

THE SUBSTANTIAL  
BENEFITS OF USING  
BINDING ARBITRATION  
FOR  
CALIFORNIA'S HEALTHCARE  
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(Condensed version)

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# THE SUBSTANTIAL BENEFITS OF USING BINDING ARBITRATION FOR CALIFORNIA HEALTHCARE PROVIDERS

## **A. Introduction.**

In 1975, California was a state in crisis. Medical malpractice insurance rates were skyrocketing, and physicians were closing their practices and leaving the state *en masse*. The California State Legislature called upon experts in the fields of law, insurance, actuarial science, statistics and underwriting to solve the problem. After lengthy hearings and the consideration of substantial evidence and data provided by those experts, the Legislature passed a series of laws collectively referred to as the Medical Injury Compensation Reform Act (“MICRA”).<sup>1</sup> MICRA was designed to address the “claims side” of malpractice premiums. Thus, by capping non-economic damages, allowing for the admission of collateral sources and periodicizing of future damages, reducing plaintiffs’ attorneys’ fees, and having cases tried before arbitrators instead of juries, MICRA was designed to significantly reduce and stabilize indemnity and expense payments associated with medical malpractice actions.

Over 30 years later, there is overwhelming evidence to support the fact that MICRA works, and works effectively, in keeping malpractice insurance rates at reasonable levels.<sup>2</sup>

Although all of the various components of MICRA have had some part in stabilizing malpractice insurance rates, the authors and experts behind MICRA have been proven correct that binding arbitration would (and has) resulted in substantial reductions in indemnity and expense payments when compared with malpractice cases in the court system.<sup>3</sup> Indeed, as set forth in greater detail below, a properly administered healthcare arbitration system should result in a 50% or greater reduction in indemnity payments and as much as a 75% reduction in expenses when compared to the same/similar cases in the court system.

## **B. Arbitration Defined.**

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<sup>1</sup> MICRA is chiefly made up of five statutes: 1) Civil Code § 3333.1 (admission of “collateral sources” into evidence); 2) Civil Code § 3333.2 (\$250,000 limitation on non-economic losses); 3) Business and Professions Code § 6146 (limitation on plaintiff’s attorneys fees); 4) Code of Civil Procedure § 667.7 (periodicizing of payments); and 5) Code of Civil Procedure § 1295 (binding arbitration of medical malpractice claims). For further discussion of the MICRA laws, see Zuetel, *The Medical Injury Compensation Reform Act of 1975: Then and Now*, *International Journal of Cosmetic Surgery and Aesthetic Dermatology* (September 2003, Vol. 5, No. 2).

<sup>2</sup> See, e.g., [www.micra.org](http://www.micra.org) for an extensive listing of publications and links to resource materials on MICRA.

<sup>3</sup> See, e.g., the interview with CAP/MPT’s CEO, James Weidner, in “California’s MICRA Law Called A Medical-Liability Role Model,” *BestWeek*, October 28, 2002, Release 43, by John Hillman.

What is arbitration, and why is it so effective in reducing indemnity payments and defense costs?

Arbitration is an alternative to jury trials which has been recognized by the state and federal courts for well over a century. With arbitration, instead of the case meandering through the civil (jury) court system, it is diverted into the arbitration forum where it is decided by an arbitrator(s) selected by the parties. For all intents and purposes, arbitration is like a jury trial – except for two crucial differences:

First, instead of having the case heard before a jury of laypersons in a public setting, arbitration allows for a private hearing presided over by an arbitrator(s) (usually a retired judge) hand-picked by the parties.

Second, unlike a jury verdict, the award of an arbitrator essentially represents the final word on the dispute. This avoids the substantial costs and fees incurred by insurers who would otherwise be forced to appeal/defend an appeal of, a jury verdict.

