SHOULD NEW MEXICO INCREASE ITS MEDICAL MALPRACTICE CAP?

Review of House Health and Government Affairs Committee Substitute for House Bill 267 and the Likely Effects of a Cap Increase

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INTRODUCTION

Purpose and Content of This Memorandum

Recent vetoed legislation[1] in the form of amendments to the Medical Malpractice Act proposed to increase the limit for non-economic damages[2] in medical malpractice lawsuits from $600,000 to $1 million.[3] Some of the debate over raising the limit centered on whether the measure would force a rise in the cost of medical malpractice insurance premium rates (premiums) and have other negative health care implications. The Public Regulation Commission (PRC) has estimated that, assuming no other change, the proposed new limit would increase the average total cost of premiums by three percent.[4] This change would mean that the average physician's total premium would increase from $19,953, its current figure, to $20,557, a change of $604.[5]

Two key questions follow: (1) are the PRC estimates accurate?; and (2) assuming the relative accuracy of the estimates, would a three percent (or $604) increase in the annual cost of premiums to New Mexico physicians result in:

(a) deterring physicians from practicing in the state;
(b) more medical malpractice claims;
(c) physicians practicing more defensive medicine; and
(d) an increase in the average award size per medical malpractice occurrence?

Most New Mexico physicians participate in both private and state-sponsored medical malpractice insurance programs through New Mexico's two-layer system.[6] The PRC projections were calculated using the assumption that the liability of private insurers — those that form the primary layer in the system — would remain constant. Indeed, New Mexico's recent legislation did not include a provision to raise the primary layer limit.

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[1] House Health and Government Affairs Committee Substitute for House Bill 267 (Regular Session, 2011) passed by a 41-vote margin in the house and a 31-vote margin in the senate.

[2] *Non-economic* damages are those commonly characterized as "pain and suffering". They do not include past or future medical expenses or lost wages — which compose *economic* damages — or punitive damages.

[3] House Health and Government Affairs Committee Substitute for House Bill 267 (Regular Session, 2011). The legislation also proposed to increase the cap each year to correspond to the percentage change in the Consumer Price Index; provided that the change not exceed three percent.

[4] Ins. Div., N.M. Pub. Regulation Comm'n, New Mexico Patient's Compensation Fund: Estimated Premium Impacts of Changes to Cap and to Primary Layer Limit.

[5] *Id.*

[6] Ins. Div., N.M. Pub. Regulation Comm'n, Patient Compensation FAQs, *available at* http://www.nmprc.state.nm.us/insurance/faqs.html#patientcomp.

Had the amendments to the Medical Malpractice Act been enacted, the change would have had no direct effect on private insurers. But that is not to say that the average private insurance rates paid by New Mexico physicians would stagnate. This memorandum explains briefly some of the chief reasons that private insurance rates fluctuate. With a better understanding of the complexity of factors influencing the costs of premiums, the New Mexico malpractice landscape and potential effects of an increase in the damage cap may come into better focus. Thus, a third question addressed in this memorandum is: (3) how do private insurers set premiums for malpractice insurance?

This memorandum attempts to answer questions two and three. The question on the accuracy of the PRC estimate is beyond the scope of this inquiry and, perhaps more appropriately, should be addressed by the PRC.

Challenges and Considerations in Finding and Applying Secondary Sources of Information

In surveying the vast realm of studies on tort reform and its effects on health care costs and provision, perhaps the only thing more striking than the abundance of reports is their tendency to conflict.[7] Scores of interest groups, law review authors and health and legal policy specialists have produced a staggering number of studies. Much of this research is based on weak analysis, and there is no consensus on what tort reform does or does not achieve.[8]

Another difficulty in selecting data from either side of the tort reform divide and applying it to a New Mexico analysis is that, in the medical malpractice arena, New Mexico cannot be easily compared to other states. Ideally, one or more states with relevant characteristics similar to those of New Mexico would have attempted a comparable limit increase, and the results of that endeavor would be available to inform New Mexico lawmakers and the public about the probable outcomes of New Mexico's reform.[9] However, New Mexico's medical-legal environment is like that of no other state. Its particular features could skew a proper comparison of reforms and outcomes.

