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SUPERIOR COURT OF CALIFORNIA, COUNTY OF STANISLAUS

HOLLY STINNETT,  
Plaintiff,

v.

TONY Y. TAM, M.D., MODESTO  
SURGICAL CENTER, et al.

Defendants..

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CASE NO. 384025

DECLARATION OF JAY ANGOFF IN  
OPPOSITION TO DEFENDANTS'  
MOTION TO REDUCE NON-  
ECONOMIC DAMAGES

I, JAY ANGOFF, do hereby declare:

**A. Introduction**

1. My name is Jay Angoff and I am a lawyer in Jefferson City, MO. I served as Director of the Missouri Department of Insurance between 1993 and 1998, having been appointed by Governor Mel Carnahan in February 1993. As Missouri Insurance Director I was responsible for the enforcement of the Missouri laws relating to the approximately 1,800 insurance companies and 77,000 insurance agents licensed in Missouri. Prior to serving as Missouri Director I served as Deputy Commissioner of the New Jersey Department of Insurance, having been appointed by Governor Jim Florio in March 1990.

I also served as Special Assistant for Health Insurance Policy to Governor Florio. In addition, I have served as Director of the Private Health Insurance Group at the U.S. Health Care Financing Administration; as vice-president for strategic planning at Quotesmith.com, an internet insurance quotation service and broker; and as counsel to the National Insurance Consumer Organization, a public interest educational and advocacy organization. I have been involved with the insurance industry and its regulation for more than 20 years.

2. I have been particularly heavily involved with the medical malpractice insurance industry. As Missouri Insurance Director, I supervised the analysis contained in the Department's annual report on medical malpractice insurance, and implemented new sections of that report. Since 2002 I have personally collected and compiled medical malpractice insurance data from the Annual Statements insurance companies file with state insurance departments and the National Association of Insurance Commissioners (NAIC). Since 2002 I have also been analyzing malpractice insurers' rate filings. I have testified on medical malpractice insurance in Congress and before a majority of state legislatures, and I have participated in hearings on medical malpractice rates both in state legislatures and at state insurance departments. I have also written about medical malpractice insurance for both popular and legal publications.

3. I am also familiar with California insurance law. I am a co-author of Proposition 103, the insurance reform initiative enacted by the voters in 1988. I have represented and continue to represent plaintiffs in matters challenging the use of certain rating factors in

violation of Proposition 103. One such case is *Landers v. Interinsurance Exchange of the Automobile Club of Southern California*, L.A. Superior Court Case No. BC281759, in which plaintiff alleged that the Auto Club had been unlawfully surcharging its policyholders who had had a gap in insurance coverage. As a result of the settlement in that case, 120,000 policyholders each received refunds of approximately \$187 each. Another case challenging a similar surcharge is *Proposition 103 Enforcement Project v. GEICO*, L.A. Superior Court Case No. BC266218, as a result of which policyholders received refunds and GEICO changed its practices. A similar case against Safeco Insurance Co. is also pending in Los Angeles Superior Court. I was also involved this year in challenging the acquisition of SCPIE, California's largest malpractice insurer, by The Doctors Company, the state's largest malpractice carrier.

4. Counsel for plaintiff has asked me to undertake three tasks: first, to discuss the differences, if any, between the condition of the California medical malpractice market today and the condition of that market when MICRA was enacted; second, to determine whether California malpractice insurers would be able to earn an adequate profit at their current rates if the MICRA cap on non-economic damages were increased or eliminated; and third, to determine whether malpractice carriers have been able to succeed and prosper in states which have not enacted any limits on non-economic damages. This affidavit discusses each of those issues in turn.

**B. The California malpractice market today vs. the market when MICRA was enacted**

5. Courts commenting on MICRA in the past have noted that when MICRA was enacted malpractice rates were increasing, very few firms were writing malpractice coverage, malpractice insurance claims payments were increasing, and malpractice insurers were losing money. See, e.g., Fein v. Permanente Medical Group, 38 Cal. 3d 137, 158 (1986); Fein v. Permanente Medical Group, 175 Cal. Rptr. 177, 186 (1981) ("Indicia of the problem included significantly increasing numbers of suits against health care providers and increasing settlements and awards in those suits, projected losses related to malpractice insurance, a decrease in the number of companies willing to provide malpractice insurance, and skyrocketing costs of such insurance").

Today, in contrast, malpractice insurance rates are declining; dozens of both traditional and non-traditional malpractice insurers are writing coverage; new carriers are entering the industry; claims payments are decreasing; and malpractice insurance profits have been excessive for at least a decade.

6. This section of this statement will first discuss the financial condition of California medical malpractice insurers as set forth in the annual financial statements ("Annual Statements") they file with the California Department of Insurance ("CDI"). In particular, it will review the carriers' loss ratios--the ratio between their projected claims payments and their earned premiums; their reserves--the amount they have set aside to pay future claims; and their surplus--the extra cushion they hold in addition to the amount they have set aside to pay claims.

