

By Kevin M. Bingham

The Million-Dollar Challenge

Measuring the Impact of Medical Liability Tort Reform

YOU'VE BEEN HEALTHY FOR SO LONG YOU'VE ALMOST FORGOTTEN what your family physician looks like. So when you finally try to make that emergency appointment, it comes as something of a shock to learn your doctor has left the state. Why? Could it have been something you said?

Not even close. Believe it or not, your doctor could no longer afford the ever-increasing cost of medical malpractice insurance.

Understanding the impact of proposed medical liability tort reform is a daunting challenge, particularly considering the many varied legislative, health care provider, insurance company, and patient perspectives.

Legislators need to understand how their proposed reforms may impact the ultimate cost of accessing and delivering affordable health care. In many states, this process requires an in-depth understanding of the key issues facing all sides of the health care equation: Proposed bills often go through numerous iterations based on testimony from medical associations, insurance companies, lawyers, actuaries, and patients.

Health care providers, suffering from an insurance affordability crisis, need reforms that will stabilize and ultimately lower their cost of doing business. Even more important, the relief needs to be immediate, not phased in over many years. Reports of hospitals and practices closing, reducing or eliminating services (e.g., OB/GYN, ER), and physicians relocating or retiring from practice help to illustrate the urgency of the current medical liability crisis.

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Medical liability insurers are having difficulty quantifying a reasonable premium that's fair to health care providers and reasonable enough to ensure their ongoing financial viability and solvency.

Insurance companies, responsible for setting the premiums doctors and hospitals pay, are suffering from increasing loss cost trends, lower investment returns, higher reinsurance costs, and volatile jury awards. When those costs are extremely unpredictable, ratemaking is made more difficult, since rates are determined by using historical loss and exposure information to project future costs.

Non-economic awards are highly subjective, and vary by jury and jurisdiction. As a consequence, medical liability insurers are having difficulty quantifying a reasonable premium that's fair to health care providers and reasonable enough to ensure their ongoing financial viability and solvency.

Patients, the true customers, need to know that health care will be affordable, accessible, and safe. In those situations where something goes wrong, patients also need to be assured that they'll be fairly compensated for their loss.

With these diverse perspectives in mind, it's easy to see why the passage of tort reform across the United States has been so challenging. Current laws (e.g., MICRA) and recently proposed tort reforms vary significantly from state to state. Laws and proposed bills often address areas such as:

- Cap on non-economic damages (e.g., pain and suffering, loss of consortium, loss of companionship, disfigurement, mental anguish)
- Statute of limitations
- Collateral source rule
- Limitations on attorney fees
- Periodic payment rules
- Certification requirements
- Arbitration process
- Definition of expert witness testimony
- Specialized medical malpractice judges

Tort reform proposals are often more than 50 pages or 30,000 words in length; yet a *single word change* can significantly affect a proposed bill's impact. We can illustrate this using the following example, involving a \$250,000 cap on non-economic damages.

The Bedpan Case

Medisure Insurance Co. has provided claims-made coverage to Bedpan Hospital since 1/1/2001. Medisure's claims-made policy provides Bedpan coverage for medical liability claims reported during the policy year, whether the claims happened during the current policy year or in prior Medisure policy years.

Bedpan has three claims a year (see above).

Each claim is settled for a total of \$2 million in damages, 50 percent economic (e.g., lost wages, medical expenses, funeral

Bedpan Has Three Claims a Year

CLAIM	ACCIDENT DATE	REPORT DATE	ECONOMIC	NON ECONOMIC
1	1/1/2001	1/1/2001	1,000,000	1,000,000
2	1/1/2001	1/1/2002	1,000,000	1,000,000
3	1/1/2001	1/1/2003	1,000,000	1,000,000

expenses) and 50 percent non-economic. The first claim is reported immediately, the second claim takes a year to report, and the third claim takes two years to report. Therefore, the first claim is covered under the 2001 claims-made policy (i.e., report year = policy year). The second claim is covered under the next year's claims-made policy (2002). The third claim is covered under the policy provided in 2003. For simplicity, these three claims and the above reporting pattern are repeated in each of the future years.

For providing Bedpan with claims-made coverage, Medisure charges Bedpan for the cost of claims plus a 33.3 percent loading to allow for claim handling costs, staffing expense, and a profit margin.