As mentioned *supra*, New Mexico has a state-sponsored layer of professional liability coverage for member physicians — the Patient's Compensation Fund (PCF).[10] A physician who participates in the PCF must obtain a primary layer of professional liability coverage from a

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[7] *Compare, e.g.*, Geoff Boehm, *Debunking Medical Malpractice Myths: Unraveling the False Premises Behind "Tort Reform"*, 5 Yale J. Health Pol'y & Ethics 357 (2005), *and* Leonard J. Nelson III, Michael A. Morrisey & Meredith L. Kilgore, *Damage Caps in Medical Malpractice Cases*, 85 Milbank Q. 259 (2007).

[8] Michelle M. Mello, Robert Wood Johnson Foundation, *Medical Malpractice: Impact of the Crisis and the Effect of State Tort Reforms*, Research Synthesis Report No. 10, May 2006 at 1, *available at* http://www.rwjf.org/files/research/15168.medmalpracticeimpact.report.pdf.

[9] Most of the literature on the effects of damage caps discusses imposing caps in states that have none. In this report, the inquiry is into the likely effects of a cap *increase*. In this and other ways, most evidence from other states forms an imperfect comparison.

[10] § 41-5-25 NMSA 1978.

private insurer.[11] For all damages but punitive, a private insurer owes no more than $200,000 per occurrence.[12] The PCF covers any remaining claim balance up to $400,000 for non-economic damages and any remaining balance on all other economic damages.[13]

Private insurers and the PCF operate according to different models.[14] As a result, their premium calculations are based on different variables. Thus, New Mexico essentially has in force two malpractice insurance systems, driven by different aims and affected by different circumstances. Most other states do not share this two-system approach. Therefore, studies on the effects of caps imposed in states with no PCF, for instance, might reach conclusions that cannot be wholly extended to New Mexico.

In short, the question of whether raising New Mexico's medical malpractice cap to $1 million would trigger a swell in the cost of premiums and spur a host of other negative outcomes remains difficult to answer. Perhaps the only way of knowing the results of this increase would be by implementing it. Nevertheless, some general trends uncovered by researchers using sophisticated methodologies may help to inform the debate, at least to some extent.

Methods Used in This Memorandum

Most information collected for this memorandum came from reports produced by scholars working on behalf of the Robert Wood Johnson Foundation. The reports' authors rigorously identify flaws in researchers' methodologies and derive findings only from well-designed, controlled studies.[15] These sources are arguably more reliable than most.

THE MALPRACTICE ENVIRONMENT AND EFFECTS ON THE PRACTICE OF MEDICINE

The Malpractice Environment and Physician Supply

A "small but statistically significant" relationship between caps and physician supply exists.[16] Strong studies support the proposition that few physicians choose their geographic areas of practice based on insulation from liability, though this tendency might increase in certain

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[11] § 41-5-5(A)(1) NMSA 1978.

[12] § 41-5-6(D) NMSA 1978.

[13] § 41-5-7(E) NMSA 1978.

[14] *See* discussion *infra* Part 3 (indicating that malpractice insurance companies set rates by calculating, in part, desired profits) and § 41-5-25 NMSA 1978 (indicating that the superintendent of insurance may only use the fund for purposes stated in the Medical Malpractice Act and that no income from investments or surcharges may revert to the state's general fund).

[15] "By synthesizing what is known, while weighing the strength of findings and exposing gaps in knowledge, Synthesis Products give decision-makers reliable information and new insights to inform complex policy decisions." *Supra* note 8, at table of contents page.

[16] *Id.* at 11.

specialties and in rural areas.[17] Although there is no New Mexico-specific data to inform this analysis, general studies show that state reforms directly limiting malpractice awards — including caps — are associated with a modest increase in physician supply.[18] Specifically, in states imposing initial caps, the overall physician supply increased by three percent in three years.[19] In New Mexico, with a cap already in law, it seems unlikely that physicians would leave the state because of the projected increase in PCF surcharges.

The Malpractice Environment and the Filing of Lawsuits

Similarly, there is no strong relationship between caps and the incidence of malpractice claims.[20] Proponents of caps argue that making potential payouts from lawsuits that are less attractive financially, particularly to plaintiffs' attorneys who collect contingency fees, will reduce the number of claims filed. A strong study reported that caps do not significantly reduce the frequency of lawsuit filing.[21] The number of medical malpractice claims remained relatively constant from 1986 to 2002.[22] According to a Congressional Budget Office report, approximately 15 malpractice lawsuits are filed for every 100 physicians annually, and 30 percent of those lawsuits result in an insurance payment.[23] It follows that most likely, the proposed cap increase would not change the number of lawsuits filed in New Mexico.

