



COUNCIL AGENDA: 1/9/2018
ITEM: 3.4 (18-007)

Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Toni J. Taber, CMC
City Clerk

SUBJECT: SEE BELOW

DATE: December 22, 2017

**SUBJECT: WORKERS' COMPENSATION PROGRAM: EVALUATION OF
SERVICE DELIVERY OPTIONS**

RECOMMENDATION: As recommended by the Public Safety, Finance and Strategic Support Committee on December 14, 2017:

- (a) Accept the evaluation of service delivery options for administering workers' compensation claims, including providing services In-House with City staff, through a Third-Party Administrator, and a Hybrid Model that includes both In-House and Third Party claims administration.
- (b) Direct the City Manager to:
 - (1) Continue the current Worker's Compensation Pilot Program (Hybrid Model) through the completion of the State audit of the In-House program;
 - (2) Develop a work plan for bringing the entire worker's compensation program In-House in stages upon successful completion of the State audit; and
 - (3) Return through the budget process with funding recommendations for bringing the program In-House in stages beginning in 2019-2020.



Memorandum

TO: PUBLIC SAFETY, FINANCE, AND
STRATEGIC SUPPORT COMMITTEE

FROM: Julie Edmonds-Mares

SUBJECT: SEE BELOW

DATE: December 7, 2017

Approved

Date

12-7-17

**SUBJECT: WORKERS' COMPENSATION PROGRAM: EVALUATION OF SERVICE
DELIVERY OPTIONS**

RECOMMENDATION

Accept the evaluation of service delivery options for administering workers' compensation claims, including providing services In-House with City staff, through a Third-Party Administrator, and a Hybrid Model that includes both In-House and Third-Party claims administration.

WORKERS' COMPENSATION PILOT PROGRAM EVALUATION

At the October 19, 2017 meeting of the Public Safety, Finance and Strategic Support Committee (PSFSS), the Committee heard and accepted the Workers' Compensation Program Semi-Annual Report. This report included updates on the Pilot Program, which is slated to conclude in June 2018, and the upcoming State Audit of the In-House Workers' Compensation Program.

The Committee directed staff to return in December with an evaluation of the City's options for administering workers' compensation claims, including: (1) bringing the program In-House; (2) administering the program through a Third-Party Administrator; or (3) continuing a Hybrid Model that includes both In-House and Third-Party claims administration (as is currently in place through the Pilot Program). The Committee also asked that staff provide implementation timelines for each of the alternatives. Additionally, the Committee asked for the implementation analysis to take into consideration risk factors and the timeline related to the 2018 State Audit of San José's In-House Workers' Compensation Program.

EXECUTIVE SUMMARY

The City of San José is currently in a multi-year Pilot Program to evaluate service delivery models for providing workers' compensation benefits to employees. Under the Pilot, workers' compensation claims are split between an In-House City team and Intercare, a Third-Party Administrator (TPA). The Pilot is scheduled to conclude in June 2018. However, given the potential serious repercussions of the pending State Audit of the In-House program, staff recommends continuing the Hybrid Model until the

State Audit is concluded. Staff also recommends bringing forward additional analysis of the Pilot and making a recommendation regarding a permanent operational model within the City's 2018-2019 Operating Budget Cycle next spring for implementation in 2019-2020.

The City's options for administering workers' compensation claims include: (1) bringing the program In-House; (2) administering the program through a Third-Party Administrator; or (3) continuing a Hybrid Model that includes both In-House and Third-Party claims administration (as is currently in place through the Pilot Program). This policy decision is difficult for any city, however, in San José's case, the decision is further complicated by the facts surrounding a recent State Audit.

In 2016, the State of California conducted a routine profile audit review of the City's In-House program and its claims handling. The City failed this audit. Based on the failure, the City will be subject to another audit in December 2018. If the City does not pass a second time, under the State Labor Code, the State could take away the City's ability to self-insure for workers' compensation.

Self-insurance means that the City pays for injured workers' benefits and costs as they occur. If the ability to self-insure were revoked, the City would need to purchase workers' compensation insurance from a private insurance company. It is difficult to estimate how much more it would cost the City to purchase workers' compensation insurance for a program that currently has nearly \$27 million in annual claims costs and approximately \$3.7 million in administrative costs. In addition to claims and administration, an insurer would include profits and overhead in the premium cost and insure against the risk of future claims and costs. Staff's concerns about the upcoming December 2018 State re-audit are significant.

Based on an analysis of the advantages and disadvantages of each potential service delivery model, the following policy alternatives are available to the City:

1. Outsource the current In-House operation to a Third-Party Administrator (TPA). According to the State, if the In-House operation is outsourced to a TPA in the early part of calendar year 2018, the State will cancel the re-Audit and the City's ability to self-insure will no longer be in jeopardy from a failure of the re-Audit.

The current contract with TPA Intercare includes an option to extend beyond the Pilot period and makes this option viable from a contracting perspective. However, Council Policy 0-41 (Service Delivery Evaluation) requires a preliminary business case analysis be conducted to evaluate service delivery changes that could impact four or more full-time employees. Initial work was done prior to launching the Pilot Program, and this staff report provides much of the business case analysis required under Council Policy 0-41.

However, if directed to bring the City Council a recommendation regarding outsourcing in early 2018, staff would complete the Service Delivery Evaluation and issue a Supplemental Memorandum to this report for full City Council consideration.

2. Continue the current Hybrid Model. Staff recommends continuing the Pilot Hybrid Model until the audit is concluded. This action would minimize the number of cases subject to audit. The In-House program currently handles only workers' compensation cases for the Police Department; all others have been transferred to the TPA. In the long-term, however, staff would not recommend the Hybrid Model due to duplication of services.
3. Bringing the entire program and caseload In-House is **not** recommended in the short-term due to the upcoming State re-Audit. Bringing the cases currently with the TPA in-house would subject those cases to the audit. Should the City Council wish to bring the program In-House, staff recommends waiting until after the State Audit is completed to ensure that the City passes the audit.