7. This section of this statement will also review what the leading California malpractice insurers have said about today's malpractice insurance market. It will draw on statements made by and on behalf of The Doctors Company ("TDC"), the largest California medical malpractice carrier, in connection with its recent acquisition of SCPIE Indemnity Company ("SCPIE"), the third largest California malpractice carrier; statements by the leading carriers contained in the narrative section they file with their Annual Statements, called the Management Discussion & Analysis ("MD&A"); the Annual Report SCPIE, which is a public company, has filed with the Securities and Exchange Commission; and other data filed and statements made by other malpractice carriers.

#### The Financial Condition of the Malpractice Insurance Market Based on Annual Statement Data

##### Loss ratio data

8. Malpractice insurers, like other property/casualty insurers, use the loss ratio as the fundamental measure of an insurer's performance. The loss ratio is the ratio of an insurer's projected claims payments--known in the industry as "incurred losses"--to its earned premiums. All other things equal, the lower the loss ratio, the more profitable the insurer. As a very rough rule of thumb, if a malpractice insurer's loss ratio is between 65 and 70 and its loss projections are reasonably accurate and it is reasonably efficient, the insurer is earning a profit that is neither excessive nor inadequate, and is thus complying with the statutory standard requiring rates to be neither excessive nor inadequate. See Cal. Ins. Code sec. 1861.05(a). According to the CDI's rate-making regulations, a rate is excessive if it produces a return exceeding 6% plus the average return on short, intermediate and long-term US government bonds. 10 Cal. Code Regs. secs. 2644.16(a),

2644.20(d). An incurred loss ratio much above 70 means the insurer is likely earning an inadequate profit; a ratio much below 65 means its profit is likely excessive. Each year the CDI compiles the earned premiums and incurred losses of all licensed medical malpractice carriers in California, and publishes that data in its annual Market Share Report. Those reports are available at the CDI's website, [www.insurance.ca.gov](http://www.insurance.ca.gov). Those reports reveal that the loss ratios for the licensed California medical malpractice industry for each of the last ten years have been as follows:

**Figure 1**

**Loss Ratios: All Licensed California Medical Malpractice Carriers, 1998-2007**

<b>Year:</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
<b>Loss Ratio:</b>	<b>35.7</b>	<b>41.3</b>	<b>38.1</b>	<b>57.2</b>	<b>50.9</b>	<b>47.6</b>	<b>39.8</b>	<b>35.3</b>	<b>30.7</b>	<b>30.0.</b>

With the arguable exception of the 57.2 loss ratio in 2001, these loss ratios all produce rates which are presumptively excessive.

9. The trend in the California medical malpractice loss ratio since 2001 is particularly noteworthy: from a loss ratio in 2001 of 57.1--already a highly profitable loss ratio--the loss ratio declined each year, hitting an all-time low in 2007 of 30.0. That 30.0 loss ratio means that in 2007 California medical malpractice insurers projected they would pay out in claims only 30 cents for each dollar they earned in premium, thus leaving 70 cents of each premium dollar available for general overhead, defense lawyers fees, agents commissions, and profit. That profit is in addition to the profit provided by the income they earn on their investments.

10. Three carriers--TDC, SCPIE, and Norcal Mutual Insurance Company ("Norcal")-- have accounted for at least 61% and as much as 74% of all medical malpractice insurance written by licensed California malpractice carriers in each of the last ten years. The following table sets forth their loss ratios, along with the loss ratio of the licensed California medical malpractice market as a whole, in each of those years.

**Figure 2**

**Norcal, SCPIE, TDC and all Cal. Loss Ratios, 1998-2007**

<u>Year</u>	<u>Norcal</u>	<u>SCPIE</u>	<u>TDC</u>	<u>Cal.</u>
1998	36.7	11.1	44.9	35.7
1999	30.2	43.8	26.8	41.3
2000	45.7	26.1	30.3	38.1
2001	57.0	53.1	30.1	57.2
2002	39.6	43.1	54.9	50.9
2003	45.3	37.2	50.9	47.6
2004	42.9	36.0	36.3	39.8
2005	32.1	27.1	41.5	35.3
2006	25.2	28.6	28.9	30.7
2007	28.4	32.9	31.1	30.0

Source: Cal. DOI Market Share Reports, 1998-2007.

The loss ratios of the three leading California medical malpractice carriers are thus representative of the loss ratios of the industry as a whole. I have compiled additional data from the Annual Statements of those carriers. That data is also fairly representative of the performance of the California malpractice insurance industry as a whole.

Reserves

11. Among the data I have compiled are data on the reserving practices of Norcal, TDC and SCPIE. An insurer's reserves are the amount it has set aside to make future claims payments. Because only after nine years have elapsed will substantially all claims that

arose in a given year have been paid, an insurer can not know whether its initial estimate of its ultimate liabilities for claims arising in a given year is accurate until nine years after that year. Accordingly, in their Annual Statements insurers disclose the initial estimate they make of their ultimate liabilities for claims arising in the year nine years before the Annual Statement year, and also their current estimate of those liabilities, which is substantially equivalent to their true ultimate liability. They disclose this data, on a countrywide basis only, in Schedule P, Part 2 of the Annual Statement. For TDC, therefore, which writes in all states and writes only about one-third of its business in California, one can not fairly draw conclusions about its California business based on Schedule P data. Norcal and SCPIE, however, have always written substantially all of their business in California. Their Schedule P data therefore does enable us to see how accurate their estimates of their California malpractice claims payments have proved to be.

