

Undoing Tort Reform?



A public question for California voters could have widespread negative implications for MPL writers.

by Susan J. Forray and Stephen J. Koca

An initiative on the ballot in California this November could have wide-reaching implications for medical professional liability.

The measure has various implications for physicians, but most relevant for medical professional liability insurers is a provision that would more than quadruple California's landmark cap on noneconomic damages, enacted nearly 40 years ago.

Some 840,000 signatures—an amount that far exceeds the state's requirement of 504,000—were collected in support of the initiative, putting the initiative on the November ballot and thus turning the question of caps over to California voters.

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An enactment of the proposal would raise the cap on any outstanding claim, regardless of when it was originally filed, effective Jan. 1, 2015. This would have an immediate financial impact not only on insurers with MPL exposure in California, but also the multitude of self-insured health care entities, since the potential increased cap would apply to any matter not yet resolved via a final settlement as of the new year.

The California legislature enacted MICRA—the Medical Injury Compensation Reform Act—in 1976, at a time when physicians were increasingly retiring or leaving the state, citing sharp increases in MPL premiums and, in some cases, difficulty finding liability coverage at all. MICRA was designed to control these costs and encourage the availability of coverage, most prominently with a cap on noneconomic damages of \$250,000. MICRA does not cap economic damages such as lost wages and medical costs.

For 10 years after the law was enacted, its opponents spearheaded a series of attacks on its constitutionality, which culminated in a 1985 decision by the California

Key Points

► **The Past:** In 1976 California enacted gold-standard reform legislation to cap medical liability awards.

► **The Present:** This November, voters there will have the chance to significantly increase the reform law caps with a ballot initiative.

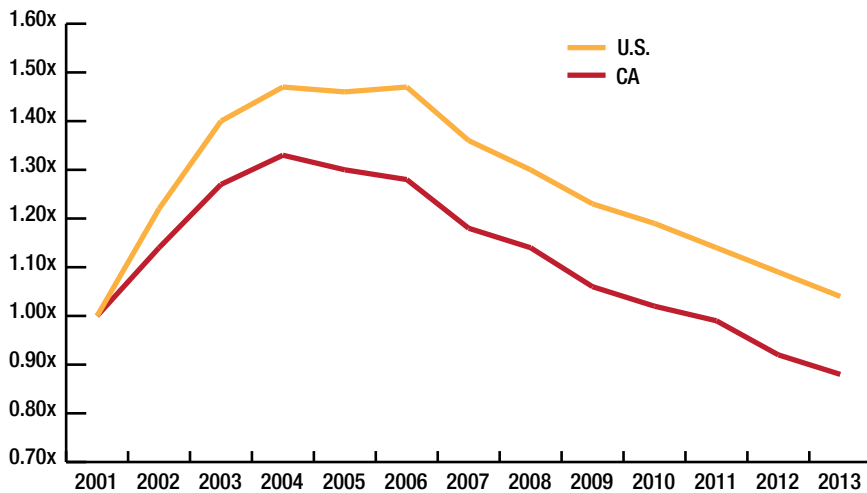
► **The Future:** Insurers are bracing for a spike in MPL claims in California, and other states with reform laws could be targeted next.

Supreme Court that found the \$250,000 cap “is rationally related to the objective of reducing the costs of malpractice defendants and their insurers.” Even with the state Supreme Court decision, the attacks on MICRA's noneconomic damages cap have never abated and have led to the issue now being presented to the voters of California this November.

Since the California Supreme Court ruling in 1985, premiums in California have increased at rates noticeably below the national average. In the first half of the past decade, premiums nationwide rose almost 50% per physician, while

Direct Written Premium per Physician, CA vs. US

Indexed to 2001



Sources: BESTLINK State/Line (P/C Lines)- P/C, US; CA and U.S. DWP for 2003 and subsequent from A.M. Best, 2001 and 2002 estimated by Milliman. Number of physicians from American Medical Association (AMA) Physician Characteristics (multiple editions). 2012 and 2013 AMA Physicians estimated by Milliman.

premiums in California rose less than 35%. For this reason, as well as its long-standing tenure, MICRA has been held by insurance professionals as perhaps the gold standard in tort reform.