Bedpan's annual insurance premiums are shown below for three scenarios:

- Table 1— No tort reform enacted (i.e., status quo)
- Table 2— Tort reform passed with a \$250,000 cap on non-economic damages, effective 1/1/2004 for claims with *accident* dates 1/1/2004 and subsequent
- Table 3— Tort reform passed with a \$250,000 cap on non-economic damages, effective 1/1/2004 for claims with *report* dates 1/1/2004 and subsequent

As shown in Table 1, Bedpan's first-year claims-made premium is \$2 million \times 1.333. Bedpan's second-year premium is \$4 million \times 1.333. Finally, when Bedpan's claims-made policy matures (i.e., stable reporting of three claims each year), Bedpan's third and subsequent year premium equals \$6 million \times 1.333 or \$8 million.

As shown in Table 2, the impact of the \$250,000 cap on non-economic damages reduces claims with accident dates 1/1/2004 and subsequent from \$2 million to \$1,250,000 (i.e., \$1 million economic plus \$250,000 capped non-economic damages).

Since the bill affects only claims with accident dates 1/1/2004 and subsequent, three claims that are in the pipeline are unaffected by the proposed tort reform. This results in a phased-in benefit from the passage of the tort reform bill.

Although the ultimate cost savings passed on to health care

providers may be 37.5 percent, it takes three years for the savings to be fully reflected in premiums charged by Medisure.

This phase-in period is often miscommunicated and misunderstood during the tort reform debate process. Frequently, the cost savings communicated to health care providers during the tort reform debate reflect the ultimate cost savings, resulting in unrealistically optimistic expectations of the benefits of insurance premium relief.

As shown in Table 3, the impact of the \$250,000 cap on non-economic damages reduces claims with report dates of 1/1/2004 and subsequent from \$2 million to \$1,250,000. Unlike Table 2, the 37.5 percent premium savings is immediate, not phased in over three years. Tort reform proposals structured in this manner offer health care providers the fastest relief.

Although the above examples illustrate the impact of a simple wording change from "accident" to "report," the true quantification of a tort reform's impact is much more difficult.

Continuing with the above example, one must ask the following questions about the cap on non-economic damages to determine if the ultimate savings calculated above are reasonable:

■ *Does the cap apply per defendant or per claimant (i.e., hard cap)?* In recent Texas tort reform activity, it was determined that the \$250,000 cap on non-economic damages for physicians would apply per defendant, up to an aggregate per claimant amount of

\$750,000 (i.e., claimant can recover from multiple defendants).

Therefore, the savings illustrated above would be reduced for two items: first, the probability that additional defendants would be named in the suit; second, the additional legal costs necessary to defend parties with no real liability (e.g., the plaintiff's attorney might name the nurse who brought the plaintiff ice chips as a defendant).

■ *Does the cap vary depending on the classification of the defendant?* For example, are health care institutions (e.g., hospitals, nursing homes, hospice) exposed to higher caps than health care professionals? In these circumstances, it's likely that health care institutions would be named in order to tap the higher cap whether they were at fault or not.

In addition, health care institutions facing higher caps may find it in their best interest to force claims down to the health care professionals with the lower caps. This cost shifting increases litigation expense and may create stress on the critical relationships institutions have developed with their physicians.

■ *Does the tort reform allow "cap busters"?* Cap busters include removing caps under certain situations (e.g., severe disfigurement or physical impairment) or waiving the cap on non-economic damages if the jury verdict for non-economic damages is unanimous.

For example, if there's a chance the cap will be waived on a

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TABLE 1. No Cap on Non-Economic Damages

	2001	2002	2003	2004	2005	2006	2007
	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
	0	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
	0	0	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
TOTAL	2,000,000	4,000,000	6,000,000	6,000,000	6,000,000	6,000,000	6,000,000
PREMIUM	2,666,667	5,333,333	8,000,000	8,000,000	8,000,000	8,000,000	8,000,000

TABLE 2. \$250,000 Cap on Non-Economic Damages

Tort reform applies to claims with accident dates 1/1/2004 and subsequent

	2001	2002	2003	2004	2005	2006	2007
	2,000,000	2,000,000	2,000,000	1,250,000	1,250,000	1,250,000	1,250,000
	0	2,000,000	2,000,000	2,000,000	1,250,000	1,250,000	1,250,000
	0	0	2,000,000	2,000,000	2,000,000	1,250,000	1,250,000
TOTAL	2,000,000	4,000,000	6,000,000	5,250,000	4,500,000	3,750,000	3,750,000
PREMIUM	2,666,667	5,333,333	8,000,000	7,000,000	6,000,000	5,000,000	5,000,000
INCREMENTAL SAVINGS				-12.5%	-12.5%	-12.5%	0.0%
CUMULATIVE SAVINGS				-12.5%	-25.0%	-37.5%	-37.5%