Medical malpractice arbitration in California actually preceded the enactment of MICRA, and had been used effectively for nearly fifty years before MICRA came into being. The authors of MICRA and their actuaries were obviously so impressed with the benefits offered by arbitration, they created a special statute to codify its existence, California Code of Civil Procedure § 1295. That Section allows any healthcare provider which uses the language contained in the statute on his/its physician-patient forms, to require binding arbitration of all claims of medical malpractice (as well as related claims) by any patient who signs that form.

*C. Evidence of The Substantial Savings Occasioned by Arbitration.*

*i. Savings on Indemnity Payments from Arbitration.*

For obvious reasons, those healthcare providers and insurers shrewd enough to use arbitration to hold down indemnity payments, do not want their *secrets* revealed to the general public -- least arbitration be perceived as unfair to injured patients, and taken away through unfavorable legislation or court action. Notwithstanding this fact, several independent studies unequivocally confirm that a well-run arbitration program is vastly superior to the California jury system, and can significantly reduce overall indemnity payments which would otherwise be required if not for arbitration.

- In 2002, *The Public Citizen*, a public interest watchdog group headed by Ralph Nadar, concluded its investigation of the California healthcare arbitration system (here, Kaiser Healthplans) by noting that arbitration awards “tend to be a fraction of what juries award in comparable cases,” and that mean awards in Kaiser arbitrations were between 75% - 90% less than jury verdict awards in similar California medical malpractice cases. (“Arbitration Clauses in Insurance Contracts: The Urgent Need to Reform,” [www.Citizen.org](http://www.Citizen.org).) The report further

noted that median arbitration awards were between 50% - 80% less than those rendered by California juries.

In 2005, *The Public Citizen* essentially reiterated its 2002 findings in noting that medical malpractice “arbitration claimants receive only about 20 percent of the damages that they would have received in court,” and that many claimants are thus deterred from pursuing otherwise meritorious claims. (“Mandatory Arbitration Clauses: Undermining the Rights of Consumers, Employees and Small Businesses”).

- The numbers referenced in *The Public Citizen* were substantially verified by another expert in malpractice, who noted that awards in medical malpractice arbitrations throughout California are only 20% of value of those rendered by juries. D. Lawton, “Fair Shake? Arbitration Industry Has No Incentive to Reform a System that Serves it Well,” L. A. Daily Journal, July 24, 2002, page 6.
- Each year, the Medical Underwriters of California (“MUC”) compiles and analyzes \$1 million + jury verdicts, arbitration awards, and settlements throughout California, and publishes the results in its “Large Loss Survey.” In 2002, MUC noted a record 40 medical malpractice verdicts and settlements exceeding \$1 million. ([www.miec.com](http://www.miec.com)).

Significantly, 86% of all \$1 million + adjudications were the result of jury trials. Only 14% were the result of arbitrations.

Of equal significance is the fact that *jury verdicts were 340% larger than arbitration awards*. The average indemnity payment in arbitrated cases was \$1.446 million, whereas the average indemnity payment in the jury-tried matters was \$4.996 million.

The reasons for this disparity, according to MUC, include “[p]laintiff attorneys belief, corroborated by actual experience, that juries will award higher amounts” than can be obtained in settlement or arbitration.

Things have actually worsened since 2002<sup>4</sup> for those who continue to use juries to resolve their medical malpractice lawsuits.

Thus, in 2003, California experienced the second largest number of \$ 1 million + judgment/settlements in history, at 48.

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<sup>4</sup> Indeed, there has not been much joy since the start of the new millennium. According to Jury Verdict Research’s Current Award Trends in Personal Injury in the year 2000, the median jury award in medical malpractice cases was \$1,000,000 and the median jury settlement value was \$650,000 (April 23, 2001 *Medical Economics*). The median jury award for The Doctors Company (TDC) in 1998 – the most current figures TDC has chosen to make public -- was allegedly \$350,000 (*The Doctors Advocate*, 2d Quarter 2000, TDC Publications).

