

EARLY OFFERS

An Approach to Medical Malpractice Reform

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IN PERSONAL INJURY CASES, the current system of tort liability has long been unworkable, especially because the insured event is extremely complex. Under the current system, a plaintiff must prove two difficult elements: the defendant's fault and the economic value of noneconomic damages, mostly pain and suffering. The system is fraught with uncertainties, which cause excessive costs and delay for both sides. In the end, we don't have a sensible insurance system that results in prompt payment to needy victims. Rather, we have a system that results in prolonged, expensive fights over whether claimants are deserving.

As a cure for this sad tale, we focus on a proposed statute that gives a defendant an incentive to make an "early offer," defined as a sum large enough to compensate injured victims for their net economic losses, including attorneys' fees. If such an early offer is tendered, the injured victim in a negligence action will normally forfeit the opportunity of winning full common-law damages for both economic and noneconomic damages at trial.

Under this system, a defendant has the option—not the obligation—to offer the claimant, within 180 days after a claim is filed, periodic payment of the claimant's net economic losses as they accrue. Economic losses under an early-offers statute must cover medical expenses, including rehabilitation, plus lost wages, to the extent that all such costs are not already covered by insurance or other collateral sources, plus attorney's fees. A defendant can't make a low-ball offer and still earn the advantage of avoiding a full-scale tort claim.

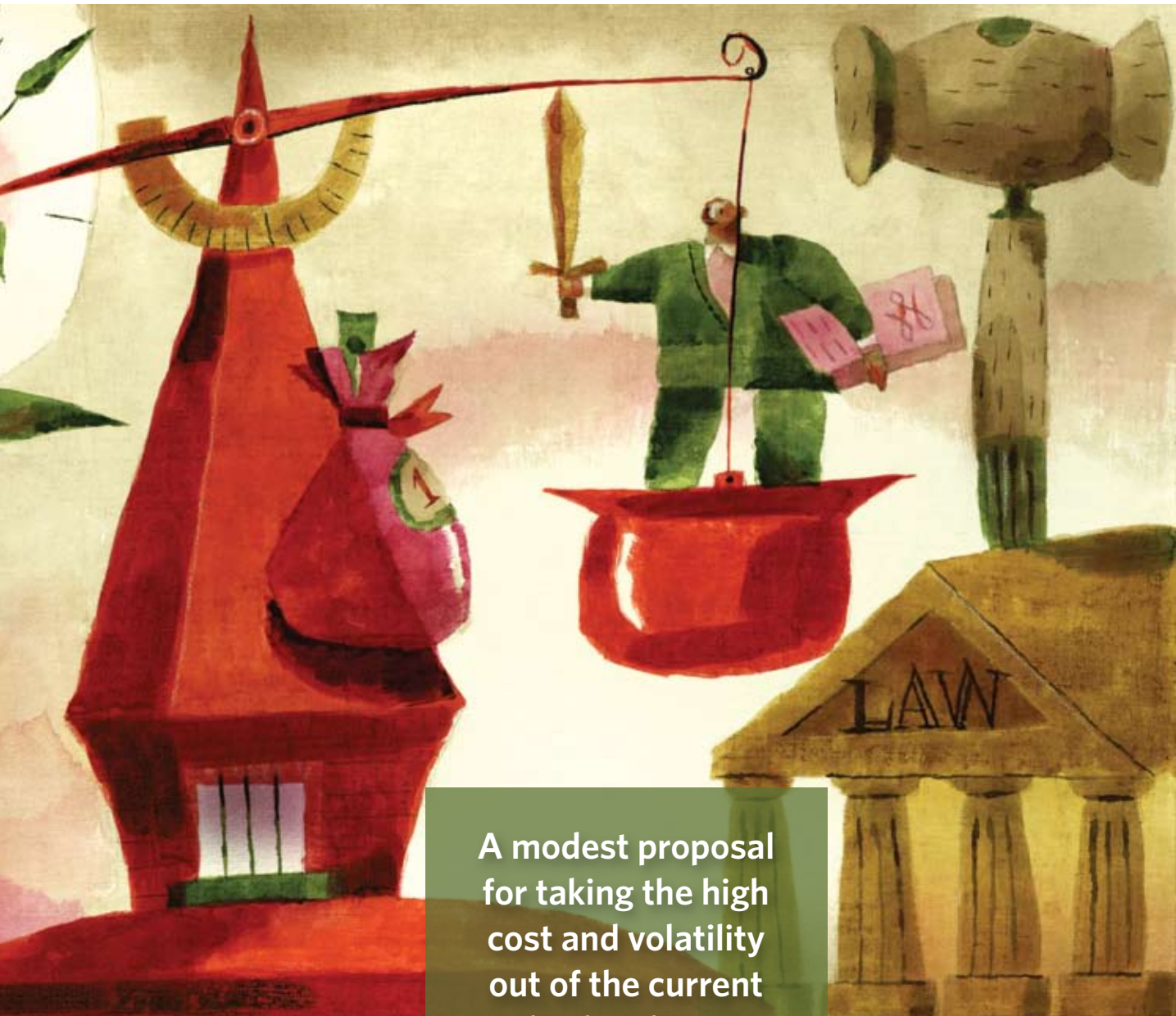
If the defendant decides not to make an early offer, the injured