12. Figure 3 compares the amount that Norcal initially estimated it would pay out for claims arising in each of the ten most recent years for which its true ultimate liabilities are known with the amount it actually paid out for claims arising in that year.

### Figure 3

#### Norcal

#### Initial Incurred Loss Estimates v. Incurred Losses Reported After 9 Years, 10 Most Recent Years (\$000's omitted)

<u>Year</u> <u>Claims</u> <u>Arise</u>	<u>Initial Estimate</u> <u>of Incurred Loss</u> <u>For Year</u>	<u>Reported</u> <u>Incurred Loss 9</u> <u>Years Later for</u> <u>Year</u>	<u>Difference in</u> <u>Dollars</u>	<u>Difference in</u> <u>Percentage</u>
1989	75,886	39,919	-35,967	-47.4
1990	88,510	52,405	-36,105	-40.8
1991	91,228	56,533	-34,695	-38.0
1992	95,195	66,885	-28,310	-29.7
1993	104,228	77,947	-26,281	-25.2
1994	116,137	81,129	-35,008	-30.1
1995	130,594	88,810	-41,784	-32.0
1996	158,889	111,869	-47,020	-29.6
1997	154,304	102,257	-52,047	-33.7
1998	157,383	123,880	-33,503	-21.3
<b>Totals</b>	<b>1,172,354</b>	<b>801,634</b>	<b>-370,720</b>	<b>-31.6</b>

Source: 1998-2007 Annual Statements, Part 2--Summary.

As the table indicates, Norcal has consistently and substantially over-reserved: for the most recent ten years for which its true ultimate liabilities are known, it actually paid out 31.6% less than it initially estimated it would pay out. (Said another way, Norcal initially reserved 46.2% more than it ultimately ended up paying out.) Because rates are based on the amount the insurer estimates it will pay out, not on the amount it has actually paid out, the fact that Norcal's estimates of the amount it would ultimately pay out have consistently been far higher than its actual payouts is an indication that its rates have consistently been excessive.

13. Similarly, for claims arising in the ten most recent years for which substantially all claims have been paid, SCPIE has also consistently and substantially over-reserved. Specifically, as Figure 4 indicates, for claims arising during that 10-year period SCPIE ended up paying out 29.6% less than it initially projected it would pay out. Put another way, SCPIE initially projected it would pay out 42.1% more than it ultimately paid out. As with Norcal, the fact that SCPIE's estimates of the amount it would ultimately pay out have consistently been far higher than its actual payouts is an indication that its rates have consistently been excessive.

**Figure 4**

**SCPIE  
Initial Incurred Loss Estimates vs. Incurred Losses Reported After 9 Years,  
10 Most Recent Years  
(\$000's omitted)**

<b>Year</b>	<b>Initial Estimates of Incurred Loss For Year</b>	<b>Reported Incurred Loss 9 Years Later for Year</b>	<b>Difference in Dollars</b>	<b>Difference in Percentage</b>
1989	122,679	72,317	-50,362	-41.1%
1990	118,157	75,350	-42,807	-36.2%
1991	117,981	90,345	-27,636	-23.4%
1992	131,059	89,251	-41,808	-31.9%
1993	134,700	96,047	-38,653	-28.7%
1994	136,749	91,938	-44,811	-32.8%
1995	140,962	81,782	-59,180	-42.0%
1996	130,573	94,431	-36,142	-27.7%
1997	111,354	79,602	-30,752	-27.9%
1998	146,152	137,269*	-8,318	-5.7
<b>Totals:</b>	<b>1,290,366</b>	<b>908,332</b>	<b>-382,034</b>	<b>-29.6%</b>

\* The relatively higher ultimate liabilities for accident year 1998 are due to reinsurance and other non-California claims payments

Source: 1998-2007 Annual Statements, Part 2--Summary.

## Surplus

14. I have also compiled data on the surplus of the three leading California malpractice insurers. The surplus of an insurance company is the amount it holds over and above the amount it has reserved to make its estimated future claims payments. There are two main sources of surplus funds: profits the company declines to distribute to its owners--its policyholders in a mutual company, its stockholders in a stock company--and funds that are transferred from reserves to surplus because the company has paid out less in claims than it has reserved for such claims. Because the three leading California malpractice carriers' profits have been excessive and because they have routinely reserved far more than they have actually paid out, their surplus has soared during the last five years.

15. The purpose of surplus is to ensure that the company will be able to pay claims even if the amount it has reserved to pay them proves to be too low. Accordingly, the National Association of Insurance Commissioners ("NAIC") has established a formula, based on the risk assumed by the insurer and the quality of the assets it holds, that produces a minimum required surplus for each insurer: if a company's surplus falls below that level, then the state insurance department is required to put the company into rehabilitation. This level of surplus is called the authorized control level, or ACL surplus level. As a practical matter, insurers must hold at least 200% of ACL, since if an insurer's surplus falls below 200% of ACL it must file a plan with the state insurance department setting forth how it plans to attain the 200% of ACL level. Typically, insurers hold surplus equaling substantially more than 200% of ACL. The ratio between the insurer's actual surplus and its ACL level surplus is called the risk-based capital ratio, or RBC ratio.