BACKGROUND

About San José's Workers' Compensation Program

The City's Workers' Compensation Program is one component of the City's overall health and safety efforts for employees. The City's first goal is to prevent injuries and accidents. Second, the City aims to assist employees who have a work-related injury in receiving appropriate and timely medical care so that they can get back to work as quickly as possible. Addressing workers' compensation costs requires a comprehensive approach beginning with injury prevention, through treatment and return to work, or in certain cases, through the work-related disability retirement process.

Workers' compensation is a State-mandated benefit for workers who are injured on the job. California requires all employers to have workers' compensation coverage (either through an insurance company or a State-approved self-insurance program) even if they have only one employee. The State mandates the following benefits:

- Medical Care: Workers injured on the job are entitled to receive all medical treatments including physician services, hospitalization, prescriptions, x-rays, lab studies and/or dental care reasonably required to cure or relieve you from the effects of your injury.
- Payments for lost wages: If an employee is temporarily disabled by a job injury or illness, they can receive benefits for up to 104 weeks of payments within five years from the date of injury (for injuries on or after Jan. 1, 2008). Tax-free temporary disability payments are two-thirds of the employee's average weekly pay, up to a maximum set by State law. Payments are not made for the first three days the employee is disabled unless they are hospitalized as an inpatient or unable to work for more than 14 days.

Public Safety Officers - Labor Code Section 4850 requires that all public safety officers employed at the time of an industrial injury receive full salary in lieu of temporary disability for a period up to one year. If the public safety officer continues to be disabled after exhausting the one year of full salary, the injured employee will then receive temporary disability at two-thirds of the employee's average weekly wage, up to the maximum set by State law.

- **Return to Work:** If the injury or illness prevents an employee from returning to the same job, there may be an opportunity for modification of the regular job, alternative employment in another position, or retraining.
- **Payments for Permanent Disability:** If the injury or illness results in a permanent impairment, the injured employee is entitled to permanent disability benefits.
- **Death Benefits:** If the injury results in death, a benefit will be paid to surviving dependents. This is a State determined amount and varies depending on the number and type of dependents.

San José Workers' Compensation Budget

The City of San José is self-insured for workers' compensation. This means that, when a worker is injured, the City pays the worker's medical expenses, disability payments and other benefits/costs as mandated under State law. In the 2017-2018 Adopted Budget, the City has budgeted from all funds \$22.6 million for workers' compensation claims and nearly \$3.9 million for claims administration by both the In-House team and the TPA.

Table 1 below provides detail about the budgeted claims administration expenses. Table 2 (next page) provides detail about the City's annual costs for claims, including medical care, temporary disability/Labor Code section 4850 benefits, return to work, permanent disability and death benefits.

Table 1: Fiscal Year 2017-2018 Claims Administration Budget

Item	2017-2018 Budget
Personnel (In-House team: City staff salaries, retirement, benefits)	\$1,178,000
Non-Personal/Equipment (supplies + contract)	\$155,000
Third-Party Administrator (Intercare contract)	\$2,136,000
Sub-Total Ongoing Costs	\$3,469,000
One-Time Temporary Staff (In-House team)	\$409,000
Total 2017-2018 Costs	\$3,878,000

Table 2: Workers' Compensation Total Claims Costs

	2015-2016 Actuals	2016-2017 Actuals*	2017-2018 Budget
Police	\$6,583,902	\$7,839,991	\$7,700,000
Fire	\$7,972,233	\$7,079,017	\$8,300,000
DOT	\$879,103	\$573,046	\$1,200,000
PRNS	\$1,376,700	\$992,877	\$1,500,000
Public Works	\$450,000	\$773,730	\$800,000
Other Departments	\$890,990	\$823,993	\$1,000,000
General Fund Total	\$18,152,928	\$18,082,654	\$20,500,000
Special Funds Total	\$1,273,171	\$1,305,739	\$2,100,000
ALL FUNDS	\$19,426,099	\$19,388,393	\$22,600,000
LC 4850 Benefits ¹	\$5,352,371	\$7,573,406	n/a
Total	\$24,778,470	\$26,961,799	

¹ Workers' compensation costs also include "4850 Benefits". These benefits are funded from both the Police and Fire Departments' personal service budgets, consistent with where the cost of the position is budgeted. The Labor Code that provides for these benefits applies specifically to safety officers and provides Police and Fire sworn personnel with full pay for up to one year for each workers' compensation claim. The 4850 benefits are not subject to income tax so the benefits are paid to the recipient tax free.

* Source data: FMS (Dollar amounts may vary slightly from Navrisk due to timing)

Self-insured employers, such as San José, must be State-approved and pay the same benefits to injured employees as employers that contract with a private insurance company to provide workers' compensation insurance.

History of the Pilot Program and Past Audits

The City Auditor's Workers' Compensation Audit Report in 2009 recommended that staff provide the Public Safety, Finance, and Strategic Support Committee (Committee) with regular reports on the City's Workers' Compensation Program. Staff now provides this report to the Committee on a semi-annual basis.

In the years since the audit, the City has implemented a number of changes to the Workers' Compensation program. A detailed timeline including prior City Council and Committee direction is provided in Attachment A.

Most notably, the City is currently in the midst of a multi-year Pilot Program in which the City is contracting with a Third-Party Administrator (TPA) to handle a portion of claims administration and to also handle bill review, utilization review, and medical case management for all claims.

In 2013, the initial TPA selected for the Pilot was Athens Administrators. Athens experienced various challenges, in part due to a lack of specialized management at the City of San José to effectively support the Pilot Program.

On January 1, 2017, following a competitive bid process and City Council approval of a new TPA vendor, the City replaced Athens with Intercare. As of May 22, 2017, all non-Police Department claims were transferred from the In-House team to Intercare (with the In-House team only handling claims for the Police Department).

The City filled the Division Manager position for workers' compensation approximately one year ago, and Intercare is succeeding. Moreover, Intercare and the Division Manager are collaborating to develop new workflows and strategies to address the 2009 City Auditor recommendations and contain costs, while maintaining quality service delivery for our employees.

