

Bad Medicine

Why Bush's malpractice policy will only help insurers

BY SASHA POLAKOW-SURANSKY

FOR THE THIRD TIME IN AS MANY DECADES, DOCTORS across the country are protesting rising medical-malpractice insurance premiums. The American Medical Association (AMA) is promoting its long-standing goal of medical-liability reform in the shape of a \$250,000 cap on "pain and suffering" (noneconomic) damages in malpractice cases. Karl Rove must be thrilled. For an administration determined to deplete the coffers of Democratic trial-lawyer donors—and damage presidential hopeful Sen. John Edwards (D-N.C.) in the process—malpractice reform is a godsend.

It is also a powerful wedge issue with the potential to alienate doctors from Democrats after their recent collaboration on the Patients' Bill of Rights. Just one year ago, the AMA and trial lawyers were working together to pass legislation allowing patients to sue HMOs. But with reimbursements declining and malpractice premiums rising, trial lawyers are the physicians' new target.

President Bush's AMA-backed proposal to cap pain and suffering damages at \$250,000 will satisfy the AMA's desire to shield doctors from liability while curtailing maimed patients' rights to sue. But in the end it is more likely to line the pockets of insurance companies than reduce rates for doctors.

Depending on whose statistics you use, the median jury award for malpractice ranges from \$125,000 to \$1 million. The Physician Insurers Association of America reports that claim payments of more than \$1 million have increased from less than 2 percent in 1990 to almost 8 percent in 2001, driving the median up from \$150,000 to more than \$300,000. Contrary to insurance-industry claims, however, overall medical-malpractice payouts have not increased substantially. During market downturns, insurers set aside vast reserves to pay anticipated claims, counting these reserves as "incurred losses"—even while these funds accrue investment income. But excluding these set-asides, actual insurance-company payouts increased only 1 percent from 1998 to 2001, according to Americans for Insurance Reform (AIR)—far less than premium increases in most states.

Medical-malpractice law is a lucrative industry, as many a phone book cover will attest. But contrary to the administration's line, increasing jury awards are not single-handedly driving premiums through the roof. Rather, a steep decline in insurers' projected investment income is largely responsible for rising rates. Medical-malpractice insurers do not invest heavily in stocks; in fact, approximately 80 percent to

90 percent of their investments are in the bond market, and bond income has been declining. Moreover, insurance companies are technically barred from recovering **past** losses by raising premiums, an argument the **AMA** parrots to dismiss claims that insurance companies are at fault. But insurance companies do regularly raise rates based on projected investment losses. For medical-malpractice insurers, investment income represents a far greater share of profits than in other lines of coverage due to the long lag (up to 10 years) between premium payments and claim payouts. And when investment income evaporates, it hits hard. AIR's J. Robert Hunter, an actuary and former Texas insurance commissioner, tracked premiums and insurance-industry investment returns over the last 30 years. He found that each of the three

malpractice insurance "crises" directly coincided with declining insurance investment returns.

Insurance competition in the 1990s, followed by steep drops in interest rates, drove premiums up sharply. As *The Wall Street Journal* exhaustively documented in 2002, malpractice insurers launched a price war in the 1990s after major companies realized they had set aside too much capital in loss reserves. As large insurers such as St. Paul Cos. released reserves, medical malpractice suddenly appeared immensely profitable and multiple new companies entered the market, aggressively undercutting the larger companies and one another. The result was a bargain for doctors and a brewing storm for insurers. As claims piled up, the low rates no longer proved adequate to cover costs. The largest insurer,

BY STEPHANIE MENCIMER

One day in 1973, 68-year-old Elmer Norman went to his doctor for some hearing tests and a prescription for antibiotic to treat an ear infection. But when Norman submitted the bills to Colonial Penn Franklin, his health insurer, the company denied his \$48 claim, arguing, among other things, that the prescription drug he'd received wasn't actually a prescription drug and therefore wasn't covered. Incensed, Norman contacted William Shernoff, the famous California trial attorney who'd won a landmark lawsuit against an insurance company a few years earlier.

Blind in one eye and mostly deaf—he wore a homemade hearing aid made from big stereo headphones and a microphone connected to a box on his belt—Norman eventually persuaded Shernoff to take his \$48 case. During the litigation, Shernoff discovered that Colonial Penn had duped about 100,000 seniors into believing they were getting a "new and improved plan" when, in fact, it actually cut coverage to save more than \$4 million annually. Colonial Penn's treatment of the seniors so outraged the jury that it awarded Norman a jaw-dropping \$4.5 million, the company's annual savings, in punitive damages. (The case was settled for somewhat less.)

