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MEDICAL MALPRACTICE

Case Study on California



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Preface

December 31, 1986

Representative John Edward Porter and Senator John Heinz, Chairman, Senate Special Committee on Aging, asked GAO to identify the actions taken by the states to address medical malpractice insurance problems and to determine changes in insurance costs, the number of claims filed, and the average amount paid per claim. These case studies discuss the situation in each state.

This study on California focuses on the views of various interest groups on perceived problems, actions taken by the state to deal with the problems, the results of these actions, and the need for federal involvement. A summary of the findings for all six case studies can be found in our overall report, Medical Malpractice: Six State Case Studies Show Claims and Insurance Costs Still Rise Despite Reforms (GAO/HRD-87-21, December 31, 1986).



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Overview

California health care and insurance officials we contacted generally believe that the state's comprehensive 1975 medical malpractice legislation, which has survived numerous constitutional challenges, has helped to moderate increases in the cost of malpractice insurance and in the size of malpractice awards/settlements. Key provisions of the legislation are a \$250,000 limit on awards for noneconomic damages, a fee schedule for plaintiff attorneys, and provisions for periodic payment of awards \$50,000 or over for future damages. These officials told us that they expect the legislation to have a greater effect in the future since the California Supreme Court has upheld the major provisions as constitutional, and the U.S. Supreme Court has twice refused to hear cases regarding this legislation. Despite these efforts, however, physician and hospital malpractice premiums are continuing to rise, as are the number and size of malpractice claims and settlements.

The California Trial Lawyers Association believed the legislation has impaired the rights of the injured malpractice victim to receive fair compensation for injuries caused by health care providers' negligence.

California's health care providers and malpractice insurers still believe that there are major problems in the state regarding the high cost of malpractice insurance, the excessive size of malpractice awards/settlements, the high legal costs associated with defending claims, and the incentive to perform medically unnecessary procedures to reduce the risk of liability (i.e., defensive medicine).

There was no widespread support among the groups we surveyed for any federal involvement. Officials generally believed that malpractice problems should be addressed at the state level.

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California: State Officials Believe Reforms Have Helped to Moderate Increases in Claims and Premiums

Background

Population, Physician, and Hospital Characteristics

California is the most populous state. Over 90 percent of its 25.6 million people live in urban areas.¹ California had 69,208 physicians as of December 31, 1985,² and 483 nonfederal community hospitals with 83,033 available beds in 1984.³ A total of 55,936 physicians were providing patient care—46,122 were office-based and 9,814 were hospital-based. Table 1 shows the distribution of patient care physicians among 13 selected specialties.

Table 1: Number of Nonfederal Patient Care Physicians in California in Selected Specialties as of December 31, 1985

	Office-based practice	Hospital-based practice		Total
		Residents	Full-time physician staff	
General practice	7,075	636	286	7,997
Internal medicine	7,193	1,672	382	9,247
Pediatrics	3,156	656	228	4,040
Psychiatry	3,110	482	429	4,021
Pathology	966	197	145	1,308
Radiology	1,025	56	109	1,190
Ophthalmology	1,592	138	17	1,747
General surgery	2,898	779	113	3,790
Anesthesiology	2,358	308	171	2,837
Plastic surgery	549	41	16	606
Orthopedic surgery	1,967	264	57	2,288
Obstetrics/gynecology	3,173	394	105	3,672
Neurosurgery	409	61	19	489

Of California's 483 community hospitals, 242 were nongovernment, not-for-profit hospitals; 101 were state and local government hospitals; and 140 were investor-owned (for-profit) hospitals. Sixty-one percent of the state's community hospital beds were in nongovernment, not-for-profit hospitals; 19 percent were in state and local government hospitals; and 20 percent were in investor-owned hospitals. The most prevalent hospital size in California was the 100- to 199-bed facility. The hospitals of

¹Population and ranking are as of July 1, 1984 (preliminary), and the urban/rural mix is as of April 1, 1980, from the *Statistical Abstract of the United States 1986*, 106th Edition, pp. 10, 12.

²*Physician Characteristics and Distribution in the U.S., 1986 Edition*, Department of Data Release Services, Division of Survey and Data Resources, American Medical Association, (forthcoming).

³*Hospital Statistics, 1985 Edition*, American Hospital Association, p. 50.

that size accounted for 23 percent of the total community hospital beds. California had 13 community hospitals with more than 500 beds each, which accounted for about 11 percent of the state's community hospital beds. The occupancy rate for California community hospitals was 64 percent in 1984.

**Regulation of Insurance
Rates and Description of
Medical Malpractice
Insurers**

California insurers are not required to obtain rate approval from the state insurance department, but they must provide rates and supporting information to the department if requested.

According to officials of the state insurance department, competition is keen among the physician-owned insurers, so availability of malpractice insurance is not a problem in California.