16. An insurer may need an unusually large surplus if it routinely under-reserves, since in that case it may need to invade its surplus to pay claims. The leading California malpractice carriers, in contrast, have historically over-reserved, not under-reserved, as explained in paragraphs 11-13; we would therefore expect them to hold lower-than-average amounts of surplus. In fact, however, they each hold substantially larger surpluses, and have substantially higher RBC ratios—the ratio between the insurer’s actual surplus and its ACL surplus--than do all comparably-sized malpractice insurers except Medical Protective, which is the fifth largest malpractice carrier in California. Moreover, TDC holds more surplus than any other insurer writing exclusively malpractice coverage in the nation, and has by far the highest RBC ratio of all such comparably-sized carriers.

17. Notably, both the surpluses and RBC ratios of Norcal, SCPIE and TDC reached all-time highs in 2007, as Figure 5 indicates.

**Figure 5**

**Norcal, SCPIE, TDC: Actual Surplus v. Minimum Required Surplus (“MRS”),  
2003-2007  
(in \$millions)**

	<u>Norcal</u>			<u>SCPIE</u>			<u>TDC</u>		
	<u>Actual Surplus</u>	<u>MRS</u>	<u>Actual ÷ MRS</u>	<u>Actual</u>	<u>MRS</u>	<u>Actual ÷ MRS</u>	<u>Actual</u>	<u>MRS</u>	<u>Actual ÷ MRS</u>
2003	246.0	58.3	422%	140.2	46.3	303%	350.2	81.1	432%
2004	309.1	60.0	515%	136.5	38.0	359%	405.6	81.0	501%
2005	336.7	58.5	576%	145.6	29.9	487%	503.2	69.1	728%
2006	398.0	57.6	691%	164.4	24.1	682%	656.0	70.3	933%
2007	441.4	52.3	844%	195.8	21.0	932%	804.2	69.6	1144%

Source: 2007 Annual Statements, Five Year Historical Data Pages.

As the table indicates, SCPIE, TDC and Norcal increased their surpluses by 40%, 80%, and 130%, respectively, during the last five years. Moreover, the ratio between Norcal's actual surplus and its minimum required surplus--its RBC ratio--doubled, TDC's more than doubled, and SCPIE's tripled. These surplus levels are perhaps the best evidence of how flush the California medical malpractice industry is today.

18. Due to its excessive profits and as indicated by figure 3, supra, its redundant reserves, the surplus of TDC rose to such a high level in 2007--more than \$800 million--that it could afford to use almost \$300 million of that surplus to buy SCPIE and still maintain a high RBC ratio. Some of the disclosures made by TDC and SCPIE in connection with that acquisition are referred to in the next section.

### The Financial Condition of the California Malpractice Insurance Market According to California Malpractice Insurers

#### Competition

19. The malpractice insurance industry itself today acknowledges how healthy and competitive it is, both nationally and in California. An economic consulting firm retained by TDC and SCPIE, for example, recently told the CDI and the California Attorney-General that its analysis "showed that the medical malpractice industry nationwide is intensely competitive," with "strong, healthy competitors, and growing competition from new and expanding companies." Guerin-Calvert and Orszag, Economic Analysis of the Proposed Acquisition of SCPIE Holdings, Inc. by The Doctors Company, Apr. 28, 2008, at 3 (hereinafter "TDC-SCPIE Economic Analysis").

Regarding the California malpractice market in particular, the TDC-SCPIE analysis emphasized the following:

Public data from A.M. Best identifies a very large number of competitors for medical malpractice insurance products....These include large national firms like Medical Protective or MedPro (which is owned by Berkshire Hathaway) and specialty insurance companies with operations in California, such as Norcal and MIEC. These principal competitors are financially strong and in many cases growing.

TDC-SCPIE Economic Analysis at 3. The TDC-SCPIE analysis further emphasized that “the industry in California is extremely competitive with sophisticated national companies....” Id. at 8. It concluded that “physicians can choose from many credible alternatives,” and that “[a] combined TDC-SCPIE faces significant pressure from expanding local and national players and the risk of losing customers were they to fail to offer competitive services and rates.” Id. at 3, 8-9.

20. In its 2007 MD&A SCPIE also emphasized the intense competition in the California medical malpractice market today. It stated as follows:

The Company competes with numerous insurance companies in the California market. The Company’s principal competitors for physicians and medical groups in California consist of three physician-owned mutual or reciprocal insurance companies, several commercial companies and a physicians’ mutual protection trust, which levies assessments primarily on a “claims paid” basis. In addition, commercial insurance companies compete for the medical malpractice insurance business of larger medical groups and other healthcare providers.

SCPIE 2007 MD&A at 6.

#### Ease of entry

21. TDC and SCPIE have further emphasized that the California malpractice industry is even more competitive than the number of firms currently in the California market would

indicate because entering the market is so easy. They also note that recently many firms have in fact entered the market or have substantially expanded. They explain as follows:

“[A] number of large national insurance companies operate all across the country. While some have operations in California, others do not. These companies face low barriers to entry if they seek to expand their operations into California and are therefore able to quickly and effectively enter new markets. To compete in a new state, these competitors must only obtain a license there....

“Indeed, California is particularly conducive to entry and expansion. The attractiveness of the state for entry and expansion of these competitors can readily be ascertained by the large number of individual competitors and recent examples....