The Norman case became famous among consumer advocates fighting unscrupulous insurance companies. J. Robert Hunter, a former Texas insurance commissioner and the current director of insurance for the Consumer Federation of America, says Norman's case "did more in one year to reform claims practices than years of regulation." He says that for years afterward,

lawyers would turn up claim documents from national insurance companies with notes to adjusters reading, "Handle this one right. It's from California."

Insurance companies, though, have waged an expensive battle ever since to make sure that the Elmer Normans of the world never again see their day in court. They have funded efforts to stack the federal judiciary with such pro-business nominees as Priscilla Owen, who, as a Texas Supreme Court justice, once threw out a jury verdict against an insurance company that had approved a woman's spleen and gallbladder surgery and then refused to pay.

The industry has also spent millions on a massive public-relations campaign against "runaway jury awards" and "greedy trial lawyers" in an effort to pressure states to restrict citizens' rights to sue. In California, insurance companies spent more than \$44 million in 2000 to overturn two year-old state laws that allowed a person injured in an auto accident to sue the other (at-fault) driver's insurance company for refusing to settle or lowballing payment on a legitimate claim. Similar campaigns are underway in states like West Virginia, where such laws are still on the books. Meanwhile, the U.S. Chamber of Commerce plans to fork over \$40 million this year in lobbying for federal restrictions on citizens' legal remedies. Much of that money comes from insurance companies.

The industry's tactics for pressuring state legislators are as cutthroat as some of its claims handling; in April, AIG Chairman Maurice "Hank" Greenberg, who raised millions for George W. Bush's 2000 presidential

campaign, said his firm would stop buying municipal bonds from states that don't restrict citizens' rights to sue. Such strategies have worked. In the past decade, more than 40 states have instituted some kind of limits on citizens' ability to check corporate malfeasance through civil suits. And in April, in *State Farm v. Campbell*, the U.S. Supreme Court declared a large punitive damage award unconstitutional in a decision that took language right from the American Insurance Association's amicus curiae ("friend of the court") brief. The ruling, which has wide-reaching implications for consumers, stems from a case that demonstrated why such awards are often well deserved.

In 1981, Curtis Campbell caused a car accident that killed one person and disabled another. The injured parties sued Campbell for damages and wrongful death, but repeatedly offered to settle with State Farm for the limit of Campbell's \$50,000 auto insurance policy. State Farm, however, forced the case to trial and led Campbell to believe that it would pay for any damages assessed above the limits of his policy. But when the jury awarded the plaintiffs \$185,849, an agent from State Farm bluntly told Campbell and his wife, "You may want to put 'for sale' signs on your property to get things moving."

Stunned, Campbell sued the insurance giant for acting in bad faith. During that litigation, which dragged on for years, Campbell's attorneys showed that State Farm's pressure on Campbell to go to trial—far from being an "honest mistake," as the company argued—as part of a nationwide policy to meet corporate fiscal goals by cap-

St. Paul, left the market. To add to the mess, falling interest rates meant declining yields on bonds. To stay afloat, insurers had to raise rates. "When interest yields decrease, rates must increase," Jim Hurley, a medical-malpractice expert at the actuary firm Tillinghast-Towers Perrin, told the Senate Committee on Appropriations in March.

WHILE GENERAL PRACTITIONERS HAVE NOT BEEN PARTICULARLY hard hit by rising premiums, neurosurgeons, obstetricians and other high-risk specialists have seen rates soar. According to the trade journal *Medical Liability Monitor*, annual premiums for obstetrician/gynecologists in Las Vegas increased from \$79,000 in 2001 to nearly \$108,000 in 2002, while those in Miami saw premiums skyrocket from

\$159,000 to more than \$210,000. In states such as Pennsylvania, Nevada and Florida, doctors have retired early, left the state or stopped delivering babies to contain their insurance costs. While the overall number of doctors in these states is actually rising, certain specialties are feeling the pressure. Dr. Shripathi Holla, a neurosurgeon in Scranton, Pa., has seen his total malpractice insurance payments double in the last few years to approximately \$150,000. Meanwhile, other area neurosurgeons have stopped practicing or retired early, and one recently moved to Maryland. "I am unable to recruit anyone to come to this town," says Holla. As a result, he finds himself on call for three different area hospitals on any given night, and he is sometimes the only surgeon willing to perform risky oper-