In 2005, one of the jury-related settlements was so high (\$395,000,000) that the authors of the report intentionally excluded it “as that would have skewed our 2005 numbers beyond recognition.” And, in just three years, average (indemnity) settlement payments increased from \$3,535,192 (in 2002) to \$4,315,103 (in 2005) – i.e., by over 22%. Interestingly, the number of jury trials during this time have actually *declined*. What has increased since 2002 is both the size, and number, of jury related settlements. MUC opined in its 2005 survey that this may well be as a result of “[f]ear of runaway jury verdicts and much higher defense costs of trying cases.”

What has not changed is the fact that arbitrations still result in far lower indemnity payments. Indeed, according to the 2005 study, arbitrations resulted in average payments of \$1,332,493, while jury trials resulted in average payments of \$3,264,997 – **nearly 2 ½ times higher!** And, as mentioned above, jury related settlements are higher still, at \$4,315,103 per case!

Sadly, there have been no positive changes since 2005. Indeed, in 2006, the total number of \$1 million + resolutions jumped over 25% from just the year previous. Average indemnity payments were the fourth highest in ten years. And jury verdicts were nearly 32% higher than arbitration awards. Indeed, million dollar plus jury verdicts averaged \$5,000,000, whereas arbitration awards averaged \$3,800,000.

- In CIGNA HealthCare of California’s (CHC of CA) 12 year plus experience with arbitration, the (mean) average indemnity payment per claim was \$35,829, and the average indemnity payment per *arbitrated* claim was \$16,937. Indeed, during the 1993-99 time period, CHC of CA conducted its own analysis of the arbitration program managed by Zuetel & Torigian. Its conclusion: during that six year time period, arbitration had saved it approximately \$46,000,000, representing the difference between the reserved value of the case, and the final outcome (via settlement or arbitration).
- In 2004, Zuetel started a medical malpractice insurance company called “Fairway Physicians Insurance Company, RRG” (Fairway), which currently insures nearly 1,000 physicians, medical practices and clinics, and various other healthcare providers throughout California. Fairway requires that all insureds use binding arbitration to resolve medical malpractice claims and is the first RRG to combine binding arbitration with MICRA as the cornerstone of its loss control program. In its first full year of operation (2005), Fairway wrote \$2.5 million worth of premiums, and was one of a small handful of physician start-ups throughout America which was backed by Lloyds of London. Most significantly -- and by using binding arbitration -- Fairway was able to show a loss ratio of 14.59% -- which is **less than half** the industry average of 35.34%. Not coincidentally, Fairway was the only RRG ranked in the top 20 California medical malpractice insurance companies in 2005. (See the 2005 California Department of Insurance Market Share Report at [www.insurance.ca.gov](http://www.insurance.ca.gov)).

**Conclusion: A well-run arbitration program can be expected to result in a greater than 50% reduction in indemnity payments as compared with those in the jury system.**

ii. **Savings on Legal Costs, Fees, and Related Expenses from Arbitration.**

The costs and expenses associated with the defense of medical malpractice claims have risen faster than the rate of inflation, and now represent over 50% of every dollar paid in the resolution of medical malpractice claims. (MUC 2005 study). Indeed, the well-respected insurance analysts at Conning Research & Consulting, Inc. (Conning) recently noted that

“Claim severity is increasing; numerous large judgments have gone against the industry. The medical industry has received a tremendous amount of attention (mostly negative in tone) from these judgments. The press has contributed to the public’s diminishing confidence in the quality of its health care services and increasing propensity to litigate. Litigation is the traditional means of resolving medical malpractice suits. Litigation is expensive, time-consuming, and stressful for all parties involved and, more often than not, involves a jury trial. A jury trial relies on lay individuals to make judgments about extremely difficult technical issues. One of the recurring outcomes of jury trials is a large settlement. Although usually reduced on appeal, the cost of litigation is significant. Therefore, arbitration and mediation no longer are luxury options, but are necessities to reduce expense and maintain relationships.” (emphasis added)

Conning, “Industry Insight...Medical Malpractice Insurance” (October 2002, Issue No. 5), p. 17.