ANALYSIS

This analysis section includes the following:

- State Audit Timeline and Analysis—provides important context to analyze the potential Workers' Compensation Program options and the timeline for implementation.
- Service Delivery Models—describes the three service delivery options (In-House, TPA, or Hybrid Model) and the pros and cons of each.
- Service Delivery Costs—describes the estimated cost of the various models assuming different implementation/caseload scenarios.
- Policy Decisions and Next Steps—provides an overview of key policy decisions the Council will need to make.

State Audit Timeline and Analysis

In 2016, the State of California conducted a routine profile audit review of the City's In-House program and its claims handling. The State of California Department of Industrial Relations audits workers' compensation administrators at least once every five years to ensure that injured workers are obtaining appropriate medical care and benefits. The City failed this audit.

Based on the Audit failure, the State assessed the City: (1) a penalty in the amount of \$142,215; (2) additional disability payments in the amount of \$16,089.91; and (3) additional medical and medical legal payments of approximately \$16,000. Based on the failure, the City will be subject to another audit in December 2018.

If the City does not pass a second time, under the California Labor Code, the State could take away the City's ability to self-insure for workers' compensation.

The Labor Code states:

Upon a second or subsequent audit failure, the administrative director shall refer the matter to the Insurance Commissioner or the Director of Industrial Relations and request that a hearing be conducted to determine whether the certificate of consent to self-insure shall be revoked.

In addition, any employer that fails to meet the full compliance audit performance standards in two consecutive full compliance audits shall be rebuttably presumed to have engaged in a general business practice of discharging and administering its compensation obligations in a manner causing injury to those dealing with it (which could result in a Civil Penalty up to \$100,000).

—California Labor Code Section 129.5

Self-insurance means that the City pays for injured workers' medical expenses, disability benefits, and other claims-related costs as they occur. If the ability to self-insure were revoked, the City would need to purchase workers' compensation insurance from a private insurance company. It is difficult to estimate how much more it would cost the City to purchase workers' compensation insurance.

Workers' compensation insurance companies not only provide insurance to cover medical costs and all other benefits when a worker is injured (except Labor Code section 4850 full salary for public safety officers; this benefit, which totaled more than \$7.5 million in 2016-2017, would still be paid directly by the City). Workers' compensations insurers also administer and pay claims, using their own internal staff or outsourcing the claims handling to a TPA. From a policy perspective, being required to purchase an insurance policy for workers' compensation essentially outsources the City's program.

In addition to the costs of claims and administration, a workers' compensation insurer would include profits and overhead in the premium cost and insure against the risk of future claims and costs. Staff was unable to find comparable costs for such a policy. All of the 20 largest cities or 10 largest counties in California are self-insured for workers' compensation.

As a result, staff's concerns about the upcoming December 2018 State re-audit are significant. Following is an analysis of the 2016 audit and the Department's work to resolve the issues identified through the audit process.

In 2016, the State audited claims with dates of injury from 2013 through 2015. The State's Audit Unit reviewed a total of 78 randomly selected Indemnity claims and 47 randomly selected Denied claims, for a total of 125 claims reviewed. From this small sample, the State identified 567 claims handling violations, and assessed more than \$142,000 in penalties, as noted above. According to the State Audit Unit, these violations constituted a failure of the Audit and equated to poor quality claim handling on the part of the City.

In addition to the above,

- In 2016, the City was the subject of a Target Utilization Review Audit by the same State Audit Unit. The In-House operation was assessed penalties of \$3,000 for three (3) failures to respond to requests for medical treatment; and
- The City also was assessed \$120,000 in penalties by the State Audit Unit for failure to properly address Independent Medical Review Appeals in 24 claims.

It is important to note that the State Audit and the Target Utilization Review Audit pertain to cases handled by the In-House workers' compensation team. They do not pertain to the City cases handled by

the TPA used under the Pilot Program. TPAs are audited separately by the State. The City's TPA during this time period (Athens Administrators) passed the 2015 State Audit of their claims handling. Based on the State's audit cycle, Intercare likely would not be audited for its San José claims until 2020.

The City has been working to address the issues identified in the 2016 State Audit. At the time of the 2016 audit, the In-House team included five to seven permanent and temporary staff handling an average caseload of 300 claims each. The industry standard is for a regular claims adjuster to handle an average caseload of 145 claims and for a Future Medical Examiner to handle an average caseload of 250 claims.

With Council approval, the Human Resources Department brought on a new Third-Party Administrator (Intercare), adding funding so cases could be shifted from the In-House team to the new TPA (thus bringing In-House caseloads per City employee down), and purchased a new version of its existing claims-management software system. As these actions were underway, the Department hired an experienced Division Manager to oversee the Workers' Compensation and Safety Division in November 2016. Additional funding of over \$1.5 million was approved by the City Council as part of the 2017-2018 Adopted Budget for the Workers' Compensation Program. This included \$1.1 million for the Intercare contract, \$115,000 for the claims management software, and \$331,000 to continue temporary staffing.

In an effort to address the issues identified in the State Audit, staff also conducted an internal review of more than 300 Indemnity and Denied claims. These claims were not selected by the State for the Audit but involved dates of injury from 2013 through 2015. This internal review revealed additional claims handling violations, consistent with the violations found by the State in the randomly selected 125 claims.

Based on the failure of the Audit, the In-House operation will be re-audited in December 2018. As noted above, if the In-House operation fails the re-Audit, the City's ability to self-insure for workers' compensation may be terminated by the State.

Given the pending re-audit, there are two possible near-term actions available to the City:

1. Continue the current Hybrid Model until the re-audit is concluded. This action would minimize the number of cases subject to audit. The In-House program currently handles only workers' compensation cases for the Police Department; all others have been transferred to Intercare.

OR

2. Outsource the current In-House operation to a TPA. According to the State, if the In-House operation is outsourced to a TPA in the early part of calendar year 2018, the State will cancel the re-Audit and the City's ability to self-insure will no longer be in jeopardy from a failure of the re-Audit. The current contract with Intercare includes an option to extend beyond the Pilot period. However, it would be very difficult to complete all of the necessary analysis and staffing changes to implement this option within the required timeframe.