TDC-SCPIE Economic Analysis at 7.

22. The examples TDC and SCPIE cite of recent new entry and expansion in the California malpractice insurance market include the following:

\* General Star National Insurance Company filed a new program for standard physicians and surgeons on October 30, 2007. It was approved with an effective date of January 1, 2008. Prior to this, General Star marketed a niche product to hard-to-place physicians.

\* Fairway Physicians Insurance Company RRG now underwrites standard and nonstandard physicians and surgeons and selected classes of healthcare facilities.

\* Premier Physicians Insurance Company RRG has started to provide medical malpractice coverage in California in the last few months. the program is open to all physician classes and is backed by Lloyd’s of London.

\* Physicians Risk Retention Group, LLC was licensed in December 2007 to provide professional liability to physician members of Physician Associates of Greater San Gabriel Valley.

\* MedPro appears to have become more aggressive in the standard market in recent months.”

TDC-SCPIE Economic Analysis at 7.

#### Decreasing claims

23. TDC and SCPIE and many other carriers have noted that malpractice claims are decreasing. In its 2006 Annual Report, for example, SCPIE notes that its claim frequency has declined by 36.5% over the past four years, which it characterizes as a "marked decline." SCPIE 2006 Annual Report, at 4, 14. In that same Annual Report it notes that its total projected losses plus loss adjustment expenses—defense lawyers fees—declined for the third straight year, *Id.*, and in its 2007 MD&A it notes that this decline continued in 2007. SCPIE 2007 MD&A at 3. Similarly, TDC’s 2006 MD&A includes the following chart setting forth claims per 100 doctors:

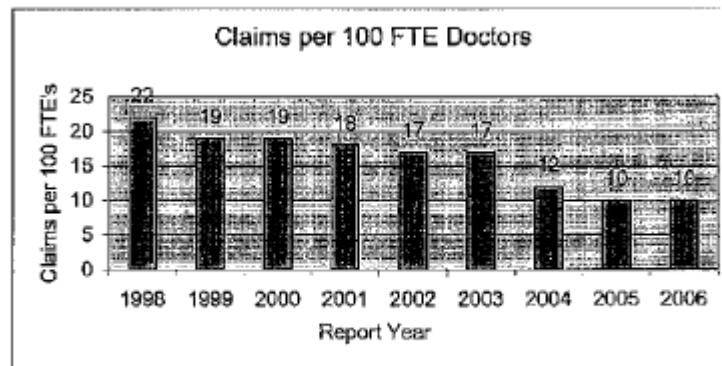


Table 4

Note: "FTE" means "full-time employees."

TDC 2006 MD&A at 15. As this chart indicates, TDC’s frequency has declined from 22 to 10, or by more than 50%, in nine years. Moreover, in its 2007 MD&A TDC reveals that its frequency declined again in 2007, to 9 claims per 100 FTE doctors. 2007 TDC MD&A at 13.

24. Interestingly, perhaps the frankest acknowledgement of how little malpractice insurers are paying out in claims comes from a non-California malpractice insurer, American Physicians Capital ("ACAP"), which is publicly held. On ACAP's July 2007 conference call to discuss its first-half 2007 results, ACAP CEO Kevin Clinton said he has kiddingly told his Board of Directors that pretty soon ACAP would be paying out nothing at all. See ACAP July 23, 2007 Conference Call, Final Transcript, at 5 (available at [www.APCapital.com](http://www.APCapital.com)). Similarly, on ACAP's October 2007 conference call Mr. Clinton reported that the downward trend in medical malpractice claims had continued to such an extent in the third quarter of 2007 that ACAP's claims managers now had little to do: in response to a stock analyst's comment that "the golf games of those claims managers must be pretty good," Mr. Clinton responded that "we're trying to turn them into the Maytag repairman." See ACAP Oct. 26, 2007 Conference Call, Final Transcript, at 4 (available at [www.APCapital.com](http://www.APCapital.com)). In addition, Mr. Clinton indicated that malpractice claims have decreased to such an extent that there is not enough work for malpractice defense lawyers. He explained that "Because of the decrease in the number of claims, we have a lot of defense attorneys knocking on the door looking for business now because the business for them has kind of dried up." Id. at 9.

#### Over-reserving

25. Malpractice carriers have also acknowledged that they have been over-reserving-- i.e., paying out less in claims than they had reserved for those claims. Insurers refer to this phenomenon as losses "developing favorably." In its 2006 Annual Report, for example, SCPIE noted that both it and other malpractice carriers in California have over-reserved. SCPIE explained:

“Prior to the Company’s expansion outside of its California healthcare liability markets beginning in 1997, the Company had historically experienced favorable development in loss and LAE reserves established for prior years on both a gross and net basis....The Company believes, based on its analysis of annual statements filed with state regulatory authorities, that its principal California competitors experienced similar favorable loss and LAE reserve development in those years.

SCPIE continued:

“The Company has continued its historical policy of estimating the current year’s incurred losses in a manner designed to protect against unfavorable trends in large losses or severity....This policy, along with a significant decrease in the frequency of claims (a cumulative 36.5% over the last four years) has allowed favorable development in the core healthcare reserves of between 4.8% and 7.3% of the preceding year-end net reserve balances.”

SCPIE 2006 Annual Report at 14.