Finally, on pages 18-21 of the Conning Report are a series of recommendations to the question: “What must insurers do?” Pages 17 and 19 note the following:

“[The] failure to enhance arbitration and mediation could result in increased litigation and settlement costs; loss cost and expense control are essential to improve the combined [loss] ratio. ... Another way to slow runaway litigation costs is through ADR (alternative dispute resolution). Insurance companies benefit in two ways: cost savings and customer service. Evidence indicates that arbitration is less expensive than litigation, and also has proven to be less disruptive to the insurer/insured relationship. Courts have continued to support the use of arbitration in medical malpractice liability claims settlements.” (emphasis added)

According to the United States Department of Health and Human Services, the medical malpractice insurance “crisis is a result of litigation excess...the most dramatic cost driver [of which] is the effect of the few cases that result in huge jury awards [and

which also] influence every settlement discussion as well.” USDHHS, *Update on the Medical Litigation Crisis: Not the Result of the ‘Insurance Cycle’*” (Sept. 25, 2002).

Arbitration results in much less costly resolutions.<sup>5</sup> It does so by eliminating most of the unnecessary proceedings, appearances and paperwork associated with jury trials and by punctuating the litigation process itself: both leading up to the trial and within the trial/arbitration proceeding itself.

These effects have led to significant cost savings for those insurers and healthcare providers who effectively employ arbitration to resolve their malpractice claims:

- CAP/MPT has boasted a 37% reduction in defense costs through arbitrating > 40% of its cases. [www.cap-mpt.com](http://www.cap-mpt.com). Therefore, a carrier should expect a reduction in defense costs exceeding 75% or more, should 80% + of all cases be placed in a well-administered arbitration program.
- \$180,000: The average cost in 2001-02 to try a jury trial, according to The Doctors Company (“Practicing Medicine May Be Dangerous to Your Livelihood,” TDC Publications 2002). Compare Zuetel’s 12 year + experience with CHC of CA (Exhibit “3”), which resulted in approximately \$52,000/claim being spent for costs in arbitrated matters.
- Fairway Physicians Insurance Company’s (arbitration related) costs resulted in a loss-ratio of 14.59%, well less than half the industry standard (35.34%) -- which industry predominantly uses juries to adjudicate claims. (See DOI 2005 Market Share Report).
- Finally, see the California Association of Health Plans’ study entitled *Settling Disputes Through Arbitration: A Superior Alternative to Court*, which notes that “the studies overwhelmingly support the claim that arbitration is less expensive and faster than court...[and] that arbitrators are less prone than juries to award huge damage settlement.” (Issues Brief, February 16, 2000, [www.calhealthplans.com](http://www.calhealthplans.com)).

**Conclusion: A well-run arbitration program can be expected to result in as much as a 75% reduction in defense costs as compared with those in the jury system.**

#### ***D. The Reasons Why Arbitration Has Beneficial Effects on Indemnity***

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<sup>5</sup> Since some of the biggest opponents of arbitration are defense attorneys, you cannot necessarily depend on them for recommending or enforcing arbitration on your behalf. Indeed, as noted by the authors of *Risk Management for the Practicing Physician*, “defense attorneys for you [physicians] and your insurance company have also seen a significant increase in their fees for each case as well. ... [and] are now accumulating fees and expenses of nearly \$100,000 for each case defended, successful or not. While they are paid to do their best job for you, they also have little incentive to change the system or to come to a quicker or alternative dispute resolution [i.e., arbitration] for you.” C. Mandell, et al, *Ibid*, pp. 11; 17 (Guardian Publishing 2004) (emphasis added).

### ***Payments.***

The Arbitrator's sophistication/conservatism acts to limit value of sympathy, plaintiffs' lawyer "tricks," and prejudice against foreign trained physicians/doctors with language difficulties, etc.