A third option, bringing the entire program and caseload in-house, is not recommended in the short-term due to the upcoming re-audit. Bringing the cases currently with the TPA in-house would subject

those cases to the audit. In addition, hiring enough experienced staff to handle those cases in time for the State Audit would be a Herculean task given the staffing shortages in the industry outlined below.

Should the City Council wish to bring the program In-House, staff recommends waiting until after the State Audit is completed to ensure that the City passes the audit. The risks of failure are too significant.

Service Delivery Models

Following is an analysis of the advantages and disadvantages for each potential Service Delivery Model, to include: (1) bringing the program In-House, (2) administering the program through a TPA, or (3) continuing a Hybrid Model (as is currently in place through the Pilot Program).

1. BRINGING THE PROGRAM IN-HOUSE

In this Model, all claims would be handled by City staff In-House and the City would no longer contract with a TPA for claims administration. The City would continue to contract for bill review, utilization review, and medical case management for all claims, as has been done since 2002.

Advantages for Bringing the Program In-House

- Control over the process – Government agencies that provide self-administered programs generally choose this option to retain the highest level of control over the claims process and results. This also includes the potential to maintain control over costs.
- Effective Communication – Self-administered programs, when adequately staffed and conveniently located for employees, are generally considered to offer better communication as injured employees and departments have greater access to and connection with the claims operation. This helps to minimize and manage potential challenges.
- Consistency – An In-House program would provide more consistency in service level and communications to employees than a hybrid model, as well as less duplication of program costs for management and overhead.

Disadvantages for Bringing the Program In-House

- The State Audit will not be canceled. Bringing the full program caseload in-house prior to completion of the audit would further complicate the audit and increase the risk of failure. As described above, if the City fails the 2018 audit, the ability to self-insure workers' compensation claims is at risk and costs would increase significantly.
- Recruiting and Staffing Challenges: Workers' compensation is a specialized field, and there are staffing shortages throughout the entire industry. In Northern California, the workers' compensation industry is primarily located in the greater Sacramento area, the East Bay, and San Francisco, which means San José must attract skilled employees who are willing either to relocate or to commute great distances to retain their current housing situation. The Division must compete against both public sector and private sector employers. Private sector TPAs also

offer greater opportunities for promotional advancement due to their size. The City's claims team is relatively small with limited opportunities for promotion.

Based on this analysis, staff believes it may not be realistic to timely recruit and on-board competent additional staff while the State Audit is underway. Staff is recommending that, if the City Council chooses the In-House model, implementation of the model occur after the audit is complete and with a phased approach. The State Audit will only look at the claims being administered by the City team, not the claims being handled by the City's current TPA (TPAs undergo their own State Audits).

It is critical to note that the In-House operation failed the 2016 State Audit in part due to staffing challenges. It is well established that the In-House operation has a history of staffing issues. This is a byproduct of the workers' compensation industry and budgetary issues at the City of San Jose (which impacted all City Departments). With that in mind, there is no guarantee that staffing issues will not occur in the future, subjecting the City to ongoing risks of not being able to comply with State Audit requirements in future years. In contrast, TPAs are not subject to these risks as they can easily increase/replace staff as needed and, in turn, bill clients for the costs.

Staff is also concerned about the City's long-term ability to hire and retain expert workers' compensation staff given the challenges outlined above. Turnover is a significant risk.

- Technology Costs – In 2016, the Council approved upgrading the In-House team's 1990s-era legacy claims management system to the vendor's current Navrisk system, with a goal of quickly achieving productivity improvements through automated workflow, use of sophisticated business rules, and enable better compliance with best practices. Staff has discovered several challenges with this new system that need to be resolved. Bringing the full program In-House likely will require investment in a more robust claims management system. Unlike TPAs, whose sole business is workers' compensation and who have information technology teams dedicated to administering claims management systems, the City's IT department serves a wide variety of City departments and needs, which could delay implementation of system upgrades.

Training, and Continuing Education – Claims Adjusters require monthly training to maintain State certification and to remain current on changes in the law. Developing quality internal training resources requires staff resources and funding. The City's funding for training and education is subject to annual budget appropriation. In difficult budget years, these items frequently are cut from departmental budgets in favor of services to residents. Currently, in-house training is the responsibility of the Division Manager, a model that doesn't allow for the variety or robustness of the educational opportunities that TPAs regularly offer their employees. In contrast, most TPAs have a dedicated unit to design and deliver effective training on a consistent basis, ensuring that employees stay current with State certification and build expertise.

- Responding to Changing Legal and Regulatory Environment – Workers' compensation involves a continually evolving legal and regulatory environment. This requires research to understand changes, designing and implementing new workflows, and training of staff. Moreover, budgetary flexibility can be needed to effectively manage these changes, which could require additional staff or an upgrade to the electronic claims management system.

- Economies of Scale – Due to size, TPAs offer economies of scale. Infrastructure costs can be shared by multiple clients, allowing TPAs to provide advanced levels of service, to include a dedicated training unit, sophisticated paperless claims management system, and a dedicated information technology team.

Timeline to Bring Program In-House

Any effort to bring the program In-House should not begin until after the December 2018 State re-Audit with an estimated timeframe of no earlier than 2019-2020. It may take over a year to fully staff the program. With that in mind, the program should be brought In-House in stages and with regular updates to the PSFSS Committee and Council as staffing and capacity allows, with the TPA contract continuing through the transition period.

2. ADMINISTERING THE PROGRAM THROUGH A TPA

In this model, the entire program is outsourced to a TPA with no In-House claims team. The City would retain a specialized management team consisting of the Division Manager and 2 Analysts to manage the program and address the 2009 City Auditor Findings and reduce costs. It is important to note that the success of a TPA model requires strong management of the contract from the City. This was seen with the City's experience with the first TPA (Athens Administrators). With the current TPA (Intercare), strong management has led to a partnership in which City Departments are reporting positive customer service feedback and new workflows and strategies are being developed to address the 2009 City Auditor recommendations and contain costs.