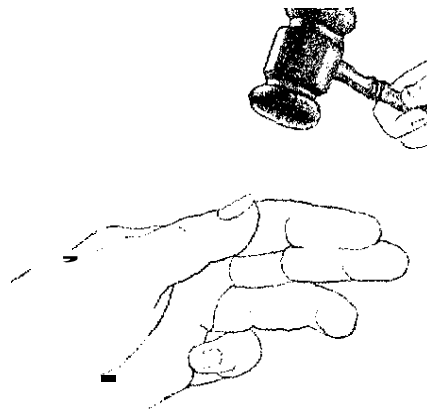
ping payouts on claims. Adjusters were even rewarded with bonuses for cheating consumers out of legitimate claims. The tactics were most actively employed against poor racial or ethnic minorities, women and the elderly, whom State Farm believed would be less likely to object or take legal action. State Farm also argued that practices in place in 1981 had been abolished, but Campbell's attorneys proved they were still in use when the care went to trial in 1996.

Campbell's lawyers introduced extensive evidence of the company's fraudulent practices around the country, which included concealing and destroying documents to avoid disclosure of the claims policy and systematically harassing and intimidating opposing claimants, witnesses and attorneys. State Farm used its vast wealth to try to wear out opposing attorneys by prolonging litigation, making meritless objections, claiming false privileges and abusing the motion process. (State Farm's litigation eventually outlived Campbell, who died in 2001 at age 83.)

The company's behavior was so egregious that in 1996, a jury awarded Campbell \$145 million in punitive damages, or 0.25 of 1 percent of State Farm's wealth. The Utah supreme court—hardly a bastion of radical liberalism—upheld the award on the grounds that, because the company's behavior was largely clandestine, it would be punished, at most, in only one out of every 50,000 cases.

Harvey Rosenfield, president of the California-based Foundation for Taxpayer and Consumer Rights, says when he originally read the Utah court's opinion, he thought State Farm would lose its license to practice

in several states. Instead, the U.S. Supreme Court overturned the Utah decision, setting guidelines for punitive damages that would be four to 10 times the amount of compensatory damages, or something more closely related to the state's maximum civil penalty for such behavior. In Utah, that figure is only \$10,000.



For a company worth \$32 billion, a \$10,000 award could hardly be considered punitive. "The ability to make the punishment fit the crime is very adversely affected [by this decision]," says Laurence Tribe, the Harvard Law School professor who argued the Campbell case. "There will be no reason for an unscrupulous company to do whatever they want to maximize profits."

Indeed, just as Elmer Norman improved corporate behavior with his lawsuit, reductions in jury verdicts often have the opposite effect. Last December, a Texas court reduced the \$32 million award in Melinda Ballard's bad-faith case against Farmers Insurance

Group to \$4 million. Ballard says insurance companies then started calling policyholders across the state and retracting offer to stopay claims, saying, "Sue us." Ballard, who has formed a nonprofit group, Policyholders of America, to lobby for insurance reform, says, "[Insurance companies'] whole purpose in life is to avoid paying legitimate claims. ... They want to be bad out on the playground and not get spanked."

The Supreme Court also ruled in the State Farm case that out-of-state evidence such as that introduced by Campbell should be banned in future trials. And yet only the states are vested with the power to regulate the billion-dollar national industry. Even though companies such as State Farm engage in interstate commerce, Congress exempted them from federal regulation in 1945 in the McCarran-Ferguson Act. The industry is exempt from antitrust regulation and oversight by the Federal Trade Commission, too.

Lawsuits such as Campbell's—and the threat of large punitive damage awards—are often the only recourse consumers have, not only to learn about insurance companies' business practices but also to prevent insurance companies from abusing them with abandon. That's why the industry wants to get the bad-faith laws off the books and put the trial lawyers who represent little guys like Elmer Norman out of business. By removing the big stick of punitive damages, the Supreme Court just helped them get a little closer to that goal. ■

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ations that trauma centers will no longer undertake. "Once some of us retire, this state is going to have a tremendous problem in terms of providing health care to its citizens," says Holla.

The Bush plan is modeled after California's 1975 Medical Injury Compensation Reform Act (**MICRA**). From 1976 to 2000, according to the **AMA**, California malpractice premiums remained stable, rising 167 percent compared with a 505 percent increase nationwide. However, California premiums increased dramatically in the years immediately following **MICRA**. They did not stabilize until 1988, three years after the California Supreme Court upheld **MICRA** and the same year that California voters passed Proposition **103**, forcing publicly traded insurance companies to reduce rates by 20 percent. Both reforms likely played a role in stabilizing California's insurance rates.