With about 22 percent of the physician market, the Doctors' Company is the leading medical malpractice insurer in California. Most physicians insured by the Doctors' Company are located in southern California. NORCAL Mutual Insurance Company is the leading medical malpractice insurer in northern California. NORCAL insures about 15 percent of the state's physicians. Two other companies that provided requested data were Physicians and Surgeons Underwriters Corporation and Cooperative of American Physicians, Inc. The Cooperative is a trust organization and is exempt from the state insurance department regulation. Two large insurers did not participate in our survey—Southern California Physicians Insurance Exchange in southern California and Medical Insurance Exchange of California in northern California. Agency officials we contacted agreed that the companies that participated in our survey would be representative of the physician medical malpractice market in California.

With respect to the malpractice insurance market for hospitals, the Farmers Insurance Group of Companies insured about 77 percent of the California hospitals in 1984. The St. Paul Fire and Marine Insurance Company (St. Paul Company) and the Association of California Hospital Districts also write malpractice insurance for California hospitals. All three companies participated in our survey.

Insurance companies in California use different rating territories. They vary among the insurance companies from as few as one to as many as five. The Doctors' Company uses three rating territories—northern California, southern California, and San Diego. The most predominately written coverage limits for physician medical malpractice policies were

\$1 million/\$3 million. For hospital malpractice policies, coverage limits varied among insurers. However, the predominately written coverage limits of the largest hospital insurer, Farmers Insurance Group of Companies, was \$500,000/unlimited.

Medical Malpractice Situation in the Mid- 1970's

In the mid-1970's, a crisis developed in California regarding the lack of available and affordable medical malpractice insurance. The number of malpractice claims and size of the awards and settlements were escalating in the state. Some commercial insurers, such as Argonaut and Cignal-Imperial, reacted by withdrawing from the market. Others raised their premiums to unprecedented levels. When the malpractice crisis peaked in 1975, among the first to feel the pinch of skyrocketing premiums were the high-risk specialties in northern California. According to an official of the Doctors' Company, premiums for these high-risk specialties increased by as much as 422 percent. Officials of the California Hospital Association told us that some doctors in California decided to discontinue providing medical care involving high-risk procedures, some moved their practices to other states, and some opted to "go bare" (practice without malpractice insurance). Further, medical care was not available in all parts of California, and patients treated by uninsured doctors faced the probability of unenforceable judgments if they suffered serious injury as a result of malpractice.

Response to Problems

In response to the statewide malpractice insurance turmoil, physician and insurance lobbyists urged passage of tort reforms. On May 16, 1975, the governor issued a proclamation that convened the state legislature in an extraordinary session. The proclamation called for the legislature to "enact laws which will change the relationship between the people and the medical profession, the legal profession, and the insurance industry and thereby reduce the costs which underlie these high insurance premiums." In September 1975 the legislature enacted the Medical Injury Compensation Reform Act of 1975 which:

- Established a sliding contingency fee schedule for plaintiff attorneys of 40 percent for the first \$50,000 recovered; 33-1/3 percent for the next \$50,000; 25 percent for the next \$100,000; and 10 percent of any amount over \$200,000.
- Imposed a \$250,000 limit on the amount recoverable for noneconomic losses to compensate for pain, suffering, inconvenience, physical impairment, disfigurement, and other nonpecuniary damage.

- Permitted a defendant to introduce evidence that the plaintiff is entitled to compensation for injuries from insurance; however, the plaintiff may then introduce evidence of premiums paid by the defendant for the insurance coverage.
- Required that the superior court, at the request of either party, order periodic payment of future damages rather than a lump-sum payment if the award equals or exceeds \$50,000 in future damages.
- Imposed a statute of limitations of 3 years after the date of injury or 1 year after the plaintiff discovers, or should have discovered, the injury, whichever occurs first. Actions by a minor under 6 have to begin within 3 years or before his 8th birthday, whichever provides a longer period.
- Required specific boards to keep certain records regarding convictions and judgments against their physicians and required reports from courts on judgments against physicians. Provided for additional reports from hospitals, health care service plans, or medical care foundations to licensing boards regarding the removal of staff physician privileges.
- Changed the name of the Board of Medical Examiners to the Board of Medical Quality Assurance, increased the membership to 19, and divided the work into three divisions.
- Required every insurer providing professional liability insurance to report to the licensing agency any malpractice settlement or arbitration award over \$3,000. (In 1979, the \$3,000 amount was increased to \$30,000 for physicians and surgeons.)
- Required a 90-day notice to health-care providers of the plaintiff's intention to sue for malpractice.
- Provided that any contract for medical services that contains a provision for arbitration of any dispute regarding malpractice also contain a specified disclosure statement as the first article of the contract.

On June 3, 1986, California voters passed Proposition 51, the Fair Responsibility Act, which amended the joint and several liability doctrine for noneconomic damages. Under a "joint and several liability" rule, all parties named in a suit are held equally responsible for damages. If the plaintiff wins the case, he can collect the full amount from any one of the defendants, even from a defendant who bears only a minor responsibility for the damages. The rule is sometimes referred to as the "deep pocket" rule, so named because the defendant with the deepest pocket sometimes ends up paying for injuries for which he was only partially responsible. Proposition 51 limits awards for noneconomic damages, such as pain and suffering, to a defendant's degree of fault in causing the damages. However, the law retains joint and several liability for economic damages, such as lost wages and medical expenses.