Advantages for Administering the Program through a TPA

- The State Audit will be cancelled – If the program is outsourced in the early part of calendar year 2018, the State will cancel the re-Audit and the City's ability to self-insure will no longer be in jeopardy from a failure of the re-Audit. This will avoid the significant financial risks outlined above.
- Complex Regulatory Framework – The workers' compensation system involves a complex and continually changing regulatory framework. Successfully managing this framework is burdensome and costly. The In-House claims team has struggled with compliance and failed the 2016 State Audit. With a TPA, the outside vendor would be responsible for all regulatory compliance issues with the City focusing on addressing the 2009 City Auditor recommendations and containing costs.
- Infrastructure and Economies of Scale – TPAs have more resources available to support claims staff and improve outcomes, to include, but not limited to:
 - Specialized oversight of the program.
 - Training Units devoted to keeping claims staff current on the latest developments/best practices in the workers' compensation industry.

- Sophisticated Claims Management systems with advanced business rules and automation to track performance and deliver quality results. Modern claims management systems also include dashboards and advanced data analytics.
- TPAs have IT teams on staff dedicated to assisting with technology issues and developing individualized reports on request.
- Staffing flexibility – TPAs are positioned to hire and retain highly experienced claims staff and can easily add staff as needed to adapt to changes in the program. Moreover, TPAs allow the City to request replacement of any staff that is not performing.

As discussed above, the In-House claims team failed the 2016 State Audit in part due to staffing challenges. These type of staffing challenges would not be an issue for a TPA. Moreover, fluctuations in the City's budget process would not adversely impact staffing at the TPA.

Disadvantages for Administering the Program through a TPA

- Control over the process – Historically, the primary disadvantage of a TPA is less control over the process and results. However, changes in the workers' compensation industry have resulted in advancements in TPA quality. TPAs are common and effective service delivery models throughout California – with 53% of the 20 largest Cities in California utilizing a TPA as the service delivery model for workers' Compensation (not including San Jose). See Attachment B – California Workers' Compensation Service Delivery Models.
- Potentially less control over costs.
- Less face-to-face contact with customers. Under the TPA model, contact with injured workers is done via phone, email, and other remote platforms. The majority of contact with departments is also done via phone and/or email.

Timeline to Administer the Program through a TPA

The current TPA, Intercare, could take over the entire program within 60 days.

Based on the current contract with Intercare, the cost to manage all open claims would be \$3,738,000 for 2017-2018.

Based on market research, Intercare is expensive for the services provided and many industry leaders for TPAs would charge approximately \$3.3 million or less to handle the City's claims, depending on caseload. With that in mind, the City can initially utilize Intercare to manage the entire program and the State will cancel the re-Audit. The City can then initiate the RFP process to evaluate lower cost options for a TPA.

3. CONTINUING A HYBRID MODEL

The Hybrid Model is currently in place as part of the Pilot Program with all non-Police Department claims handled by the TPA and all Police Department claims handled by the In-House team.

Advantages for Continuing with the Hybrid Model

- Flexibility - A Hybrid model potentially provides more flexibility to manage a complex program. For example, it may be effective to have select Departments with unique issues handled In-House with other Departments handled by the TPA, or vice versa.
- Caseload Management – If there is a surge in caseloads, the City can easily transfer those new cases to the TPA. If there are staffing vacancies, the TPA can backfill those vacancies while the City is recruiting and hiring for the positions.

Disadvantages for Continuing with the Hybrid Model

- The Hybrid Model has been challenging – It is difficult to say how much of these challenges are attributable to the uncertain nature of the Hybrid Model being a Pilot Project, which led to staff vacancies and turnover on the In-House team. In addition, the Human Resources Department had management transitions that led to inconsistent management of the TPA contract (which have since been resolved) and the replacement of the first TPA. Furthermore, the Hybrid Model created confusion for employees, departments, and medical providers as there was inconsistent communication and performance between the In-House operation and the TPA. Staff believes that it would be important, if the City Council chooses to continue permanently with a Hybrid Model, to give staff certainty that the model is no longer temporary and provide clarity about how the model will work in the future.
- Burdensome to Manage both an In-House claims team and a TPA – Based on the current open inventory of claims and history of injuries, there does not appear to be a specific need for two separate claims operations. Multiple claim operations has not improve efficiency or improve results. Instead, the In-House team and the TPA experienced different challenges during the Pilot. These challenges were compounded by having multiple management teams and different electronic claims management systems. This was burdensome to manage and prevented focused effort to improve the program.
- Unnecessary Costs and Duplication of Services – A Hybrid Model requires funding an In-House team operation and paying for the services of a TPA. This results in duplication of various services and wasted resources. As discussed above, the Hybrid Model has not improved efficiency, and instead has been burdensome to manage and has created confusion for employees on the In-House team as well as injured workers. Please note that Hybrid Models are not widely utilized by California cities to manage workers' compensation (see Attachment B: California Workers' Compensation Service Delivery Models).

Timeline to Continue with the Hybrid Model

Nothing needs to change as the current Pilot Program is the Hybrid Model. While it is scheduled to end in June 2018, the current contract with Intercare includes options to extend beyond that date. Staff could attempt to renegotiate some of terms and conditions, or issue a new Request for Proposals.

Service Delivery Costs

Over the past year, with new leadership heading the Workers' Compensation, Health, and Safety Division of the Human Resources Department, the City's workers' compensation caseload has dropped from 3,504 open cases in December 2016, to 3,037 open cases in June 2017, and is currently at approximately 2,850 open active cases. As reported to the PSFSS Committee on October 19, 2017, staff has been implementing a more robust prevention and safety program as well as reviewing and closing old claims. Although there are many factors that aid in containing costs in the workers' compensation program, the most important is understanding where the high cost, high volume, and/or high severity claims are, and taking steps to help reduce or prevent them in the future. To that end, the Human Resources Department hired an experienced Senior Safety Analyst and is in the process of conducting a comprehensive safety analysis of 16 departments, to include, but not limited to, root cause analysis of all work injuries for the past three years, site inspections, evaluation of current safety protocols and emergency procedures, and development of effective safety training programs. The new Safety Officer in Human Resources is also collaborating with other safety personnel in key departments to better understand injury drivers, and share knowledge across departments. Over time, staff has a goal of bringing the caseload down significantly. See Attachment D for a list of the City of San Jose City-Wide Safety Team.