- There are few, if any run-away verdicts in arbitration, and the cases are evaluated "on the numbers" as opposed to based on sympathy or prejudice.
- "Technical defenses" (e.g., causation, statute of limitations) are honored in arbitration, as are dispositive motions (e.g., summary judgment; dismissals) – but are usually rejected in court with the attitude: "let the jury decide" -- and the likelihood the court of appeal reverses most summary judgments in any event.
- "Tag-along" defendants need pay nothing in arbitration, but often pay a high price in litigation expenses and indemnity payments in the jury context.
- Multi-party defendants before a jury often pay a disproportionate share of the outcome; arbitration prevents this by extricating the insured from "the fray."
- Arbitration leads to predictable results before *tried and true* arbitrators; if there is an unfavorable verdict, they focus on the *true* value of the case as opposed to the *emotional* value (as focused on by juries).
- Settlements take into account the arbitration factor. Accordingly, indemnity payments in arbitration are significantly less than with juries.

### ***E. The Reasons Why Arbitration Has Beneficial Effects on Litigation Costs.***

Arbitrations are 1/2 to 1/3 the length of the same jury-tried case, and it is usually quicker to an arbitration hearing than to a jury trial.

- Arbitration results are final - no hefty appellate expenses (e.g., bonds, interest payments, appellate counsel fees); defense counsel's argument that appeal is a right not to be relinquished, is manifestly self-serving since 75% of all judgments are upheld on appeal. It is important to "do it right" the first time – i.e., at the arbitration hearing.
- There are no unnecessary costs (e.g., jury fees, meals for jurors, superior court reporters, filing fees, etc.) with arbitration.
- There are no unnecessary court appearances (e.g., status conferences, issues conferences, MSCs, TSCs, court-ordered mediations, etc.) with arbitration.

- There are no “false starts” in arbitration, but many in the court system.<sup>6</sup>

#### ***F. Use of Arbitration By California Medical Malpractice Insurance Companies***

Some opponents of arbitration – unable to counter the above-established evidence – quip that if arbitration is such a good thing, why don’t more insurers use it?

They do.

In fact, nearly all California HMOs (representing >40% of all California patients) use some form of binding arbitration against claims of malpractice, and CAP/MPT uses it in a substantial number of its cases.

The Doctor’s Company: “Despite the statements of the U.S. Supreme Court that **the law favors arbitration** and numerous state court decisions upholding arbitration statutes, the trial lawyers continue their nationwide assault on **this cost-effective and timely means of resolving disputes.**” (Jim Cathcart, Vice President, Governmental Relations, TDC, Legislative Report, Third Quarter 2000, *Liability Roundup*); “Pre-dispute binding arbitration is a mechanism that has proven to be **an effective non-judicial means of resolving disputes.**” (2/6/02 Letter to President Bush Regarding Patients’ Bill of Rights Legislation by Manuel S. Puebla, President, TDC).

SCPIE: In mid-2005, SCPIE launched the SCPIE Solo program, which is economically designed for newer physicians/maxillofacial surgeons and uses arbitration as one of its cornerstones for cost containment and corresponding lower premiums.

The one exception appears to be NORCAL, which has apparently bought into its defense attorneys’ representations that they can get better results with juries. Strangely, NORCAL requires as a prerequisite for coverage that any claims **against it** by its insured physicians, medical groups and hospitals, must be submitted to binding arbitration! (*See www.norcalmutual.com/coverages*, on-line sample policies by NORCAL, Part V, page 34, ¶ C). NORCAL obviously believes there are significant benefits to arbitration; apparently, it just does not want to share them with its insureds.