victim can proceed with a normal tort claim for both economic and noneconomic damages. Alternatively, if the claimant declines the early offer in favor of litigation, (1) the standard of misconduct is raised, allowing payment only where "wanton misconduct" is proven; and (2) the standard of proof is also raised, requiring proof of such misconduct beyond a reasonable doubt.

Because determining both liability and noneconomic damages under present tort law is costly and uncertain, it's likely that defendants in medical malpractice cases will promptly make early offers in many claims, even when liability is unclear. William Ginsburg, a leading malpractice defense lawyer, has predicted that if an early-offers statute were in effect, he would advise making the defined early offer in 200 of the 250 cases that his large interstate offices were then litigating.

The opposing fear that this early-offers scheme would lead to even higher costs is avoided because no defendants need make an offer if they wouldn't have done so without this statute. Defendants





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**A modest proposal
for taking the high
cost and volatility
out of the current
medical malpractice
system and replacing
it with swift and
simple justice.**

will make an offer only when it makes economic sense for them to do so.

Nor would this statute disadvantage victims as a class. True, injury victims would lose their recourse to full-blown tort litigation—with all its uncertainty, delays, and transaction-costs—but in exchange they're guaranteed prompt payment of their actual economic losses, plus attorney's fees.

Because the existence of pain and suffering is indeterminate and highly volatile, under an early-offers system the fear of an award of pain and suffering damages can serve (1) to deter medical service providers from indulging in anything close to what a jury might view as serious misconduct and (2) as an incentive to make early offers of economic losses, which provide prompt compensation to victims for many more (admittedly not all) of the inevitable injuries that accompany the delivery of modern medical services.

Because personal injury claims alone among all other damage claims routinely entail damages for both economic and noneconomic losses, defendants are uniquely positioned not only to make, but also to enforce, socially attractive settlements under the early-offers system.

In non-personal injury claims, in which only economic damages are at stake, no such equitable means are available to sanction a claimant who refuses to accept an offer of only a portion of the total damages claimed.

No Fault MedMal

It's not feasible to provide a full-scale, no-fault solution for medical services because it's so difficult to define the "no-fault insured event" for injuries that arise from medical treatment. Under no-fault auto insurance, an accident victim is compensated for an injury arising

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out of the ownership, maintenance, or use of a motor vehicle. Under workers' compensation laws, an industrial accident victim is compensated for an injury arising out of, and in the course of, employment.

It's not feasible, however, to force all health care providers to pay patients for any and all injuries arising in the course of medical treatment. After all, it's often impossible to determine whether a patient's injuries were caused by the treatment rendered or were just a normal extension of the patient's condition. A health care provider certainly couldn't be expected to pay every patient whose condition worsens after treatment.

Because such a comprehensive no-fault solution is unworkable, and therefore unavailable, for medical accidental injuries, the proposed early offers system is the most—and perhaps the only—workable, economical, equitable, and simplifying solution.