Caseload is a critical driver of claims administration and staffing costs. Table 3 provides a summary assessment of the costs for each of the three models at the current caseload level of 2,850, at 2,500 cases, and 2,200 cases. Detailed cost modeling is provided in Attachment C: Cost Models for Service Delivery Options. The modeling assumes an industry standard caseload of 145 claims per claims adjuster and 250 claims for future medical examiners. All of the models for an outsourced TPA program include \$407,000 in City staffing costs to administer the TPA contract and ensure quality, which is an important lesson learned from the Pilot Project. TPA costs are based on the current contract with Intercare, and per market research, Intercare is expensive for services provided and costs could be lower.

It is important to note that the resources dedicated to program administration have increased in recent years and are greater in the models below than those allocated prior to the implementation of the Hybrid Model. For instance, the program had been administered in-house by 17 positions when the Hybrid Model was implemented as part of the 2013-2014 Adopted Budget.

Table 3: Cost Models for Each Service Delivery Option

Caseload	In-House Model	TPA Model	Hybrid Model (Current Pilot Program Model)
2,850 <i>(Current Active Claim Total)</i>	\$3,560,000* 28 staff (\$4,160,000 for the First Year)	\$4,145,000**	\$3,878,000
2,500	\$3,361,000* 26 staff (\$3,931,000 for the First Year)	\$3,611,000**	\$3,611,000
2,200	\$2,928,000* 23 Staff (\$3,453,000 for the First Year)	\$3,344,000**	\$3,228,000
<i>*Costs do not include costs for technology upgrades to the Claims Management System. **Per market research, Intercare is expensive for services provided and costs could be lower.</i>			

Policy Decisions

Following are the key policy decisions that the City Council will need to make regarding the workers' compensation program:

- Determine which model of workers' compensation claims administration—In-House, TPA, or Hybrid—provides the most effective service to the City's injured workers within the limits of the City's budget situation.
- Determine an appropriate timeline for implementation based on the pending 2018 State Audit of the current In-House program.

In addition to the information presented in this report, Council Policy 0-41 (Service Delivery Evaluation) requires a preliminary business case be conducted to evaluate service delivery changes that could result in the addition, deletion, or reclassification of four or more full-time employees.¹ Council approved a Workers' Compensation Service Delivery Evaluation on October 30, 2012 with the outcome being the current Pilot Project using the Hybrid Model. While this report covers many components of a Service Delivery Evaluation, there are a set of questions to be answered and additional work to do if outsourcing the program is being considered. It is possible for staff to bring the full

¹ Council Policy 0-41: <http://www.sanjoseca.gov/DocumentCenter/View/3836>

Service Delivery Evaluation Analysis to Council in early 2018 if there is a desire to avoid the State Audit. However, the timeframe is tight, especially given the deliberation time necessary. That said, staff did not want to preclude any policy alternatives being available to the City Council given the gravity of the potential situation facing the City with respect to the upcoming audit.

Next Steps

As discussed in this report, given the potential serious repercussions of the pending State Audit of the In-House program, staff recommends continuing the Hybrid Model until the State Audit is concluded. This action would minimize the number of cases subject to audit as the In-House program currently handles only workers' compensation claims for the Police Department. All non-Police Department claims have been transferred to the TPA and would not be subject to this audit of the In-House program.

Staff also recommends bringing forward additional analysis of the Pilot and making a recommendation regarding a permanent operational model within the City's 2018-2019 Operating Budget Cycle for implementation in 2019-2020. However, if the City Council would like to make a more immediate permanent service delivery model change, the following would be the next steps for the different models.

For the In-House Model: Staff would bring forward a proposal and timeline through the budget process. Again, staff does not recommend beginning to bring the program In-House until after the December 2018 State Audit due to the increased risks of adding to the City's In-House caseload while the audit is underway. The most prudent course, should the City Council choose this option, would be to bring the program In-House in stages and with regular updates to the PSFSS Committee and the City Council as staffing and capacity allows, with the TPA contract continuing through the transition period.

For the TPA model: A critical decision for the City Council would be how quickly to put in place this option, as transferring current cases to the TPA in early 2018 would result in the cancellation of the State Audit.

For the Hybrid Model: Staff would bring forward a contract extension until the completion of the State Audit. Following the audit, staff would bring forward recommendations regarding continuing with the current TPA or issuing a new bid process.

CONCLUSION

The City is currently in a multi-year Pilot Program to evaluate service delivery models for providing workers' compensation benefits to employees. The Pilot is scheduled to conclude in June 2018 to coincide with the annual budget process. Based on the continuing review of the TPA and In-House team, staff believes there will be sufficient evidence to make a recommendation on the permanent service delivery model within the upcoming 2018-2019 Operating Budget cycle for implementation in 2019-2020. This would enable City Council direction regarding Workers' Compensation Program service delivery that can be implemented in a timeframe that would take into consideration the pending December 2018 State Audit.

December 7, 2017

Subject: Workers' Compensation Program: Evaluation of Service Delivery Options

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Long-term, the Administration recommends moving forward with either the In-House Model or TPA Model. Further consideration of the Hybrid Model as a permanent model is not recommended at this time given the disadvantages discussed above. Between the In-House and TPA Models, the TPA Model assumes much less risk for the City and would be subject to less disruption in the future as a result of staffing and program administration challenges, while the In-House Model would potentially be less costly and provide more opportunities for face-to-face communication with injured employees.

/s/

Julie Edmonds - Mares

Deputy City Manager/Acting Human Resources Director

Attachment A: Timeline of Workers' Compensation Pilot and Past Council Direction

Attachment B: California Workers' Compensation Service Delivery Models

Attachment C: Cost Models for Each Service Delivery Option

Attachment D: City-Wide Safety Team

For questions, please contact Howard Stiskin, Workers' Compensation, Health & Safety Division Manager, at (408) 975-1418.