#### ***G. Conclusion – Caution.***

Arbitration, properly administered, can result in a significant reduction in indemnity payments and litigation costs. However, since it significantly reduces the

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<sup>6</sup> Although *physician satisfaction* with arbitration is beyond the scope of this paper, researchers Elizabeth Rolph, Erik Moller and John E. Rolph found a 96% satisfaction rate by physicians who use arbitration -- especially those with actual arbitration experience. “Arbitration Agreements in Health Care: Myths and Reality,” 60 Law & Contemp. Probs. 153 (Winter 1997) (Duke University School of Law). Their exhaustive study also reaffirmed the fact that arbitration is more efficient and less cumbersome than jury trials, as well as being cheaper, faster, and more predictable.

attorneys fees which defense counsel would otherwise earn had the case proceeded to a jury forum, some of the biggest opponents of arbitration are actually *defense* counsel. Moreover, since arbitration calls upon special expertise, most lawyers (defense counsel included) do not feel comfortable with it.

It is therefore crucial that only attorneys who possess the requisite expertise in arbitration – and who also believe in its cost-cutting aspects – be used to administer a healthcare arbitration program.

## DISTINCTIVES BETWEEN JURY TRIAL/ARBTRATION

	<u>LAWSUIT</u>	<u>PROCEEDINGS</u>	<u>DISCOVERY</u>	<u>TRIAL</u>
<u>JURY</u>	<ol style="list-style-type: none"> <li>1. File lawsuit – expenses of service on Parties and filing with Court</li> <li>2. File Answer               <ol style="list-style-type: none"> <li>a) Demurrers – rarely granted, merely educate opponent; costly</li> </ol> </li> <li>3. Misc. Motions               <ol style="list-style-type: none"> <li>a) Change of Venue</li> <li>b) Motions to Strike</li> </ol> </li> <li>4. If co-defendant, respond/attend their motions, demurrers, etc.</li> </ol>	<ol style="list-style-type: none"> <li>1. Status Conference</li> <li>2. Follow-up Status Conferences</li> <li>3. Trial Setting Conference</li> <li>4. Final Status Conference</li> <li>5. Issues Conference</li> <li>6. MSJs</li> <li>7. Judgment on Pleadings</li> <li>8. Exhibit Conference</li> <li>9. Misc. Conferences/court appearances</li> <li>10. Dispositive motions almost never granted</li> </ol>	<ol style="list-style-type: none"> <li>1. Frequent Motions and problems</li> </ol>	<ol style="list-style-type: none"> <li>1. Many false starts</li> <li>2. Prepare Jury Instructions</li> <li>3. Prepare Voir Dire Questions</li> <li>4. Select Jury</li> <li>5. Trial – 3 x longer than arbitration; moves slowly, accommodate jury</li> <li>6. Doctor attends <u>public</u> proceedings beginning to end</li> <li>7. Jury fees</li> <li>8. Court Reporter Fees</li> <li>9. Appeal – double the attorneys fees</li> </ol>
<u>ARBITRATION</u>	<ol style="list-style-type: none"> <li>1. No Demurrer or Answer – mere Demand/confidential acknowledgment letter satisfactory</li> <li>2. Not necessary</li> <li>3. Arbitration separate proceeding – no need to attend court proceeding</li> <li>4. N/A</li> </ol>	<ol style="list-style-type: none"> <li>1-7 No need for any of these; if doctor wants MSJ/Motion to dismiss, he can so move</li> <li>8-9 N/A</li> <li>10. Dispositive motions (e.g., MSJs) frequently granted</li> </ol>	<ol style="list-style-type: none"> <li>1. Virtually no motions or problems since arbitrator decides entire matter</li> </ol>	<ol style="list-style-type: none"> <li>1. No false starts</li> <li>2-4 N/A</li> <li>5. Arbitration is in <u>private</u>, lasts about 1/3 as long as similar jury trial – streamlined proceedings</li> <li>6. Doctor present only for his testimony – minimal disruption in his practice</li> <li>7-8 N/A; Arbitrator’s fees split equally between parties</li> <li>9. Arbitration essentially ends all further proceedings</li> </ol>