Effect of California Tort Reforms

No major effect from any specific tort reform or action was perceived by three or more interest groups we surveyed.⁴ However, numerous health care and insurance officials we contacted credited the state's medical malpractice legislation with moderating California's increases in the cost of malpractice insurance and in the size of malpractice awards, particularly when compared to other states. Agency officials said the legislation has helped to slow the upward trend in escalating insurance premiums and jury awards. An official of the Doctors' Company stated that the Medical Injury Compensation Reform Act has been cited as a model for other states and has been credited with California's relative stability while a malpractice crisis is emerging across the nation. Further, a May 1985 California Medical Association-sponsored study concluded that the state's malpractice legislation had been effective in holding down malpractice claim costs. The study attributed savings in claims costs ranging from 8 percent in 1976 to 49 percent in 1985 to California's malpractice legislation.

Since the legislation was enacted in 1975, its provisions have been frequently contested in California courts. The act has withstood four separate California Supreme Court challenges. The U.S. Supreme Court has refused to hear two cases that were brought before it. An attempt to repeal the act in the California legislature was defeated in 1985. We were told that some plaintiff attorneys negotiating malpractice settlements and some courts frequently functioned on the basis that the act would be found unconstitutional and, as a result, did not abide by its provisions. Several officials believe that the full impact of the act will now be felt since the U.S. Supreme Court in 1985 refused to hear a case questioning the constitutionality of California's cap on noneconomic losses, such as pain and suffering, which, in effect, upheld the provision's constitutionality.

Key Indicators of the Situation Since 1980

Malpractice insurance premiums for physicians have increased at a moderate rate since 1980. Rates of the largest hospital insurer decreased each year from 1980 through 1984, but increased sharply in 1985 and again in 1986. Frequency of claims against physicians increased 27 percent between 1980 and 1984, while the average paid claim against physicians increased about 87 percent. The frequency of claims against hospitals increased 17 percent, but the average paid claim increased 91

⁴Our methodology for obtaining the views of major interest groups and for analyzing their responses is described in GAO/HRD-87-21, pp. 10-11. The specific interest groups for California are shown in appendix II of this report.

percent. Further, from 1980 to 1984, insurers' average cost to investigate and defend malpractice claims more than quadrupled for claims against physicians and increased 64 percent for those against hospitals.

Physicians

Cost of Malpractice Insurance

As of January 1, 1986, there was a wide variation in malpractice insurance rates among various specialties in California. For instance, The Doctors' Company annual premium for coverage limits of \$1 million/\$3 million in southern California ranged from \$4,260 for general family practice (no surgery) to \$42,928 for obstetrics/gynecology. The NORCAL Mutual Insurance Company's rate in northern California ranged from \$3,632 for pathology and psychiatry to \$40,388 for neurosurgery. The annual premiums are higher in southern California than in northern California for most specialties.

The rate of increase in malpractice premiums has not been uniform among physician specialties. As shown in table 2, the increases in premiums from 1980 to 1986 for the selected specialties in Southern California ranged from 16 to 337 percent.

**California: State Officials Believe Reforms
Have Helped to Moderate Increases in Claims
and Premiums**

**Table 2: Cost of Insurance^a for Selected
Specialties in Southern California, 1980
and 1986**

Specialty	1980	1986	Percent increase (1980-86)
General practice (no surgery)	\$3,674	\$4,260	16
Internal medicine (no surgery)	3,674	5,924	61
Pediatrics (no surgery)	2,042	7,524	268
Pathology	3,674	4,260	16
General practice (minor surgery)	3,674	10,024	173
Internal medicine (minor surgery)	3,674	5,924	61
Pediatrics (minor surgery)	2,042	7,524	268
Radiology	3,674	16,056	337
Psychiatry	2,042	4,260	109
Ophthalmology/ surgery	6,133	10,024	63
General surgery	15,182	28,576	88
Anesthesiology	15,182	20,492	35
Plastic surgery	13,437	28,576	113
Orthopedic surgery	17,869	33,632	88
Obstetrics/ gynecology	17,869	42,928	140
Neurosurgery	17,869	37,984	113

^aRates shown are those of The Doctors' Company for a \$1 million/\$3 million claims-made policy as of January 1 each year. A claims-made policy covers malpractice events that occur after the effective date of the coverage and for which claims are made during the policy period.

As shown in table 3, in Northern California the change in premiums from 1980 to 1986 ranged from a decrease of 27 percent for anesthesiology to an increase of 92 percent for obstetrics/ gynecology.