26. TDC also now acknowledges that it has been over-reserving. In its 2007 MD&A it states that "for the year ended December 31, 2007, the Exchange experienced favorable development for the third consecutive year," and explains that "favorable development in 2007 was the result of lower than anticipated severity primarily in report years 2004, 2005 and 2006." TDC 2007 MD&A at 15, 16.

27. Similarly, in its MD&A covering 2005 and 2006 Norcal discloses that “Favorable development on prior years’ reserves due to the continued trend of lower loss payments during 2005 that continued through 2006 resulted in the reduced loss ratio in 2006.” Norcal 2006 MD&A at 12. It also notes that “favorable development in 2006 was the result of lower than anticipated severity primarily in report years 2005 and 2004," and that "the favorable development experienced in 2005 was attributable to report years 2001 and 2004.” Id. at 18.

Profitability.

28. Perhaps most significant, both the data in the insurers' Annual Statements and the narrative they provide in the MD&A accompanying those statements indicates that malpractice insurance profits are high. In its 2006 MD&A, for example, TDC says that 2006 was the most profitable year in its 31-year history, and that it expected its profits to decline from this unprecedented level in 2007. TDC 2006 MD&A at 19. In fact, however, TDC's profits increased again in 2007, by another 14%. TDC 2007 MD&A at 8.

Decreasing rates

29. The industry has acknowledged that malpractice rates are decreasing, and statements from the Attorney-General--and the industry's reaction to those statements--have made clear that those decreases will accelerate in the future. In its 2007 MD&A, for example, TDC said that it expected to reduce its rates by 5% in 2008. TDC 2007 MD&A at 7. Thereafter, however, in reviewing the proposed TDC-SCPIE merger, the Attorney-General noted that "the data also seems to show that California medical malpractice premiums are increasing while losses incurred by the industry as a whole are decreasing," Letter from Quyen Toland, Deputy Attorney General, to Valerie J. Sarfaty, CDI Acting Assistant Chief Counsel, May 30, 2008, at 5. The Attorney-General also criticized both TDC and SCPIE and the rest of the California malpractice market for not reducing their rates in accordance with their declining claims. *Id.* Therefore, the CDI directed TDC and SCPIE to refile their rates as a condition of its approving the merger. Letter from Insurance Commissioner Steven Poizner to Hilary Rowen, June 26, 2008, at 1-2. In

response to the CDI's directive, on September 1, 2008, the newly-merged TDC-SCPIE filed for a 15.4% rate decrease for its TDC policyholders and a 21.9% rate decrease for its SCPIE policyholders. The Doctors Company, California Rate and Rule Revisions, SERFF Tracking No. DCTR-125760696, State Tracking No. 08-11851 (filed Sept. 1, 2008).

**C. The effect on claims costs and premium rates of increasing or eliminating the MICRA \$250,000 limit on non-economic damages**

30. As plaintiff's economist explains, the \$250,000 cap enacted in 1975 has the buying power of \$58,000 in today's dollars. Looked at another way, \$250,000 in 1975 dollars is more than \$1 million in today's dollars. Accordingly, plaintiff's counsel has asked me to determine whether California malpractice insurers could continue to earn an adequate profit at their current rates if the MICRA cap were increased. To answer this question, I first determine the extent to which malpractice claims payments would increase if the MICRA cap were increased. I then determine whether malpractice insurers would earn an adequate profit at their current rates if their claims payments increased by that amount.

31. Two recent studies have sought to quantify the extent to which malpractice claims payments are likely to increase if the MICRA cap is increased or eliminated. The first, by McGeorge Law School professor Clark Kelso and University of Texas Ph.D candidate Kari Kelso, concludes that malpractice claims payments would increase by 5.52% if the MICRA cap were increased to \$500,000, by 8.86% if it were increased to \$750,000, and by 30% if it were eliminated. Kelso and Kelso, *Jury Verdicts in Medical Malpractice Cases and the MICRA Cap (1999)*, available at [www.mcgeorge.edu/x1234.xml](http://www.mcgeorge.edu/x1234.xml). The

second, by the Rand Institute for Civil Justice, concludes that malpractice claims payments would increase by about 13% if the MICRA cap were increased to approximately \$750,000. Rand Institute for Civil Justice, *Capping Non-Economic Awards in Medical Malpractice Trials* (2204), available at [www.rand.org](http://www.rand.org).

32. Both studies followed similar methodologies and looked at similar data. Specifically, they reviewed California malpractice verdicts reported during the 1990's and in each case determined both the amount the jury had originally awarded in non-economic damages and the amount of the judgment after the judge had reduced the verdict to comply with the \$250,000 MICRA cap. The Kelsos calculated both what the amount of the judgment would have been if all non-economic damages exceeding \$500,000, rather than \$250,000, had been excluded, and also what the judgment would have been had all non-economic damages exceeding \$750,000 been excluded. They also added up the original pre-reduction verdicts in all cases. They found that total claims payments would have increased by 5.52% if non-economic damages exceeding \$500,000 were excluded; by 8.86% if only non-economic damages exceeding \$750,000 were excluded; and by 30% if no damages were excluded. The cases they reviewed were the 310 malpractice cases resulting in a plaintiff's verdict reported in the Westlaw database for the California Jury Verdict Reporter between January 1, 1993 and March 10, 1999. They eliminated 116 cases which either did not indicate the total verdict amount or did not break out economic vs. non-economic damages. They thus analyzed the remaining 194 cases.

