



Looking Back on the Medical Malpractice Insurance Market

By Brian S. Kern, Esq. (2/03)

In his state of the union address on January 28, 2003, President George W. Bush called on Congress to pass medical malpractice reform. Exactly one week later, Striking New Jersey physicians gathered in Trenton to protest exorbitant liability insurance premiums.

Despite avid disagreement among doctors, lawyers, and insurance companies about the cause, most concede that high malpractice costs are a problem. All sides continue to address their concerns and weigh in with proposed solutions. The one question lost in the fray: How did this crisis begin?

In response to a medical malpractice availability crisis in the late 1970's, the Medical Society of New Jersey ("MSNJ") created The Medical Inter-Insurance Exchange, or "MIIX," a physician owned reciprocal insurance company, capitalized by New Jersey physicians that became policyholders. Sensing an opportunity from the lack of competition, the New Jersey hospitals moved in and formed Princeton Insurance Company. The two have been in competition ever since, though both have undergone significant transformation.

Due to the unique nature of insurance companies, they tend to thrive in prosperous economic cycles. The reason for this is that they not only need surplus and operating income, but they must also have adequate reserves. Reserve money is capital set aside to defend and pay out on potential claims. Since future claim activity is highly speculative, companies use conservative figures when setting reserve requirements. Moneys held in reserves can realize big returns during good economic times, offsetting the need for premium increases.

At the height of the 90's bull market, AM Best, an independent rating agency, advised all the medical malpractice insurance companies that they could never receive an "A-" or better ratings unless they diversified their product line, and diversified geographically. PHICO Insurance Company soon began to aggressively market New Jersey, and made an instant impression, as its pricing was far below the industry standard. PHICO also knew that the time from incident date to payout date was often many years. Therefore, it could collect large amounts of premium before having to pay out on claims. Its hope was that return on equity during this period would surpass losses. According to Henry Kane, one of New Jersey's largest medical malpractice insurance agents, "Our agency, and other experts cautioned both the physicians and the industry, but the short-term incentive proved too powerful a lure." PHICO was off and running. Zurich American Insurance

Company also entered the NJ market with a similar approach to PHICO, but targeted the high risk specialists. In 1994, MIIX decided to expand into other states, and use an IPO to fund the expansion. On July 30, 1999, MIIX went public. Princeton was forced to reduce premiums or lose business, and price wars ensued. On September 15, 2000, MLMIC, the largest writer of medical malpractice in New York, acquired Princeton. All along, increases in claim severity went unnoticed, as portfolios continued to produce. The bubble was growing, and so was the malpractice carriers' commitment to growth.

Suddenly, the bear market set in and exposed the soft underbelly of the insurer's low balling tactics. The predicted lawsuits and payouts materialized, but investment income was no longer generated to fund them. In August 2001, the state experienced its first major casualty, when PHICO was forced into liquidation. By the end of the year, St. Paul's, the largest writer of medical malpractice coverage in the nation, exited the market altogether. Zurich also sought to pull out of the State by the end of 2001, but The Department of Banking and Insurance rejected its filing.

At the same time, MIIX's decision to expand into Pennsylvania and West Virginia – two states deemed to be in a major crisis—proved costly. Ernst & Young told MIIX it needed to move roughly \$70,000,000 from surplus to reserves. AM Best lowered MIIX's A-rating to a B-. It would get as low as C+ before being de-listed.

Princeton would ultimately pick up thousands of new clients, but it could not provide shelter for all. MIIX's newly appointed CEO, Patricia Costante, sensed another availability crisis, and began her mission. MIIX declared that it would voluntarily enter into a solvent run-off, which secured its existing policyholders with more than \$1.2 billion in reserves. The company would cease renewing policies as of August 1, 2002.

Reminiscent of the 70's, MIIX created a new company, called, "MIIX Advantage," and once again, membership entailed a hefty capital contribution. In three short months though, MIIX Advantage had raised close to \$30 million – enough to gain approval from The NJ State Department of Banking and Insurance.