This view is now in question with the proposed initiative on the ballot. As written, the initiative would “adjust the \$250,000 cap on compensation for pain, suffering, physical impairment, disfigurement, decline of quality of life and death in medical negligence lawsuits set by the Legislature in 1975 to account for inflation and to provide annual adjustments in the future in order to boost health care accountability, act as a deterrent, and ensure that patients, their families and others who are injured by negligent doctors are entitled to be made whole for their loss.”

This change would raise the non-economic damages cap to approximately \$1.1 million effective Jan. 1, 2015.

The Financial Effect

The increase in the cap on non-economic damages most assuredly will increase the amounts paid to settle or otherwise resolve medi-

cal liability claims. It’s also likely to increase the number of filed claims as the incentive increases for plaintiff attorneys to accept a given case. Experience in other states where caps on damages have either been implemented or overturned suggests that the effect on the number of filed claims can have as great a financial impact as the increase in indemnity payments on these

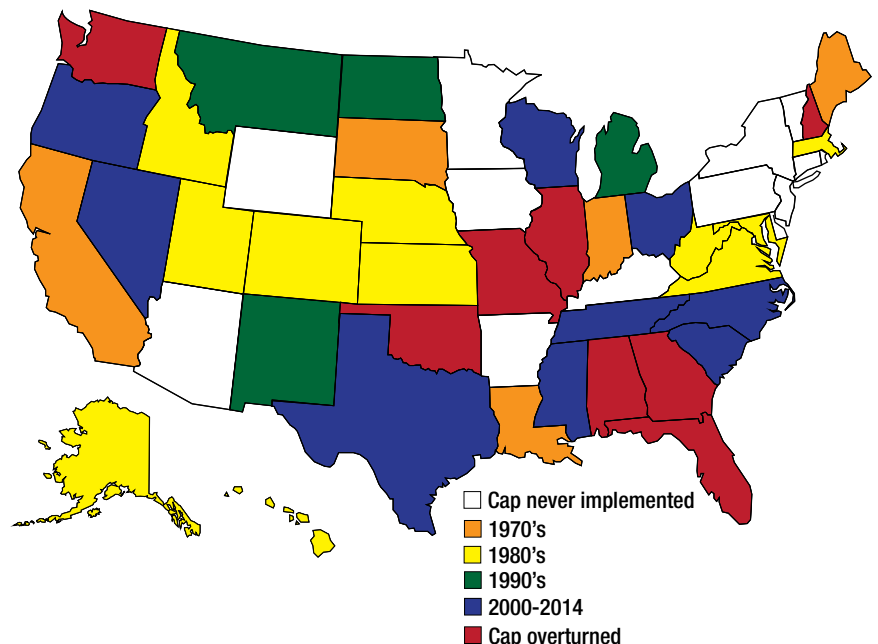
claims. While any estimate of an increase in frequency is speculative, the mid-2000s provide an example of the potential wide swing in frequency that could occur.

At that time, a hard-to-explain decline in frequency drove an unprecedented improvement in the financial results of MPL specialty insurers. A portion of the extraordinary drop in claim frequency can be attributed to an assortment of reforms that occurred across the country. While these reforms presumably contributed to the decrease, other states with no change in their tort laws also saw frequency declines.

Other likely contributors to the decline include improvements in patient safety and risk management as well as the increased adoption of early intervention in handling medical mishaps. In addition, an underlying change in societal attitudes probably contributed to the decrease in claim frequency.

Attorneys on both sides of medical liability cases have shared with us their belief that juries today are more sympathetic to health care providers and more willing to

Implementation of MPL Damage Caps by State



Source: Milliman

accept the idea that the unfortunate events giving rise to cases may have been outside of the health care providers' control. In other words, attitudes that helped tort reforms get enacted in many states could swing in the opposite direction. Further, sympathetic patients having their stories heard in California via what experts believe will be record-breaking advertising campaigns for the ballot initiative could impact societal attitudes, regardless of the final voting results in November.

Just as the incentive for plaintiff attorneys to file claims increases when a cap is overturned, the incentive for insurers to defend claims also increases. Thus the defense costs of insurers can also be expected to increase if that part of MICRA is invalidated, beyond what the number of claims itself would suggest.