**California: State Officials Believe Reforms
Have Helped to Moderate Increases in Claims
and Premiums**

**Table 3: Cost of Insurance^a for Selected
Specialties in Northern California, 1980
and 1986**

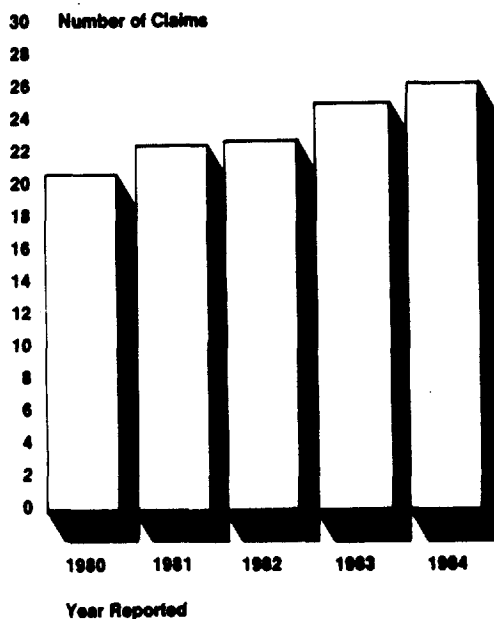
Specialty	1980	1986	Percent increase (1980-86)
General practice (no surgery)	\$4,200	\$7,340	75
Internal medicine (no surgery)	4,200	5,012	19
Pediatrics (no surgery)	3,056	5,012	64
Pathology	3,056	3,632	19
General practice (minor surgery)	4,200	7,340	75
Internal medicine (minor surgery)	4,200	5,012	19
Pediatrics (minor surgery)	3,056	5,012	64
Radiology	4,200	5,012	19
Psychiatry	2,008	3,632	81
Ophthalmology/ surgery	4,200	7,340	75
General surgery	12,740	22,096	73
Anesthesiology	19,212	14,064	(27)
Plastic surgery	12,740	22,096	73
Orthopedic surgery	23,272	33,348	43
Obstetrics/ gynecology	19,212	36,872	92
Neurosurgery	23,272	40,388	74

^aRates shown are those of NORCAL Mutual Insurance Company for a \$1 million/\$3 million claims-made policy as of January 1 each year.

Frequency of Claims

Combined data from Cooperative of American Physicians, The Doctors' Company, Physicians and Surgeons Underwriters Corporation, and NORCAL Mutual Insurance Company indicated that the frequency of claims against physicians increased slightly from 1980 to 1984. As shown in figure 1, the frequency of claims per 100 physicians increased by 27 percent from 20.4 in 1980 to 26.0 in 1984.

**Figure 1: Frequency of Claims per 100
Physicians, 1980-84**



There were wide variations in the frequency of claims filed per 100 physicians among the selected specialties. For example, as shown in table 4, from 1980 to 1984 the number of claims per 100 physicians in psychiatry increased 118 percent, while the number of claims against anesthesiologists remained the same.

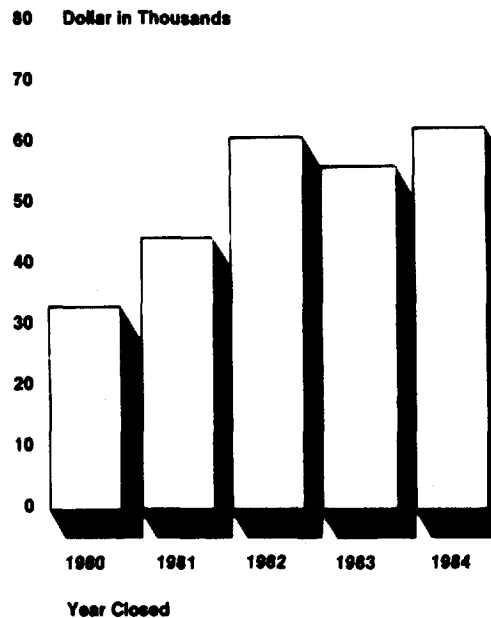
**Table 4: Frequency of Claims per 100
Physicians for Selected Specialties,
1980-84**

Specialty	1980	1981	1982	1983	1984	Percent Increase (1980-84)
Anesthesiology	20.1	19.3	17.5	20.7	20.1	0
General surgery	31.3	31.4	32.0	36.2	37.5	20
Neurosurgery	40.2	42.5	67.0	54.7	53.5	33
Plastic surgery	45.0	53.2	55.8	54.9	60.1	34
Orthopedic surgery	37.5	40.7	42.9	47.0	51.2	37
Ophthalmology/ surgery	12.6	15.1	12.4	18.4	18.0	43
Pathology	6.1	9.2	7.7	8.5	9.2	51
Obstetrics/ gynecology	33.9	41.7	44.1	49.6	51.1	51
Internal medicine	10.7	12.4	11.9	16.0	16.4	53
Pediatrics	8.1	11.3	11.4	11.1	13.4	65
Radiology	12.6	15.5	18.4	19.6	21.6	71
General practice	6.9	9.1	12.5	14.1	14.4	109
Psychiatry	3.8	6.9	6.1	7.8	8.3	118

Size of Awards/Settlements

As shown in figure 2, the average paid claim for the combined claims experience of the participating insurers of physicians in California increased from \$32,963 in 1980 to \$61,774 in 1984, an aggregate increase of 87 percent.

Figure 2: Average Paid Claim for
Physicians, 1980-84



As shown in table 5, the average payment per claim increased between 1980 and 1984 for the selected specialties included in our review. Because the number of physicians in any one specialty is relatively small, the base for spreading total claims paid is small. As a result, a few large claims paid in a given year for a given specialty could have a significant effect on the average paid claim for that specialty that year.