33. The Rand researchers reviewed 257 verdicts reported in California Jury Verdicts Weekly from 1995 through 1999. Rather than exclude the reported verdicts which did not separately break out economic and non-economic damages, they estimated such damages using a regression model for the 29% of verdicts which provided only a single damages amount. They also determined not the additional amounts that would have been paid in each case if the MICRA cap were increased to \$500,000 or \$750,000, but rather what each final judgment would have been had the MICRA cap been indexed to inflation. They determined that the indexed value of the MICRA cap was \$708,000 in 1995, \$729,000 in 1996, \$746,000 in 1997, \$757,000 in 1998, and \$774,000 in 1999, so in each of those years they excluded non-economic damages exceeding those amounts in re-calculating the final judgment. They found that total final judgments would have been 13% higher than they were under the MICRA \$250,000 cap had that cap been indexed for inflation. The range of \$708,000 to \$774,000 used by Rand in doing its calculations is substantially equivalent to the \$750,000 cap used by the Kelsos.

34. Based on the Kelsos' finding that increasing the MICRA cap to \$750,000 would increase claims costs by 8.86%, and the Rand finding that so increasing the cap would increase claims costs by 13%, it is reasonable to conclude that increasing the MICRA cap to approximately \$750,000 would reduce claims costs by somewhere in the range of 8.86% to 13%. The approximate midpoint of that range is 11%. If the loss ratio for California malpractice insurance were to have increased 11% in each of the last ten years--as it would have if malpractice claims costs had been 11% higher--those loss ratio would

still have been far below the 65%-70% range in which rates presumptively produce an adequate but not excessive return, as the following table illustrates:

**Figure 6**

**Loss Ratios: All Licensed California Medical Malpractice Carriers, 1998-2007,  
Assuming 11% Higher Claims Costs From Raising Cap to \$750,000**

<b>Year:</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
<b>Loss Ratio:</b>	<b>39.6</b>	<b>45.8</b>	<b>42.3</b>	<b>63.5</b>	<b>56.5</b>	<b>52.8</b>	<b>44.2</b>	<b>39.2</b>	<b>34.1</b>	<b>33.3.</b>

Note: Loss ratios are calculated by increasing the loss ratios shown in Figure 1 by 11%.

Thus, even if the MICRA cap had been raised to \$750,000 ten years ago and that increase had increased California malpractice claims by 11%, California malpractice insurers would have earned an excessive return in each of the last ten years but one, and in that one year they still would have been at least adequately profitable.

35. We can also estimate the likely amount by which malpractice claims payments would increase if the MICRA cap were increased to \$1 million, and thus we can also determine whether California malpractice carriers could earn an adequate profit at their current rates if the cap were so increased. Because the greater the increase in the cap the fewer cases that would be affected by the cap, each increase of \$250,000 in the cap necessarily must cause a smaller increase in claims costs than the previous \$250,000 increase. That is exactly what the Kelsos found: they determined that an increase in the \$250,000 cap to \$500,000 would increase claims costs by 5.52%, and that an increase in the cap to \$750,000 would raise claims costs by 8.86%, leaving a 3.34% cost increase (i.e., 8.86%-5.52%) for the increment between \$500,000 and \$750,000. Since each successive increment of increase in the cap will increase claims costs by less than the

previous increment--because the higher the cap is raised the fewer the number of cases it will affect--the increase in the cap from \$750,000 to \$1 million should increase claims costs by less than the 3.34% cost of the increase in the cap from \$500,000 to \$750,000.

36. The Kelsos' estimates of the extent to which claims costs would increase if the MICRA cap were raised are smaller than the Rand estimates. To take account of both the Kelsos and Rand estimates in calculating the effect on malpractice claims costs of increasing the MICRA cap to beyond \$750,000, let's assume that the total increase in claims costs produced by an increase in the cap from \$250,000 to \$750,000 is the 11% midpoint between the Kelsos' 8.86% and the Rand 13%. Let's also assume that the rate of decrease in the rate at which malpractice claims costs increase in \$250,000 increments is the same as the Kelso's found it was. Based on those assumptions, the amount by which claims costs would increase if the cap were raised to \$500,000 is 6.85%, and the additional amount by which claims costs would increase if the cap were raised from \$500,000 to \$750,000 to is 4.15%. The increase in claims costs if the cap were raised a further \$250,000 to \$1 million would thus necessarily be less than that 4.15%. However, to be conservative, let's assume that claims costs would increase by the same 4.15% if the cap were raised from \$750,000 to \$1 million as it would if the cap were raised from \$500,000 to \$750,000. The total increase in claims costs as a result of an increase in the cap to \$1 million, therefore, would be 15.15% (11% plus 4.15%). The following table shows what the loss ratios of California malpractice insurers would be with such an increase:

**Figure 7**

**Loss Ratios: All Licensed California Medical Malpractice Carriers, 1998-2007,  
Assuming 15.15 % Higher Claims Costs From Raising Cap to \$1 million**

<b>Year:</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
<b>Loss Ratio:</b>	<b>41.1</b>	<b>47.6</b>	<b>43.9</b>	<b>65.9</b>	<b>58.6</b>	<b>54.8</b>	<b>45.8</b>	<b>40.6</b>	<b>35.4</b>	<b>34.5.</b>

Note: Loss ratios are calculated by increasing the loss ratios shown in Figure 1 by 15.15%.