All of these factors serve to increase the costs incurred by insurers providing coverage for physicians and other health care providers and facilities. These are costs that must be passed to health care providers, and in turn to patients—further increasing the cost of health care in California. Meanwhile, two independent studies both estimated increases as high as 70% in medical liability costs if the ballot initiative passes.

Insurers and reinsurers are preparing now for a possible increase in claim costs. Hugo Kostelni, an MPL reinsurance broker in California with JLT Towers Re, sees companies currently exploring additional reinsurance options with the ballot initiative in mind. Although Kostelni believes “companies won't have another reinsurance spend unless they have to have it”—so don't expect companies to increase their reinsurance coverage prior to November—he has seen some companies taking steps to have an aggregate stop-loss cover “in their back pocket,” should the initiative pass.

Things to Come?

Three dozen states have adopted some form of a cap on damages over the years, although in 12 of these states the cap has been overturned or otherwise invalidated, and remains overturned in most of these cases. And while these caps are often less effective than California's, either because of higher limits or exceptions, they followed MICRA's lead and reduced costs in many MPL markets.

Texas is perhaps the best example of a state whose MPL premium has been reduced by the effects of a cap on noneconomic damages. MPL premiums in Texas had been in close step with national trends

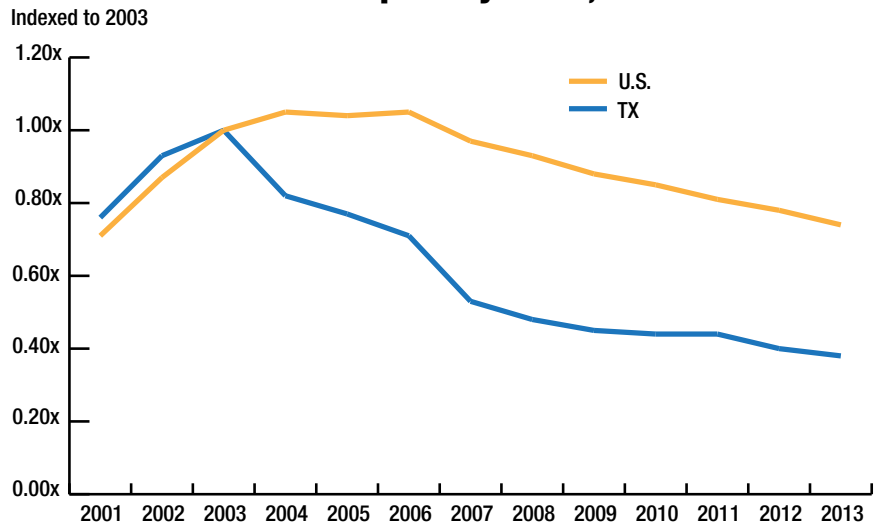
that could be seen in California if the cap is increased.

The health care market has been under pressure to constrain costs for several years, a phenomenon that likely will be exacerbated by higher awards in MPL cases.

Small community systems and small physician groups in particular may be even more likely to join forces with larger systems or groups, a trend over the past 15 years that has accelerated with the implementation of the Affordable Care Act.

That the liability of health care providers and their insurers will be expanded by an increased cap on noneconomic damages is with-

Direct Written Premium per Physician, TX vs. US



Sources: BESTLINK State/Line (P/C Lines)- P/C, US; TX and U.S. DWP for 2003 and subsequent from A.M. Best, 2001 and 2002 estimated by Milliman. Number of physicians from American Medical Association (AMA) Physician Characteristics (multiple editions). 2012 and 2013 AMA Physicians estimated by Milliman.

until 2003, the year reforms were enacted in the state. Premiums declined relative to national levels a year after reforms were enacted, and continued to moderate for several years.

While nationwide premium per physician is approximately 25% less than in 2003, MPL premiums in Texas have fallen by more than 60% since that time—a clear demonstration of the impact that reforms have had on the MPL costs in the state, and a warning sign of potential increases

out doubt, although the magnitude of the impact is highly uncertain, as is the resulting effect on health care costs themselves.

Whether this happens will be in the hands of voters in California, which has been the bellwether for the nation on initiatives from environmental protection to employment practices to MPL reform.

A vote to overturn MICRA in November could signal the beginning of the end for tort reform in other states.

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