**Table 5: Average Paid Claim for
Selected Specialties, 1980 and 1984**

	1980	1984
All physicians	\$32,963	\$61,774
Specialty		
Orthopedic surgery	101,377	36,337
Ophthalmology/ surgery	49,700	22,816
Psychiatry	75,000	66,500
Radiology	30,630	29,276
Anesthesiology	62,567	70,925
Internal medicine	57,243	73,128
General practice	23,122	36,520
General surgery	54,471	90,582
Plastic surgery	23,236	41,216
Obstetrics/gynecology	50,973	92,628
Neurosurgery	41,667	91,619
Pediatrics	3,127	135,874
Pathology	1,324	71,250

Cost to Investigate and Defend Claims

Insurers' average cost to investigate and defend claims closed against physicians more than quadrupled from \$2,284 in 1980 to \$9,358 in 1984.

In 1980, 49 percent of the malpractice claims against California physicians closed by insurers participating in our study were closed with no expense to the insurers. By 1984, the percentage of claims closed with no expense had decreased to 40 percent, while the percentage of claims closed with indemnity increased from 15 percent to 24 percent. The percentage of claims closed with only the costs incurred to investigate and defend the claim was 36 percent in 1980, increased to 41 percent in 1982, and then decreased to 36 percent in 1983 and 1984.

Hospitals

Cost of Malpractice Insurance

As shown in table 6, the total estimated malpractice insurance costs for hospitals in California⁵ increased from \$75.4 million in 1983 to \$98.6 million in 1985— 31 percent.

⁵See GAO/HRD-87-21 p. 11, for methodology for obtaining and analyzing hospital cost data. See appendix III of this report for information on the number of California hospitals in the universe,

**California: State Officials Believe Reforms
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**Table 6: Estimated Hospital Malpractice
Insurance Costs by Type of
Expenditure, 1983-85**

Dollars in millions

Expenditure	1983	1984	1985	1983-85 increase ^a	
				Amount	Percent
Total	\$75.4	\$82.9	\$98.6	\$23.2	31
Contributions to self-insurance trust funds	5.6	7.3	12.1	6.5	116
Premiums for purchased insurance	67.3	72.2	83.0	15.7	23
Uninsured losses	2.5	3.5	3.4	.9	36

^aSampling errors for the amount and percentage of increase are not presented in appendix IV, but they are comparable to the errors for the estimated costs.

Note: Detail may not add to total due to independent estimation.

In 1985, 68 percent of the hospitals had malpractice insurance costs of less than \$500,000, but 8 percent had annual insurance costs of \$1 million or more, as shown in table 7. There were no hospitals in the state with annual insurance costs less than \$25,000.

Table 7: Estimated Distribution of Annual Malpractice Insurance Costs for Hospitals, 1983 and 1985

Annual costs	1983			1985		
	Number	Percent	Cum. percent	Number	Percent	Cum. percent
Less than 10,000	0	0	0	0	0	0
\$10,000 to \$24,999	0	0	0	0	0	0
\$25,000 to \$49,999	30	13.9	13.9	25	11.7	11.7
\$50,000 to \$99,999	19	8.7	22.6	10 ^a	4.4 ^a	16.1
\$100,000 to \$249,999	58	26.7	49.3	55	25.5	41.6
\$250,000 to \$499,999	64	29.6	78.9	58	26.7	68.3
\$500,000 to \$999,999	32	14.9	93.8	50	23.4	91.7
\$1 million or more	13	6.2	100.0	18	8.2	99.9 ^b
Total	216	100.0		216	99.9^b	

^aEstimates subject to relatively large sampling error and should be used with caution.

^bDetail does not add to 100 percent due to independent rounding.

Note: The total number of hospitals each year is based on the number of responding hospitals that provided the relevant data for that year.

As shown in table 8, both the estimated average malpractice insurance costs per day and annual per bed costs increased 37 percent from 1983 to 1985.

GAO's sample, and the survey response. Unless otherwise indicated, the estimates presented in this study are also included with sampling errors in tables IV.1 through IV.5.

**California: State Officials Believe Reforms
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**Table 8: Estimated Average Hospital
Malpractice Insurance Costs per
Inpatient Day and per Bed,^a 1983-85**

	1983	1984	1985	1983-85 increase ^b	
				Amount	Percent
Average malpractice cost per inpatient day	\$8.03	\$9.68	\$11.01	\$2.98	37
Average annual malpractice cost per bed	\$2,312	\$2,674	\$3,160	\$848	37

^aTo determine the average annual malpractice cost per bed, we computed the daily occupied bed rate (the total number of inpatient days divided by 365) and increased that number by one bed for every 2,000 outpatient visits (emergency room visits were counted as outpatient visits). This number was divided into the hospital's total annual malpractice insurance costs.

^bSampling errors for the amount and percentage of increase are not presented in appendix IV, but they are comparable to the errors for the estimated costs.

As shown in table 9, 65 percent of California hospitals had increases in inpatient day malpractice insurance costs of 10 to 99 percent from 1983 to 1985, while another 16 percent had increases of 100 percent or more.