As the table indicates, even if the MICRA cap had been increased to \$1 million ten years ago and that increase had increased California malpractice claims costs by 15.15%, California malpractice carriers would still have earned an excessive profit in nine of the last ten years, and an adequate profit in the tenth year.

37. Finally, the Kelsos also calculate that if the MICRA cap were removed entirely, claims costs would increase by approximately 30%. Such an increase would result in the following loss ratios:

**Figure 8**

**Loss Ratios: All Licensed California Medical Malpractice Carriers, 1998-2007,  
Assuming 30% Higher Claims Costs Eliminating the MICRA Cap**

<b>Year:</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
<b>Loss Ratio:</b>	<b>46.4</b>	<b>53.7</b>	<b>49.5</b>	<b>74.4</b>	<b>66.2</b>	<b>61.9</b>	<b>51.7</b>	<b>45.9</b>	<b>39.9</b>	<b>39.0.</b>

Note: Loss ratios are calculated by increasing the loss ratios shown in Figure 1 by 30%.

This table indicates that even if the MICRA cap had been eliminated entirely ten years ago, California malpractice carriers would have earned a profit below the industry norm in one of those years, an adequate profit in two, and an excessive profit in the other seven. The unweighted average—i.e., an average that does not take account of annual

differences in premium volume—of all the loss ratios over the last ten years is 52.9, which indicates excessive profitability. Because premium volume has been the highest when the loss ratios have been the lowest—i.e., during the most recent four years—the weighted average of the loss ratios over the last ten years is even lower than the unweighted average, and would thus indicate even higher profitability than does the unweighted average.

38. In short, while eliminating the MICRA \$250,000 cap on non-economic damages would increase malpractice claims costs, eliminating the cap should not have a material effect on rates, since California malpractice insurers would still have been able to earn at least an adequate profit for the last ten years had the cap not existed, and would continue to be able to earn such a profit if the cap were eliminated today.

**D. The performance of malpractice insurers in states which have not limited non-economic damages**

39. Counsel for plaintiff has asked me to determine whether malpractice carriers have been able to prosper in states which have not enacted any limitations on non-economic damages. The jurisdictions with no such limitation are as follows:

AL  
AZ  
AR  
CT  
DE  
DC  
IA  
KY  
MN  
NH  
NJ

NY  
NC  
OR  
PA  
RI  
TN  
VT  
WA  
WY.

40. I am not familiar with the malpractice markets in all of those states, but I am familiar with many of them, and I know that in many states with no limits on non-economic damages malpractice insurers have been highly and even excessively profitable. For example:

a. NC. The dominant malpractice carrier in North Carolina, Medical Mutual Insurance Company of North Carolina, has been almost as profitable as the leading carriers in California. According to its Annual Statements, its loss ratio for the five-year period 2002-2006 were as follows:

<u>Year:</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
<b>Loss ratio:</b>	<b>44.2%</b>	<b>41.5%</b>	<b>43.5%</b>	<b>42.6%</b>	<b>46.5%.</b>

Because its loss trend has continued to decline but it has filed for no rate decreases, its loss ratio in 2007 declined even further, to 37.6.

b. AR. According to the two most recent Annual Reports of the Arkansas Department of Insurance, the loss ratio for Arkansas medical malpractice coverage was 42.99 in 2007 and 37.23 in 2006. (Both reports are available at [www.insurance.arkansas.gov](http://www.insurance.arkansas.gov).) In addition, according to the 2007 Arkansas report, in 2007 one of Arkansas's major malpractice insurers—Medical Protective, which is also

the fifth largest California malpractice carrier—sought and received approval of a 39.5% rate decrease.

c. KY. Kentucky is one of the seven states in which AP Capital does business. AP Capital is the company whose CEO, cited above in para. 24, says malpractice defense lawyers have nothing to do because there are so few malpractice claims.

d. OR and WA. In its 2007 MD&A TDC says that it is focusing on writing business in what it calls its eight “core states,” which are the states in which it believes it can make the highest profit. 2007 MD&A at 8. In two of these states—OR and WA-- there is no limitation on non-economic damages. Moreover, in all but one of TDC's other core states, non-economic damages are limited to a much lesser extent than they are in California.

41. In fairness, in one state among the 19 with no limits on non-economic damages—New York—medical malpractice insurers have not been profitable. Their lack of profitability, however, is due to a unique New York law which requires them to provide an additional \$1 million in free malpractice coverage to doctors with hospital privileges who purchase \$1.3 million in coverage, and which also requires insurers to provide below-cost coverage to doctors who are demonstrably bad risks.

42. In short, the data from states that have not limited non-economic damages indicates that malpractice insurers have been able to prosper in states that do not limit non-economic damages.

I declare under penalty of perjury that the foregoing is true and correct and that if called upon to testify to any of the foregoing I could competently do so. This declaration was executed in Jefferson City, Missouri, on November 19, 2008.

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