Timeline of Workers' Compensation Pilot and Council Direction

Workers' Compensation Actions	
Date	Action
April 8, 2009	City Auditor released "Audit of the City of San José's Workers' Compensation Program ² " with seven recommendations for improving the program and containing costs.
March 8, 2011	City Council ³ 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.
June 14, 2011	Council adopted the Mayor's June Budget Message ⁴ , which stated: <i>"Workers' Compensation Reforms: The Cost of the City's Workers' Compensation Program is higher than comparable California cities and counties. There is potentially \$10-12 million in savings related to workers' compensation reform. In addition, the City Council has approved achieving 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."</i> 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.
December 15, 2011	The Public Safety, Finance, and Strategic Support Committee accepted staff's report regarding the Workers' Compensation Reform Plan and recommended the same to the City Council. This Plan included exploring an alternative service delivery model that was different than the City's current in-house administration service delivery model.
March 20, 2012	Staff released a Request for Proposals (RFP) for comprehensive workers' compensation Services including: claims administration; bill review; utilization review; and medical case management.
October 30, 2012	The City Council approved staff's recommendation ⁵ that the City engage in a two-year Pilot Program using a Third-Party Administrator (TPA) to handle a portion of claims administration and to also handle bill review, utilization review and medical case management for all claims.

² Audit Report: <http://www.sanjoseca.gov/DocumentCenter/View/3262>

³ Item 3.3: "Status Report on the Alternative Service Delivery Evaluation for Workers' Compensation Administration and Employee Health Services." http://www3.sanjoseca.gov/clerk/Agenda/20110308/20110308_0303.pdf

⁴ Budget Message: http://www3.sanjoseca.gov/clerk/Agenda/20110614/20110614_0901.pdf

⁵ Item 3.3, "Workers' Compensation – Alternative Service Delivery Evaluation Analysis,"

http://www.sanjoseca.gov/clerk/Agenda/20121030/20121030_0303.pdf

Workers' Compensation Actions	
Date	Action
May 21, 2013	The City Council approved an agreement ⁶ with Athens Insurance Services, Inc. DBA Athens Administrators to handle a portion of claims administration and all City bill review, utilization review, medical case management, and provide an option to use a Medical Provider Network for the period of June 1, 2013-June 30, 2015 for a total amount not to exceed \$4.6 million. During this Pilot, the City was able to implement the Medical Provider Network (MPN). With the help of Athens Administrators, the City was able to secure a partnership with MedEx to provide a streamlined approach to physicians when an employee is injured. The MPN provides a list of qualified doctors who have gone through an extensive application/background review to ensure they are qualified doctors for injured workers.
June 10, 2014	As part of the 2014-2015 Adopted Operating Budget, a dedicated liaison for sworn employees was also added to closely monitor and assist the needs of our public safety officers. This position was filled in the latter part of 2014 and is the sworn officers' one point of contact for workers' compensation/benefits questions and help.
June 23, 2015	The City Council approved a one-year extension of the Athens Administrators' contract through June 30, 2016 to allow additional time to evaluate performance of the Pilot Program. The total amount was not exceed \$6.9 million.
October 1, 2015	The MedEx Medical Provider Network was replaced by the Anthem/Blue Cross Medical Provider Network as Anthem/Blue Cross offered a more comprehensive network of medical facilities. The transition was accomplished to better meet the needs of City of San José employees.
June 21, 2016	The City Council approved a final contract extension with Athens Administrators through December 31, 2016 to provide staff time to further evaluate the program and conduct an RFP for these services. Compensation was increased by \$1.4 million, with an amount not to exceed \$8.3.
July 12, 2016	Staff released a new RFP for Third-Party Administrator services.
November 17, 2016	The PSFSS Committee heard and accepted the "Workers' Compensation Semi-Annual Report."

⁶ Staff report: <http://sanjoseca.gov/DocumentCenter/View/16988>

Workers' Compensation Actions	
Date	Action
November 29, 2016	The City Council voted to extended the Pilot program for an additional 18 months (through June 30, 2018) ⁷ and to replace the Third-Party Administrator (Athens) with Intercare ⁸ . After completion of the pilot, and based on the outcome of the Pilot Program, Council directed staff to return to Council to approve an option to extend the agreement with Intercare if appropriate, rather than allow for the Administration to solely exercise any options related to the agreement. Staff was further directed to return to Council with a standard set of measurement for outcomes on criteria for a cost per closed case and the legal settlement comparisons of the TPA legal process versus the City legal process. Council also approved the purchase of a cloud-based workers' compensation software system (Navrisk Vision) to replace the existing legacy system (Renaissance).
January 1, 2017	New phase of Pilot Program begins with Intercare as Third-Party Administrator.

⁷ Item 3.7, "Approval of the Continuation of a Hybrid Service Delivery Model for Administration of the Workers' Compensation Program." Staff report:

http://sanjose.granicus.com/MetaViewer.php?view_id=&event_id=2660&meta_id=603045

⁸ Item 3.8, "Report on RFP and Actions Related to Workers' Compensation Comprehensive Services." Staff report:

http://sanjose.granicus.com/MetaViewer.php?view_id=&event_id=2660&meta_id=603047. Supplemental memorandum:

http://sanjose.granicus.com/MetaViewer.php?view_id=&event_id=2660&meta_id=603484.

California Workers' Compensation Service Delivery Models

Largest 20 Cities in California (excluding San José)

	City	Model
1	Los Angeles	Hybrid: <ul style="list-style-type: none"> • Civilian In-House • Police TPA (Tristar) • Fire TPA (AIMS)
2	San Diego	In-house
4	San Francisco	Hybrid: <ul style="list-style-type: none"> • 2/3 In-House • 1/3 TPA (Intercare)
5	Fresno	TPA (RISICO)
6	Sacramento	In-House
7	Long Beach	In-House in City Attorney's office
8	Oakland	TPA (JT2 Integrated Resources)
9	Bakersfield	TPA (AIMS)
10	Anaheim	In-House
11	Santa Ana	In-House
12	Riverside	In-House
13	Stockton	TPA (CorVel)
14	Chula Vista	TPA (Intercare)
15	Irvine	TPA (AdminSure)
16	Fremont	TPA
17	San Bernardino	TPA (York Risk Services, AdminSure)
18	Modesto	TPA (York, RFP issued recently)
19	Fontana	Hybrid: <ul style="list-style-type: none"> • 5% In-House (First Aid cases only) • 95% TPA (JT2 Integrated)
20	Oxnard	TPA (RFP issued recently)
	Total	TPA: 10 of 19 (53%) In-House: 6 of 19 (32%) Hybrid: 3 of 19 (16%)