**Table 9: Estimated Distribution of
Changes in Malpractice Insurance
Costs per Inpatient Day From 1983 to
1985**

Percentage change	Hospitals		
	Number	Percent	Cum. percent
Increases of less than 10 or all decreases	41	19.0	19.0
+10 to 49	93	42.9	61.9
+50 to 99	49	22.5	84.4
+100 to 199	20	9.3	93.7
+200 to 299	10 ^b	4.4 ^b	98.1
+300 or more	4 ^b	1.8 ^b	99.9 ^a
Total	217^a	99.9^a	

^aDoes not add to adjusted universe or 100 percent due to independent rounding.

^bEstimates subject to a relatively large sampling error and should be used with caution.

Note: The total number of hospitals is based on the number of responding hospitals that provided data for both 1983 and 1985 so that the percent change could be calculated.

**Malpractice Insurance Rates for
Hospitals**

The cost of medical malpractice insurance with the Farmers Insurance Group of Companies, California's largest hospital insurer, decreased each year from 1980 through 1984 but increased significantly in 1985 and 1986. More specifically, the annual average premium per occupied bed for an occurrence policy⁶ increased 78 percent, from \$836 in 1980 to \$1,485 in 1986. Table 10 shows the rates on a year-to-year basis.

⁶Under an occurrence policy, the insurance company is liable for any incidents that occurred during the period the policy was in force, regardless of when the claim may be filed.

**Table 10: Rates per Occupied Hospital
Bed^a for Primary Coverage, 1980-86**

1980	1981	1982	1983	1984	1985	1986
\$836	\$695	\$669	\$568	\$522	\$869	\$1,485

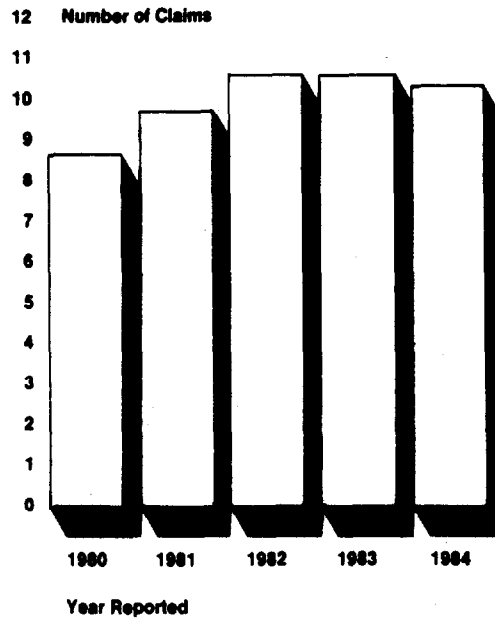
^aRates shown are those of the Farmers Insurance Group of Companies for an occurrence policy as of January 1 each year. The policies most hospitals purchased from this insurer include a \$5,200 per-occurrence deductible. The rates shown are for different limits of coverage since the per-occurrence coverage changed significantly over time. For example, the per-occurrence coverage increased from \$110,000 in 1980 to \$500,000 in 1986.

A Farmers Insurance Group of Companies official stated that rate decreases for 1981, 1982, 1983, and 1984 were due to excess premiums the company collected during the late 1970's. The excess monies were used to offset premiums charged from 1981 through 1984. Further, the Farmers Group had a contract with the California Hospital Association to provide insurance to Association members at an agreed-upon rate. In this respect, the Farmers Group established a member's reserve account for excess premiums to be used to dampen premium swings for member hospitals. The account had grown to \$41 million by 1981, and this enabled the company to offer premium reductions for the years 1981 through 1984. However, by the latter part of 1984, member reserves dropped sharply. This necessitated premium increases in 1985 and 1986. Also, in 1984 the California Hospital Association ended its contract with the Farmers Group.

Frequency of Claims

The combined claims experience for insurers of California's hospitals (The Farmers Insurance Group of Companies, the St. Paul Company, and the Association of California Hospital Districts) indicated that the frequency of claims reported per 100 occupied hospital beds increased 17 percent, from 8.6 claims in 1980 to 10.1 in 1984, as shown in figure 3.

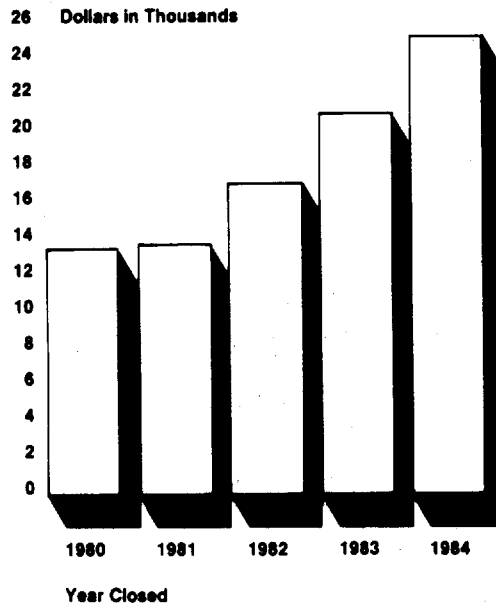
**Figure 3: Frequency of Claims per 100
Occupied Hospital Beds, 1980-84**



Size of Awards/Settlements

The average paid claim against California hospitals increased 91 percent, from \$13,025 in 1980 to \$24,874 in 1984, as shown in figure 4.

