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Paying Price: PES Payroll's Stuart Grant.

Workers' Comp At What Cost?

INSURANCE: Arbitration adds millions to 'low-price' policies.

By **HOWARD FINE** Staff Reporter

When workers' compensation premiums were skyrocketing 10 years ago, many companies were tempted by policies that offered much lower rates.

But now, some companies that signed those policies are claiming there was a booby trap inside: arbitration clauses in policy addendums that make it expensive to dispute claims payouts by insurance carriers.

Several companies in Southern California — including two in Los Angeles County — have been embroiled in disputes with their insurance carriers and claims handlers over these arbitration clauses. One company executive said it has millions at stake in the litigation.

"The millions of excess dollars we've had to put out for workers' compensation insurance as a result

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Insurance: Arbitration Costs Blindside Customers

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of these policies has prevented us from growing," said Stuart Grant, chief executive of **PES Payroll**, a Burbank entertainment industry payroll service. PES Payroll is disputing the arbitration policy of **Chartis Inc.**, a unit of New York giant **American Insurance Group**.

An attorney representing Chartis said the arbitration policy was clear and that if PES Payroll and other policyholders don't like it, they are free to get workers' compensation coverage from another carrier.

DMS Facility Services Inc. of Monrovia is also involved in a dispute over an arbitration clause from its former insurance carrier, **Zurich Insurance Co.** of Schaumburg, Ill. And a San Diego plumbing, heating and air-conditioning contractor with considerable work in Los Angeles, **A.O. Reed & Co.**, recently spent three years in a dispute with its insurance carrier, **Travelers Property & Casualty Co.** of Hartford, Conn., over an arbitration clause.

The objection is not so much that the payment of claims can be expensive under such a policy. It's that if the company believes the insurance carrier has agreed to too big a claim too easily, the company's first recourse is to go through an arbitration process that is typically held out of state. That can add hundreds of thousands of dollars in travel expenses and local attorneys, who must be brought up to speed.

The issue has attracted the attention of state lawmakers, who passed a law in September requiring workers' compensation insurance companies to disclose their arbitration policies when premiums are negotiated and not in side agreements. The law will take effect July 1.

State Insurance Commissioner David Jones, who sponsored the legislation, is looking further into the out-of-state arbitration issue; his office said that there's a possibility the department may hold hearings on the subject next year.

Nick Roxborough, an attorney with **Roxborough Pomerance Nye & Adreani LLC** in Woodland Hills, represents all three companies in their arbitration disputes. He said the state should also require arbitration proceedings be held in California and be governed by state law.

"The way it is now, it's so burdensome for employers to recover their money that many just give up, which is exactly what the insurance companies hope will happen," Roxborough said.

High deductibles

At the root of these arbitration disputes are cheaper policies that spread through the industry a decade ago. With many employer workers' comp premiums doubling or tripling between 2000 and 2002, insurance companies and brokers started marketing these policies to large employers, or those with annual premiums above \$500,000.

Most workers' comp policies don't have deductibles. But the policies in dispute carry high deductibles. However, they enable employers to slash their annual premiums by as much as 50 percent. The catch: When claims from injured workers come in, the high deductible makes the employer responsible for a huge chunk of the costs, generally the first \$250,000, but sometimes as much as \$400,000. And that's for each claim.

On the one hand, these low-premium, high-deductible policies have proved extremely favorable for companies with few or no claims from injured workers.

"If you could get your claims costs down well below your historical average, you could save tons of money with these high-deductible policies," said Jim Scanlon, chief executive of **SGB-NIA**, an insurance brokerage in Wood-

land Hills.

But on the other hand, companies that could not keep a lid on injury claims found themselves hit hard.

"If you did worse than your historical average on claims, you got killed with these policies," Scanlon said. "This was made all the worse because many of the folks peddling these policies did a poor job explaining the risks. So often the additional expenses came as a shock."

At first glance, PES seemed an ideal fit for one of these policies. While it has only 47 in-house employees, it provides payroll services and workers' compensation coverage for an estimated 60,000 to 70,000 workers in the entertainment industry. Its annual workers' compensation premium is in the seven figures.

But Grant at PES said his company has been hit with what he views as excessive claims charges of several million dollars over a six-year period. He alleges many of the charges from treating physicians were inflated and that insurance carrier Chartis and its third-party claims administrator failed to challenge these excessive bills.

"When these claims were being mishandled, our insurance carrier refused to look into it," he said. "They just passed along the bills to us. And when we protested further, they sent the case to arbitration."

Arbitration woes

The arbitration agreements in high-deductible policies usually call for a three-judge panel, with one judge picked by the insurer, one by the employer and one jointly agreed to. The panel then sets the location for the arbitration proceedings and determines which state's laws will apply.

The arbitration proceedings for PES and the other two companies mentioned above were set to be held in the headquarters city of the respective insurance company.

Grant said having the arbitration proceedings on Chartis' home turf in New York would cost his company hundreds of thousands of dollars more, forcing him to hire New York attorneys and shuttle everyone involved between New York and Burbank.

"The overarching issue is federal law that (says) arbitration agreements that have been signed should be enforced," said Andrew Stern, one of the outside attorneys with **Sidley & Austin LLP** handling the case for Chartis. "Any (other) defenses that PES has should be presented to the arbitration panel."

DMS Facility Services, the Monrovia janitorial and building services company with about 2,000 employees, signed up for a high-deductible, low-premium policy with Zurich Insurance for five years during the last decade. The claims deductible was \$350,000.

"For the first few years, it worked really well," said Carole Thorsell, an executive vice president and one of DMS' four partners.

But eventually, a dispute arose over how Zurich was handling claims and Zurich referred the case to arbitration, which was to be held near its Chicago-area headquarters.

Thorsell said that the arbitration provisions in her company's agreement with Zurich caught her by surprise.

Roxborough estimated that the additional litigation expenses would cost DMS hundreds of thousands of dollars, on top of what he characterized as claims overpayments made by Zurich and charged to DMS.

"If we have to proceed with the arbitration in Chicago, it will be a real burden to us," Thorsell said.

Thorsell said she is pleased the state legislation passed, even though it came too late to help her company.

"It means other employers won't be blindsided by this arbitration issue like we were," she said.