Largest Counties in California

	County	Model
1	Los Angeles County	TPAs (Tristar, Intercare, AIMS)
2	San Diego County	In-House
3	Orange County	TPA
4	Riverside County	In-House
5	San Bernardino County	In-House
6	Santa Clara County	In-House
7	Alameda County	TPA
8	Sacramento County	TPA (AIMS)
9	Contra Costa County	In-House
10	Fresno County	TPA (RISICO)
	Total	TPA: 5 of 10 (50%) In-House: 5 of 10 (50%)

Cost Models for Each Service Delivery Option

2,850 Cases Model (Current Caseload)

Caseload	In-House Model	TPA Model**	Hybrid Model
2,850 – Current Active Claim Total	<p>28 Staff – Total Cost: \$3,560,000 (\$4,160,000 for the First Year)</p> <p><u>Cost Detail</u></p> <p><i>Personal Services</i> \$3,274,000</p> <p><i>Non-Personal/Equipment</i> Rent: \$110,000 Claims Management System: \$146,000* Annual Office Supplies: \$30,000</p> <p><i>First Year Expenses</i> Furniture, Fixtures, Equipment: \$600,000</p> <p><i>*Costs do not include costs for technology upgrades to the Claims Management System.</i></p>	<p>Total Cost: \$4,145,000</p> <p><u>TPA</u> \$3,738,000 (based on FY 17-18 contract with Intercare*)</p> <p><u>Program Management</u> \$407,000 (Cost for City staff to manage the program, including Division Manager, analyst, and sworn staff liaison)</p> <p><i>**Per market research, Intercare is expensive for services provided. Other TPAs likely would charge \$3.3 million or less to handle the City's claims.</i></p>	<p>Current Model – Total Cost (FY 17-18): \$3,878,000</p> <p><u>Active Claims</u> 1,300 In-House 1,550 TPA</p> <p><u>TPA Sub-total</u> \$2,136,000 (based on FY 17-18 contract)</p> <p><u>In-House Sub-total</u> \$1,742,000 (FY 17-18) In-House Breakdown:</p> <p><i>Personal Services</i> \$1,178,000 (staff) \$409,000 (temporary staff)</p> <p><i>Non-Personal/Equipment</i> \$155,000</p>

2,500 Cases Model

Caseload	In-House Model	TPA Model**	Hybrid Model
2,500	<p>26 Staff – Total Cost: \$3,361,000 (\$3,931,000 for the First Year)</p> <p><u>Cost Detail</u> <i>Personal Services</i> \$3,075,000</p> <p><i>Non-Personal/ Equipment</i> Rent: \$110,000 Claims Management System: \$146,000* Annual Office Supplies: \$30,000</p> <p><i>First Year Expenses</i> Furniture, Fixtures, Equipment: \$570,000</p> <p><i>*Costs do not include costs for technology upgrades to the Claims Management System.</i></p>	<p>Total Cost: \$3,611,000</p> <p><u>TPA</u> \$3,204,000 (based on FY 17-18 contract with Intercare*)</p> <p><u>Program Management</u> \$407,000 (Cost for City staff to manage the program, including Division Manager, analyst, and sworn staff liaison)</p> <p><i>**Per market research, Intercare is expensive for services provided and costs could be \$2.9 million or lower.</i></p>	<p>Current Model – Total Cost (FY 17-18): \$3,611,000</p> <p><u>Active Claims</u> 1,150 In-House 1,350 TPA</p> <p><u>TPA Sub-total</u> \$1,869,000 (based on FY 17-18 contract)</p> <p><u>In-House Sub-total</u> \$1,742,000</p> <p><i>Personal Services</i> \$1,178,000 (staff) \$409,000 (temporary staff)</p> <p><i>Non-Personal/ Equipment</i> \$155,000</p>

2,200 Cases Model

Caseload	In-House Model	TPA Model**	Hybrid Model
2,200	<p>23 Staff – Total Cost: \$2,928,000 (\$3,453,000 for the First Year)</p> <p><u>Cost Detail</u> <i>Personal Services</i> \$2,642,000</p> <p><i>Non-Personal/ Equipment</i> Rent: \$110,000 Claims Management System: \$146,000* Annual Office Supplies: \$30,000</p> <p><i>First Year Expenses</i> Furniture, Fixtures, Equipment: \$525,000</p> <p><i>*Costs do not include costs for technology upgrades to the Claims Management System.</i></p>	<p>Total Cost: \$3,344,000</p> <p><u>TPA</u> \$2,937,000 (based on FY 17-18 contract with Intercare*)</p> <p><u>City</u> \$407,000 (Cost for staff to manage the program, including Division Manager, analyst, and sworn staff liaison)</p> <p><i>**Per market research, Intercare is expensive for services provided and costs could be \$2.6 million or lower.</i></p>	<p>Current Model – Total Cost for FY 17-18 - \$3,228,000</p> <p><u>Active Claims</u> 1,012 In-House 1,188 TPA</p> <p><u>TPA Sub-total</u> \$1,602,000 (based on FY 17-18 contract)</p> <p><u>In-House Sub-total</u> \$1,626,000</p> <p><i>Personal Services</i> \$1,178,000 (staff) \$293,000 (temporary staff)</p> <p><i>Non-Personal/ Equipment</i> \$155,000</p>

City of San Jose City-Wide Safety Team

Safety Officer	Departments
Stephanie Lau	Airport
Behilma Magday	Environmental Services
Richard Whaley	Environmental Services (RWF)
Vacant	Fire
KC Moore	Police
Larry Gonzales	Transportation
Joseph Gregory	HR Public Works PRNS PBCE Library IT Housing Finance Convention OED CAO City Council City Manager City Clerk Retirement Independent Police Auditor
HR Safety Analyst – Sharon Zimmerman	City-Wide