The most common tort reform proposals—including damage caps, changes in the collateral source rule, and regulation of claimants' attorney contingent fees—lack an early-offers law's ability to structure and encourage early and adequate pretrial settlement. As Patricia Danzon notes in the *Handbook of Health Economics*, “most actual tort reform proposals aim primarily to reduce measurable claim costs and liability insurance premiums or budgetary costs to health care providers. This budget focus is likely to result, at best, in simply shifting costs from medical providers to patients and taxpayers.”

Another advantage to an early-offers law is that the burden of other tort reform reductions falls more on the worst injured or most legitimate tort victims (whom these reforms presumably don't intend to harm) than on claimants' lawyers' fees and less-than-valid claims (which these reforms do clearly intend to affect). An early-offers law is superior to these other proposals because it avoids unintentionally disadvantaging the most needy, and, arguably, legitimate claimants.

Reducing Waste and Differences

Early-offers statutes will reduce litigation-induced waste by causing more cases to be resolved much earlier in the litigation process. Under an early-offers law, every dispute begins in the current system. If the defendant insurance company makes an early offer and the claimant rejects the offer, the standard of liability in the claimant's upcoming tort action changes from negligence to, in effect, criminal misconduct (termed “quasi-criminal”), and the burden of proof heightens from “more likely than not” to “beyond a reasonable doubt.”

Assuming the claimant wasn't injured by quasi-criminal misconduct, after an early offer is rejected, the claimant's probability of winning a full-scale tort suit diminishes drastically. The example below creates a hypothetical early offer scenario that quantifies this point and illustrates the types of trade-offs expect-

ed by early offers where there is an impasse between claimants and defendants.

For both the early offer and post-early-offer scenarios, our model adjusts future jury awards to their “net expected present value.” Net expected present value bundles together four adjustments of nominal future jury awards. These four adjustments account for (1) probability in outcome; (2) timing of outcome, and specifically a positive rate of time preference by individual actors; (3) the claimant's lawyer's contingent

fee; and (4) other litigation-induced costs.

Any future nominal jury award must first be adjusted twice for probability: once for the probability that the jury will find the defendant liable, and again for the probability of various damage awards. We conflate these two adjustments into one weighted average probability of a damage verdict. Combining probability with the three other adjustments results in a dollar amount for the value claimants should attach to their claims.

If the claimants attach similar values to their claims, settlement before trial will likely occur. However, information asymmetries are common in the physician-patient relationship, increasing the likelihood that the claimants will perceive differently the probabilities of liability and damages, making settlements less likely. A system of early offers can dramatically reduce the differences between claimants' values, and increase the likelihood of a settlement.

EXAMPLE 1. Claimant P files a claim against Defendant D. If the claim isn't settled, a suit is expected to be filed within a few months and continue for the typical time from injury to payment, about three years. P estimates the probability that D will be found liable at 85.0 percent.

But D is much more optimistic about its chances. D's estimate of this probability is one-half of P's estimate, or initially 42.5 percent. D also estimates the damages likely to be awarded in case of liability as being significantly lower than P does—specifically estimating damages at 80 percent of P's estimate. P and D both adjust their respective expected payoff/payout estimates for the cost of hiring lawyers and adjust for time spent using the same inflation-adjusted annual discount rate at 2 percent.

P's minimum acceptance or reservation price of about \$400,000 is higher than D's maximum paying (or reservation) price of about \$280,000. The parties fail to bargain out a settlement because their respective prices are out of range of each other.

Assume an early offers statute is in effect. Within the statute's prescribed period, D makes an early offer to pay P's uncompensated economic loss as it accrues. The present value of this offer is estimated at about \$175,000 while D's last offer in tort is about \$280,000.