The Malpractice Environment and Defensive Medicine

One concern with rising premiums is that doctors will begin to practice "defensive medicine", which can take one of two forms.[24] Physicians afraid of the possibility of lawsuits will order tests, referrals and procedures that are not medically justified in order to reduce the legal risk of malpractice.[25] Additionally, physicians may altogether avoid a field of medicine that may be more prone to malpractice lawsuits[26] (e.g., obstetrics/gynecology or anesthesiology).

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[17] *Id.* at 25.

[18] *Id.* at 11.

[19] *Id.*

[20] *Id.*

[21] *Id.* at 24.

[22] Perry Beider & Stuart Hagen, Congressional Budget Office, *Limiting Tort Liability for Medical Malpractice*, January 8, 2004 at 4, *available at* http://www.cbo.gov/ftpdocs/49xx/doc4968/01-08-MedicalMalpractice.pdf.

[23] *Id.*

[24] Mello, *supra* note 8, at 5 n.3.

[25] *Id.*

[26] *Id.*

"Good, but not uniform" evidence suggests that caps reduce defensive medicine.[27] Strong evidence links a modest decrease in defensive medicine with states imposing initial caps.[28] In New Mexico, the proposed cap increase would likely have a less significant effect on the practice of defensive medicine.

The Malpractice Environment and Claims Payouts

Moderately strong research points to evidence that — predictably — caps "substantially" reduce the average size of malpractice awards by between 20 percent and 30 percent.[29] Notably, these results surfaced in states previously having no caps. In New Mexico, where proposed legislation sought to merely *increase* the cap in place, results would likely differ. Most likely, the average award size would increase, but the overall impact of the change would be weaker than that observed in the cited study.

Analysts observe that decreased award sizes caused by caps disproportionately burden the most severely injured patients.[30] A cap increase in New Mexico would very likely have the effect of making available to severely injured patients more money to redress their suffering.

FACTORS INFLUENCING THE COST OF PRIVATE INSURANCE PREMIUMS

Like most other forms of insurance, malpractice premium levels reflect risk.[31] But how this risk is calculated differs in the malpractice context. Insurers set rates prospectively using the following determining factors: the projection of payouts for physicians in a particular risk category; the uncertainty of that projection; projected administrative expenses and investment income; and desired profit levels.[32] Past losses and expense levels factor into the rate-setting calculation.[33]

Recent trends have influenced several of the factors contributing to risk levels and premium rates. Some of these trends are: growth in both physician mutual companies and hospital self-insurance, and a corresponding decrease in commercial insurers; the increased cost of reinsurance — or insurance for insurers — after September 11, when reinsurers suffered massive

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[27] Michelle M. Mello, Allen Kachalia & Sarah Goodell, Robert Wood Johnson Foundation, *Medical Malpractice - Update*, April 2011 at 3, *available at* http://www.rwjf.org/files/research/72097.medmal.update.pdf.

[28] *Id.* at 2, Table 1.

[29] *Id.* at 2.

[30] Mello, *supra* note 8, at 15.

[31] Michelle M. Mello, Robert Wood Johnson Foundation, *Understanding Medical Malpractice Insurance: A Primer*, Research Synthesis Report No. 8, 1 (2006).

[32] *Id.*

[33] *Id.*

losses; the growth of joint underwriting associations, or state-mandated insurers, and patient compensation funds; and relatively poor investment returns since 2000.[34]

When analyzing New Mexico's malpractice environment, it is important to keep in mind that physicians may be subject to private insurance rate fluctuations wholly independent of the Medical Malpractice Act's provisions and effects. Moreover, had it passed, the proposed legislation amending the act would theoretically have little or no bearing on private insurance rates. The amendments would not have had a direct causal effect on private insurance premiums.

CONCLUSION

Though nationwide data may help — generally and by extrapolation — to answer questions related to New Mexico's potential medical malpractice cap increase, the state's particular situation makes applying nationwide data challenging. Since the proposed increase would affect the PCF alone, and because the factors that influence the PCF rate changes may arguably be evaluated with greater certainty, the results of the proposal are perhaps simpler to gauge. In general, the cap increase would have a modest influence on premiums. The increase would not significantly affect physician supply, the number of malpractice claims filed or the practice of defensive medicine. Under the proposed increase, the overall impact to physicians, insurance companies and the medical and legal environments in New Mexico would be slight, while that to the most severely injured victims would be marked.

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[34] *Id.* at 3.