**Figure 4: Average Paid Claim for
Hospitals, 1980-84**



**Cost to Investigate and Defend
Claims**

The combined data of the California hospital insurers shows that the average cost to investigate and defend claims closed against hospitals increased from \$3,422 in 1980 to \$5,608 in 1984—64 percent.

In 1984, 30 percent of claims against California hospitals were closed with no expense to the companies, and 30 percent were closed with only the costs incurred to investigate and defend the claim.

**Major Medical
Malpractice
Problems—Current
and Future**

Major current or future malpractice problems in California identified by three or more of interest groups we surveyed⁷ related to the following:

- Cost of medical malpractice liability insurance.
- Size of awards/settlements for medical malpractice claims.
- Legal expenses/attorney fees for medical malpractice claims.
- Individual physician actions to reduce or prevent medical malpractice claims.

⁷Our methodology for obtaining the views of major interest groups and for analyzing their responses is described in GAO/IIRD-87-21, pp. 10-11. The specific interest groups for California are shown in appendix II of this report.

**Cost of Malpractice
Insurance**

Most physician organizations, the California Hospital Association, and malpractice insurers believed the high cost of basic and excess liability coverage for physicians is a major problem.

The Cooperative of American Physicians commented that higher malpractice insurance costs are due to increased numbers of claims filed and excessive malpractice verdicts. The Association of California Hospital Districts cited the unprofitability of the medical malpractice insurance business caused by excessive costs of claims. The California Society of Plastic Surgeons commented:

"... malpractice premiums approximate 20 to 25 [percent] of the average physician's net take home [pay]. Without relief the next 5 years will find this trend accelerating. This is true of excess liability insurance as well as basic and [tail coverage]. Hospitals will face the same problem, as will the insurance carriers."

An official of the California Hospital Association told us that hospitals were seeing a dramatic increase in the cost of excess malpractice insurance coverage over \$1 million.⁸

**Size of Awards and
Settlements for Malpractice
Claims**

Excessive malpractice awards/settlements in relation to economic costs arising from injuries are viewed by the physician group, the California Hospital Association, and malpractice insurers as a major problem that will continue over the next 5 years.

Officials of the California Hospital Association told us that they believe awards are based on emotion rather than on hard data on economic costs. They believed the legislative cap on pain and suffering should eliminate some of this.

The California Society of Plastic Surgeons said that "while obviously damaged individuals should be compensated, it seems inappropriate to make every injured person an instant millionaire."

Also, the Cooperative of American Physicians said "juries have become desensitized to the value of the dollar and find multimillion dollar verdicts common."

⁸We refer to the basic level of insurance liability coverage as primary and the coverage above the basic level as excess or above-primary coverage.

Legal Expenses and Attorney's Fees for Malpractice Claims

The physician group, California Hospital Association, and malpractice insurer group expressed the opinion that legal costs associated with defending malpractice claims are excessive. They believed this was a major problem that will also occur into the next 5 years. An official of The Doctors' Company said that about 45 percent of the amount paid on its claims was consumed by defense and claims handling costs.

The California Hospital Association stated that "when the costs of defending cases is equal to or greater than amounts paid to claimants, legal costs are far out of line with the intent of the judicial system."

The Association of California Hospital Districts commented "the system is inefficient with too small a percentage of the total dollar spent going to the injured party." An official of Professional Risk Management of California, Inc., believed an ominous trend exists in escalating legal costs, for both the plaintiff and the defendant. Officials from the California Hospital Association also said that costs to defend and to pursue claims are entirely too high compared to the amount paid to the injured party.

Incentives to Practice Defensive Medicine

California's physician group, hospital association, and malpractice insurer group stated that there are strong incentives for physicians to perform medically unnecessary tests or treatments to reduce their risk of liability. The California Society of Pathologists stated that "the malpractice crisis has caused physicians to practice defensive medicine and thereby increase the cost of health care."

The Farmers Insurance Group of Companies commented that physicians have strong incentives to practice defensive medicine. They said:

"... attorneys have advised physicians that they must protect themselves against allegations of misdiagnosis because of their failure to perform certain tests which were readily available."

The Physicians and Surgeons Underwriters Corporation commented that "the threat of legal action has caused M.D.s and hospitals to overreact in practicing defensive medicine."

An official of The Doctors' Company said:

"Defensive medicine is very real, but it is most difficult to quantify. The decisions of physicians regarding tests (not so much for treatments) is a conscious act of the doctor, resulting from a number of factors at work on his decision making process,

Medical Malpractice Insurers Requested to Provide Statistical Data for California

	Provided data for		Did not provide requested data
	Physicians	Hospitals	
Association of California Hospital Districts		X	
Cooperative of American Physicians	X		
The Farmers Insurance Group of Companies		X	
Medical Insurance Exchange of California			X
NORCAL Mutual Insurance Company	X		
Physician and Surgeons Underwriters Corporation	X		
Professional Risk Management of California, Inc.	X ^a	X ^a	
Southern California Physicians Insurance Exchange			X
St. Paul Fire and Marine Insurance Company		X	
The Doctors' Company	X		

^aData not included in our data base due to several missing data elements.