Even with MIIX Advantage, Princeton, and the now heavily sought-after ProMutual Group (a Massachusetts based, physicians owned company) writing coverage, obstetricians and surgeons experienced difficulty locating affordable coverage. Though the excess and surplus market rarely turns down applicants, it is extremely costly, requires deductibles, and does not cover doctors once they stop paying premiums without exorbitant "tail" costs.

A newcomer, Conventus Inter-Insurance Exchange, seized the opportunity, and entered into the market. Structured similar to MIIX Advantage, Conventus would also require a sizable capital contribution. Despite the entry of Conventus, availability was still a major problem. OB/GYN's stopped delivering babies, and neurosurgeons ceased performing operations. Two counties found themselves without even one neurosurgeon.

In late January 2003, Insurance Commissioner Holly Bakke published a study of the malpractice crisis. The Star-Ledger front-page report revealed the findings that only a little more than 7% of NJ physicians were hit with a 30% or greater premium increase. Physicians were livid.

Ms. Bakke's study was based off of statistical data taken from the months of January through August of 2002. The study failed to account for an average 10% increase in August, and than a greater than 25% rate increase taken by all three major carriers on November 1, 2002, December 1, 2002, and January 1, 2003, respectively. During this time, many doctors also reduced coverage or changed their practice. Ms. Bakke promised to address these concerns in a new study to be released sometime around March. But talks of a work stoppage among physicians were already underway.

Knowing that other states faced similar problems, New Jersey doctors began looking for solutions. They looked to Florida to find physicians practicing without insurance, and sheltering their assets. They also looked at Nevada to discover that a trauma center was forced to close because its doctors were also protesting medical malpractice rates. Mississippi, Pennsylvania, and West Virginia were in worse shape than New Jersey. Indeed, California was one of only a handful of states with a stable insurance market. Despite its notoriety for liberal litigation and billion dollar jury awards, doctors discovered that California was not in a crisis. Why? Many believe the answer lies in a 1978 law that capped non-economic damages at \$250,000. A couple of sparks flickered within the medical staffs in Ocean County, and within weeks, a grassroots campaign ignited throughout New Jersey. By mid-January, the brushfires became a firestorm.

Throughout the state, doctors were getting organized. Hundreds at a time were gathering to vent frustrations and find a collective voice. The message became clear and loud: Frivolous lawsuits were out of hand; many jury awards were unjustified; and liability was destroying the health industry. Doctors were demanding tort reform, including a cap on non-economic damages and a tightened statute of limitations.

The grassroots effort was gaining momentum. Soon MSNJ voted to devote its full efforts to the cause. President of the Medical Society, and former Olympic boxer, Dr. Robert Rigolosi, entered the ring with his colleagues. "We are concerned about patient access to medical care, and there is no doubt that doctors are avoiding the high-risk specialties and procedures. The best and brightest are not going into the field, and the future of medicine is in jeopardy" said Dr. Rigolosi. MSNJ helped to open the lines of communication with the media and the legislature, and the formal announcement was made: On February 3, 2003, physicians throughout New Jersey were closing their doors to all but those patients in need of emergent care.

Speakers were sent to every corner of the State to address hospital medical staffs and coordinate the effort. All of the pieces were soon in place. Via blast faxes and the Internet, doctors were provided material on how to close their offices, what to say on their answering machines, and where to be.

On February 4, doctors were asked to dress in white lab coats, and gather at The Trenton Statehouse steps at 11:00 am to deliver their united message: “Tort Reform Now!” Incidentally, February 4th was the day that Governor James McGreevey would deliver his budget proposal to Congress. He would be inside to hear the chants.

Thousands of white coated physicians attended the Trenton rally, and would echo their theme the next day in front of the offices of State Senator Joseph Vitale in Woodbridge, and Neil Cohen in Union. Siding with the trial lawyers, Vitale and Cohen have remained the leading opponents to caps on non-economic damages. Though Vitale introduced two bills (A-50, and S-2174) aimed at reducing medical malpractice premiums, which require an expert witness to practice the same specialty as the defendant, a more limited discovery period, financing of large premiums, and structured payment of settlements or awards, physicians viewed the proposal as grossly inadequate.

