activity	Tentative Schedule	
	Alternative 2 - 100% Use of TPA	Alternative 3 - Pilot Program 40-50% TPA
Council consideration of recommended alternative service delivery model and direction to negotiate and execute contract amendments subject to meet and confer process	October 2012	October 2012
Council approval of award of contract with selected vendor subject to meet and confer process	November 2012	November 2012
Meet and confer with affected bargaining unit if applicable	November 2012	November 2012
Discussion with Departments on taking part in pilot program	November 2012	November 2012
Transition begins to use of TPA	January 2013	January 2013

October 16, 2012

Subject: Workers' Compensation Service Delivery Evaluation Analysis

Page 15 of 15

PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This item meets Criterion 3 and will be posted on the City's website for the October 30, 2012 Council agenda.

COORDINATION

This memorandum has been coordinated with the Department of Finance, City Manager's Budget Office, City Manager's Office of Employee Relations, and the City Attorney's Office.

CEQA

Not a Project, File PP10-069(a), City Organizational & Administrative Activities.



Alex Gurza
Deputy City Manager

For questions please contact Alex Gurza, Deputy City Manager at (408) 535-8150.