But critics of caps insist that pain and suffering damages are necessary to deter careless medical practice and compensate for injuries such as blindness, disfigurement and the loss of sex function, which cannot be quantified in economic terms. Limiting these awards, they argue, will do nothing to reduce costs to doctors and will only trample patients' rights. Linda McDougal, the Minnesota woman whose breasts were mistakenly removed after she was incorrectly diagnosed with cancer because her files were mixed up with another patient's, suffered few quantifiable economic losses. She had health insurance, and her employer covered medical bills and lost wages. But "she will have to go through life mutilated for no reason," says Carlton Carl of the Association of Trial Lawyers of America. George Annas of the Boston University School of Public Health contends that doctors in general are far too worried about being sued.

"Most doctors don't get sued," says Annas, referring to a 1990 Harvard study showing that only one in eight malpractice victims ever takes his or her case to court. "Compare that to patients who worry about being killed; it's not even in the same league."

FAR MORE EFFECTIVE THAN AN ARBITRARY CAP ON DAMAGES would be a more systematic effort to weed out bad doctors and prevent malpractice in the first place. Dr. Sidney Wolfe, director of Public Citizen's Health Research Group, says, "You should protect patients with doctor discipline and protect good doctors with low premiums." Public Citizen ranks state medical boards according to their records of disciplining negligent doctors. "Five percent of the doctors account for 50 percent of the malpractice payouts," he says. "The primary failing is at disciplining doctors. A lot could be remedied by taking bad doctors out of practice."

Meanwhile, CEO Richard Anderson and President Manuel Puebla of the Doctors' Company, a so-called physician-owned mutual, each earn approximately \$2 million per year. Wolfe declares that doctors are "being used as a human shield by the malpractice insurance companies" who want tort reform to protect only themselves. After all, in many states where caps have been enacted, insurance premiums have continued to rise. Nevada, Missouri and Ohio all have some form of cap, but all three figure prominently on the **AMA's** "crisis states" map. Instead of turning their backs on the real causes, Wolfe says, doctors "should be marching for

discipline reform and insurance reform."

Dr. Marcia Angell, former editor of *The New England Journal of Medicine* and now a professor at Harvard Medical School, is not surprised. "[Doctors] are not economists. They don't think in terms of how a business makes up for a loss of profits. They have been at loggerheads with the trial lawyers for so long that it's always a knee-jerk reaction." Moreover, she observes, many lawsuits arise due to the lack of a social safety net. "As long as we have a system based on avoiding sick people and not taking care of them, you leave sick and injured people with very little alternative other than to sue and to get some care that way," says Angell.

Remarkably enough, insurance companies don't even promise that a cap on lawsuits will solve the problem. In 2002, the American Insurance Association noted, "The insurance industry never promised that tort reform would achieve specific premium savings." And American Tort Reform Association President Sherman Joyce told *Liability Week* in 1999, "We wouldn't tell you or anyone that the reason to pass tort reform would be to reduce insurance rates." If doctors are genuinely concerned about reducing the cost of malpractice premiums and not simply shielding themselves from liability, it would only be logical to demand that for every dollar an insurance company saves as a result of tort reform, doctors should save a dollar on their premiums.

Ironically, Bush boasted about just such a policy during the 2000 campaign, when he proudly credited a Texas law with saving consumers billions of dollars. But these days the White House won't give its blessing to any such reform. Enticed by the prospect of passing widespread tort reform, Rove and Senate Majority Leader Bill Frist (R-Tenn.) have other things in mind. In early April, a far-reaching bill cracking down on class-action lawsuits was approved by the Senate Committee on the Judiciary, bringing it to the floor even before malpractice reform.

AMA President-elect Dr. Donald Palmisano concedes that other remedies are available. In Massachusetts, Indiana and Louisiana, malpractice lawsuits undergo a pre-screening process, substantially reducing the number of questionable lawsuits without restricting the rights of patients to sue. Other top **AMA** officials admit that the caps for which they are lobbying hard may not even bring premiums down. "Dropping premiums would be great, but stabilizing is what we want," says an **AMA** spokeswoman. But stabilizing rates at levels that are already driving neurosurgeons and obstetricians out of business is no solution. While a cap on pain and suffering damages may result in marginal savings for general practitioners, there is no evidence that it would provide relief to those who perform the riskiest procedures. If the **AMA** succeeds in passing a \$250,000 cap without a provision forcing insurance companies to pass their savings on to doctors, rates may well continue to climb, in which case growing numbers of obstetricians will stop delivering babies, more neurosurgeons will retire early or shy away from risky procedures, and more mutilated patients will be denied compensation.

And in the end, Karl Rove and his buddies in the insurance industry will be laughing all the way to the bank. ■

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