After D makes the early offer of about \$175,000 (plus 10 percent

A risky dollar is worth much less than a dollar without risk, especially for the seriously injured.

for the claimant's lawyer), the early offer reduces P's estimate of the probability of liability from 85 percent to 2 percent. This is a result of the post-early-offer heightened standard of both misconduct and proof. The probability in this example is now only about 2 percent because it's difficult to prove gross negligence beyond a reasonable doubt. Consequently, the net expected present value of the judgment after an early offer is probably less than the cost of litigating; the post-offer tort claim has a *negative* value of around \$20,000.

In light of the amounts in the parties' minds without an early offer regime, one might ask what P is getting that makes the trade-off of a likely lesser amount from an early offer advantageous. P gains a prompt net payment of a sum certain covering essential medical and wage losses of \$173,400, as opposed to three years of delay from a tort action, with non-trivial risk of getting nothing at all, plus a projected wide variance of damages awards if and when any are awarded.

A risky dollar is worth much less than a dollar without risk, especially for the seriously injured. As emphasized above, the claimant has received an early-offer binding guarantee of about \$175,000 for uncompensated losses as they accrue. The claimant will actually receive more or less depending on the claimant's actual accrual of net economic loss. But the variance of the acceptance of early offers curve is determined by the claimant's medical progress, not by uncertainty surrounding potential jury deliberations.

The defendant assumes the risk associated with the claimant's medical fortunes. In return for bearing little or no risk in litigation—a highly valuable benefit to suffering and injured tort victims—a claimant in the example gives up the amount already covered by insurance, as well as the possibility of pain and suffering or punitive damages.

Most important, the risk-shifting mechanism of early offers shrinks the effects of litigation-induced costs that cause so many of the tort system's ills. Because rational claimants won't go to trial after an early offer, when the probability of prevailing is so low and when a socially adequate and binding offer is open, many more cases will be settled quickly, with substantial savings for both claimants and defendants.

Early offers leave relatively few realistic bargaining issues and thus reduce the likelihood of litigation. Moreover, since early offers will encourage disputes to be resolved quickly, before trials can begin, parties avoid incurring a large portion of the usual litigation-induced costs:

➤ **Trial expenses in addition to lawyers' fees.** There is much less need, for example, to hire expert witnesses, generate reams of documents for discovery, or perform extensive jury research and mock trials if the claim has been settled within the first 180 days.

➤ **Lost beneficial reliance.** Since claimants and defendants will

quickly resolve cases except for the few involving quasi-criminal conduct, they can better predict their liabilities and assets, plan for the future based on those predictions, and enjoy the benefits of certain reliance on those plans.

➤ **Opportunity cost of trial.** When an early offer has been made, claimants and defendants need not allocate time and resources to protracted trials and pretrial negotiations. Their most valuable opportunities in lieu of trying a case are free for the taking. A claimant may use the time that would have been spent on a trial much more advantageously, for example, with family or working. For an

insurance company or other defendant that need not litigate, resources that would have been needlessly spent on litigation will be freed for much better alternative uses.

➤ **Peace of mind.** Perhaps the greatest benefit to claimants and many defendants from an early offer is the peace of mind that comes from no longer having to face the emotional ordeal of a trial. At an earlier point, if an early offer is tendered, claimants may rest assured that much of their risk has been assumed by the defendant. Defendant insureds may also rest at ease that they won't be dragged through ugly, prolonged litigation or otherwise publicly stigmatized.

Just as important, with an early offer already on the table, provisions under the early offers statute provide defendants with an incentive to apologize and make information available to claimants and others without fear of additional tort exposure. Greater information about the causes of an injury and hearing some defendants apologize can not only increase the parties' peace of mind but can make for more frequent and prompt communication between health care providers, leading to more effective safety programs.

Finally, it should be noted that an early offer will likely be made whenever its value is less than the defendant's forecast of its liability in tort (based on the amount the defendant sets aside as a reserve to pay the claim).

The early-offers plan has many of the same positive effects as damage caps, restrictions on contingent fees, and limits on collateral source recovery, but with this crucial difference: defendants must pay for the advantage of such reforms through prompt compensation for claimants' essential losses. Early offers furnishes one of those exceedingly rare opportunities to improve an unfortunate situation—in this case medical malpractice litigation—with no increase (and possibly a decrease) in dollar costs. ●

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