THREE-YEAR PHASE-IN

TABLE 3. \$250,000 Cap on Non-Economic Damages

Tort reform applies to claims with accident dates 1/1/2004 and subsequent

	2001	2002	2003	2004	2005	2006	2007
	2,000,000	2,000,000	2,000,000	1,250,000	1,250,000	1,250,000	1,250,000
	0	2,000,000	2,000,000	1,250,000	1,250,000	1,250,000	1,250,000
	0	0	2,000,000	1,250,000	1,250,000	1,250,000	1,250,000
TOTAL	2,000,000	4,000,000	6,000,000	3,750,000	3,750,000	3,750,000	3,750,000
PREMIUM	2,666,667	5,333,333	8,000,000	5,000,000	5,000,000	5,000,000	5,000,000
INCREMENTAL SAVINGS				-37.5%	0.0%	0.0%	0.0%
CUMULATIVE SAVINGS				-37.5%	-37.5%	-37.5%	-37.5%

IMMEDIATE

unanimous verdict, it becomes much more difficult to determine the cost saving of the cap illustrated above. One not only has to analyze historical jury verdicts for the probability of returning a unanimous decision (assuming the data is credible or available), but one must also attempt to estimate the likelihood that jurors may be more likely to render a unanimous verdict if they realize the plaintiff's non-economic damages will be

capped without it.

■ *Does the tort reform require a constitutional amendment?*

If a constitutional amendment is required, there's a possibility that tort reforms could be overturned by the courts in subsequent years, leaving insurers on the hook for higher losses with rates that reflect anticipated future savings.

For example, Ohio reforms enacted in 1975 were challenged

**Without a constitutional amendment in certain states
and a coordinated package of tort reforms,
the true benefit of any tort reform package may take years to determine.**

in the courts in 1982 and eventually overturned in 1985. Ohio insurance company rates became inadequate the moment the reforms were overturned because the premium collected for their current and most recent policies still reflected the full impact of the tort reform. Alabama, Illinois, New Hampshire, Oregon, and Washington have also passed caps that were eventually held to be unconstitutional.

In addition to these states, a number of state constitutions prohibit the enactment of any law that would limit any damages a plaintiff would recover for personal injury or death.

■ *How long does it take for medical malpractice claims to be reported?*

Depending on the types of claims an organization faces, roughly 60 percent to 80 percent of the claims occurring in a policy period will be reported in a subsequent policy period. For some claims, where the patient doesn't realize he or she has been injured, the lag in reporting an accident can span longer than five years. Therefore, the phase-in period described under scenario two would likely take significantly longer than three years.

■ *Will the claim filings of claims speed up in anticipation of the new law?*

Under scenarios two and three, the actual savings might be overstated, assuming plaintiff attorneys decide to speed up claim reporting in order to beat the impact of the proposed tort reform effective date of 1/1/2004.

■ *What is the insurance company's current medical liability position from a profit/loss perspective?*

If an insurance company's indicated premium rate change is +40.0 percent, and the estimated premium savings from tort reform 37.5 percent, insurance consumers in the above example would NOT see a 37.5 percent premium savings but a net premium increase of 2.5 percent (e.g., 40.0 percent - 37.5 percent). This fact is often misunderstood and lost in the communication of tort reform's final impact.

Quantifying the savings from any proposed tort reform bill is a tricky process; one must be very careful to fully understand every word and sentence in the proposed legislation. As illustrated above, a change in one word from "accident" to "report" resulted in a three-year versus one-year phase-in period. If we were to expand our analysis to include other reforms—such as limits on attorneys' fees, statute of limitations, collateral source rule, etc.—one can only imagine the vast number of permutations that might result. Even more daunting is the determination of whether court challenges will result in all or part of the tort reform being overturned.

In the end, the true premium savings for health care providers and health care institutions won't be known until the courts, insurance companies, and lawyers have had time to analyze the impact and develop effective strategies to minimize (or maxi-

mize) every aspect of the legislation. As mentioned above, Ohio's cap on non-economic damages was overturned 10 years after the law was passed. Without a constitutional amendment in certain states and a coordinated package of tort reforms, the true benefit of any tort reform package may take years to determine.

Regardless of these challenges, early and frequent involvement in the tort reform process is the best strategy for influencing future cost savings. Those who have mastered key tort reform issues and prepared effective strategies to support their arguments have the best chance of shaping the outcome of the tort reform debate.

In the meantime, if you live in one of the 18 medical liability crisis states, make sure you have a map and a full tank of gas, just in case you have to visit one of the few remaining OB/GYNs in the state. ●

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