In fact, MSNJ funded a study by actuarial consulting firm powerhouse, Tillinghast-Towers Perrin, which confirmed the physicians’ sentiments. According to the study, the Vitale proposal would do little to curb premiums, and “would likely produce a net overall increase in malpractice costs.”

Notably, Tillinghast also concluded that the best, and perhaps only, way to reduce costs in the short-term was a \$250,000 cap on non-economic damages. \$500,000 caps would “produce minimal or no benefits.”

Theoretically, a cap on non-economic damages should free up money otherwise tied up in reserves, and lower reinsurance costs. Without the looming threat of a bank-breaking pain and suffering award, actuaries would be able to predict losses more accurately. As such, medical malpractice would be a safer, more desirable sector for insurers.

Of the approximately 22,000 physicians in New Jersey, it is estimated that half of them participated in the work stoppage in some way. The emergency rooms were flooded, as patients who called their primary care physicians heard a shocking recording: This office is closed until effective tort reform is passed. If this is an emergency, call 911 or go to your local hospital. If this is not an emergency, call your legislator.

Thousands of patients throughout the state phoned 1-877-KEEPMEDS, a telephone line supported by MSNJ and the State’s Hospital Association. The calls were automatically routed to their local legislatures. Simultaneously, the trial lawyers were moving vigorously in opposition to caps in any form. The American Trial Lawyers Association of New Jersey (ATLA) argued that each case is fact sensitive, and capping damages will prevent victims of malpractice from fair recovery. They blame the stock market and mismanagement by insurance companies for the current crisis, pointing out that in every bear market, the insurance industry tries to create the illusion of a crisis in order to fast track legislative reform, and justify sharp rate increases. Dennis Donnelly, a top NJ plaintiff attorney, agreed. “There is no crisis from the civil justice system, only from insurance carriers and cyclic economic trends,” he said. It was time to negotiate.

After many intense discussions between key senators and MSNJ, it appeared the legislature was ready to listen. By week's end, Dr. Rigolosi called for an end to the work stoppage, pending hope for legislative action. He felt the organization had been effective, and talks for tort reform were under way.

Key legislators were proposing, for the first time, a cap -- \$300,000 on non-economic damages for any individual -- with any excess award to be paid by a state fund. The fund would be capitalized by a surcharge of \$3.00 per person on health insurance and workers' compensation policies, and \$50.00 on every doctor, lawyer, and accountant professional liability policy.

The concept was interesting, but physicians still felt exposed. They refused the proposal as written, but offered critical amendments that would make the plan acceptable. Physicians wanted to limit the fund to \$20,000,000 in annual payouts, and limit awards to one million dollars per claim, or the amount raised by the fund each year in aggregate.

A second critical element was statute of limitations, and a strict limit of four years to bring a suit after injury, except in birth cases, where a suit could be brought within six years of birth. Furthermore, application of the new laws must apply to existing cases, not just those yet to be brought.

Another point of contention is legislative adoption of the "net opinion rule." This rule provides that no expert may offer testimony unless he or she can support it with recognized, tangible evidence. Under the proposal it would no longer be possible for an expert to simply give an opinion without underlying documentation, such as a journal, text book, article, protocol, or the like. Absent such support, the testimony would be excluded.

As legislatures continue to hammer out agreeable proposals, the battle of the headlines continues. A telephone poll conducted and released by the Star Ledger indicated that 68% of those polled supported the leave of absence, 82% blame the problem on "too many lawsuits." 63% still faulted insurance companies, but only 30% cited bad medicine.

Trial attorneys countered with another Star Ledger report that doctors last year lost only about 26 percent of trials, and the median of the jury awards was \$300,000. The report called caps into question, but admittedly did not include figures on the reported 732 cases settled, only the 205 cases tried.

A new bill is in the works, and it is hoped that an acceptable compromise will be reached. If so, New Jersey may well become the model for every other state facing a malpractice crisis in America.