Organizations Receiving GAO Questionnaire for California

Completing questionnaire	Not completing questionnaire
Physician group:	
California Medical Association	California Psychiatric Association
California Society of Pathologists	California Association of Neurological Surgeons
California Radiological Society	California College of Surgeons (Northern and Southern Divisions)
District IX, American College of Obstetricians and Gynecologists	California Orthopedic Association
California Society of Plastic Surgeons	California Association of Ophthalmology
American Academy of Pediatrics, California District	
American College of Physicians, Northern California	
American College of Physicians, Southern California	
California Academy of Family Physicians	
California Society of Anesthesiology	
Hospital association:	
California Hospital Association	
Bar association:	
None	California Bar Association
Trial lawyers:	
California Trial Lawyers Association	
Malpractice insurers:	
The Farmers Insurance Group of Companies	St. Paul Fire and Marine Insurance Company
Physicians and Surgeons Underwriters Corporation	Southern California Physicians Insurance Exchange
The Doctors' Company	
Association of California Hospital Districts	
Cooperative of American Physicians	
NORCAL Mutual Insurance Company	
Medical Insurance Exchange of California	
Professional Risk Management of California, Inc.	
Insurance department:	
State of California, Department of Insurance	

Number of California Hospitals in the Universe, GAO Sample, and Survey Response

Number of hospitals		Hospitals completing questionnaire	
Universe ^a	Sample	Number	Percent
483	113	56	50

^a1983 data.

Estimated Hospital Data and Related Sampling Errors for Policy Years 1983, 1984, and 1985

Table IV.1: Hospital Malpractice Insurance Costs and Related Sampling Errors by Type of Expenditure

Dollars in millions

Expenditure	1983		1984		1985	
	Amount	Sampling error ^a	Amount	Sampling error ^a	Amount	Sampling error ^a
Total costs	\$75.4	\$9.2	\$82.9	\$11.2	\$98.6	\$13.8
Contributions to self-insurance trust funds	5.6	5.2	7.3	5.1	12.1	7.5
Premiums for purchased insurance	67.3	11.2	72.2	13.3	83.0	16.4
Uninsured losses	2.5	.8	3.5	1.6	3.4	1.4

^aSampling errors are stated at the 95-percent confidence level.

Note: Detail may not add to total due to independent estimation. The adjusted universe of hospitals to which the estimated amounts relate was 216 in 1983, 1984, and 1985. The adjusted universe is that portion of the total universe based on the sample response rate for which we can estimate data.

Table IV.2: Distribution of Annual Malpractice Insurance Costs and Related Sampling Errors for Hospitals

Figures in percents

Annual cost	1983		1985	
	Hospitals	Sampling error ^a	Hospitals	Sampling error ^a
Less than \$10,000	0	0.0	0	0.0
\$10,000 to \$24,999	0	0.0	0	0.0
\$25,000 to \$49,999	13.9	5.0	11.7	3.7
\$50,000 to \$99,999	8.7	7.3	4.4 ^b	5.0
\$100,000 to \$249,999	26.7	10.3	25.5	10.6
\$250,000 to \$499,999	29.6	10.0	26.7	10.8
\$500,000 to \$999,999	14.9	5.5	23.4	7.6
\$1 million or more	6.2	3.4	8.2	4.0

^aSampling errors are stated at the 95-percent confidence level.^bEstimate subject to a relatively large sampling error and should be used with caution.

Note: The adjusted universe of hospitals was 216 in 1983 and 1985.

Table IV.3: Average Malpractice Insurance Costs per Inpatient Day and Related Sampling Errors

1983		1984		1985	
Cost per day	Sampling error ^a	Cost per day	Sampling error ^a	Cost per day	Sampling error ^a
\$8.03	\$1.40	\$9.68	\$1.83	\$11.01	\$1.50

^aSampling errors are stated at the 95-percent confidence level.
Table IV.4: Average Annual Malpractice Insurance Costs per Bed and Related Sampling Errors

1983		1984		1985	
Cost per bed	Sampling error ^a	Cost per bed	Sampling error ^a	Cost per bed	Sampling error ^a
\$2,312	\$336	\$2,674	\$361	\$3,160	\$356

^aSampling errors are stated at the 95-percent confidence level.

Appendix IV
**Estimated Hospital Data and Related
Sampling Errors for Policy Years 1983, 1984,
and 1985**

**Table IV.5: Distribution of Changes in
Malpractice Insurance Costs per
Inpatient Day From 1983 to 1985 and
Related Sampling Errors**

Figures in percents

Changes	Hospitals	Sampling error^a
Increases of less than 10% or decreases	19.0	10.2
Increases of 10% to 49%	42.9	12.4
Increases of 50% to 99%	22.5	10.5
Increases of 100% to 199%	9.3	7.5
Increases of 200% to 299%	4.4 ^b	5.0
Increases of 300% or more	1.8 ^b	2.9

^aSampling errors are stated at the 95-percent confidence level.

^bEstimates subject to a relatively large sampling error and should be used with caution.

Note: The adjusted universe of hospitals was 216.

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