



INSURANCE “CRISIS” OFFICIALLY OVER – MEDICAL MALPRACTICE RATES HAVE BEEN STABLE FOR A YEAR

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The most recent data from the Council of Independent Agents and Brokers now confirms that the large medical malpractice insurance rate increases that took hold around the nation in 2001 and 2002 have ended.

The average rate hike for doctors over the past six months has been *0 percent*. This is following similar results for the last quarter of 2004, which saw rates rising only 3 percent at the end of that year. By comparison, rates jumped 63 percent during the same quarter of 2002.

This phenomenon it is occurring whether or not states enacted restrictions on patients’ legal rights, such as “caps” on compensation.

This study explains why.

Introduction

In the last few years, the nation’s medical lobbies, insurance and health care industries have been advancing a legislative agenda to limit their liability for medical malpractice that causes injuries and death. One of the principal arguments on which these industries rely is that laws that make it more difficult for the sick and injured to go to court (i.e., “tort reform”) will reduce medical malpractice insurance rates for doctors.

Great pressure has been brought to bear on Congress and state legislatures around the country to restrict the rights of innocent patients to recover for their injuries and to hold accountable in court those responsible. Many states succumbed to this pressure and have enacted “caps” on compensation or other so-called “tort reforms.”

Contrary to the medical and insurance lobbies' message – that medical malpractice lawsuits and claims were to blame for the increase in insurance rates – the fact is that in 2001, commercial property insurance rates jumped *across the board*. In other words, rate hikes for doctors were only a small part of a much larger insurance problem that affected homeowners, motorists and all kinds of policyholders. It also affected states whether or not they had already enacted severe “caps” on compensation for patients, such as Missouri and Maryland.

These kinds of volcanic eruptions in insurance premiums have occurred three times in the last 30 years – in the mid 1970s, again in the mid-1980s, and then again following the year 2001. The cause is always the same: a severe drop in investment income for insurers compounded by underpricing in prior years. Each time, insurers and the health care industry have tried to cover up their mismanaged underwriting by blaming lawyers and the legal system. To buy this position, one would have to accept the notion that juries engineered large jury verdicts in the mid-1970s, then stopped for a decade, then engineered large verdicts again in the mid-1980s, stopped for 17 years and then did it again beginning in 2001 – only to stop once again. Of course, this is ludicrous and untrue.

As with every insurance cycle, rates have now stabilized and availability is improving around the country, irrespective of tort law restrictions enacted in particular states. In all commercial lines, rate increases have slowed to a standstill and in most cases are dropping. This is despite the impact of Hurricane Katrina.

Rates for doctors have stabilized as well, having gone up on average *0 percent* during the entire last half of 2005. This is occurring whether or not a state has a “cap” on compensation for patients.

These data are further proof that the insurance crisis for doctors was caused by the economic cycle of the insurance industry, and not a tort law cost explosion as the insurance industry and others had claimed. As in the past, taking away the legal rights of injured patients made no difference on insurance rates for doctors, which are dropping everywhere.

The attached charts in the Appendix show the rate trends during this most recent hard market period, beginning in 2001 and 2002. The medical malpractice data alone is striking:

MEDICAL MALPRACTICE INSURANCE AVERAGE RATE HIKES PER QUARTER

<u>3Q</u> <u>2002</u>	<u>4Q</u> <u>2002</u>	<u>1Q</u> <u>2003</u>	<u>2Q</u> <u>2003</u>	<u>3Q</u> <u>2003</u>	<u>4Q</u> <u>2003</u>	<u>1Q</u> <u>2004</u>	<u>2Q</u> <u>2004</u>	<u>3Q</u> <u>2004</u>	<u>4Q</u> <u>2004</u>	<u>1Q</u> <u>2005</u>	<u>2Q</u> <u>2005</u>	<u>3Q</u> <u>2005</u>	<u>4Q</u> <u>2005</u>
61%	63%	54%	48%	28%	34%	19%	9%	6%	3%	2%	2%	0%	0%

*Source: Council of Insurance Agents and Brokers
Commercial Property-Casualty Market Survey
By Quarter as indicated*

Why Rates For Doctors Went Up: The Insurance Cycle, Not The Legal System

The Investment Cycle. Insurers usually do not make money from the underwriting of insurance; they make money by the investments of the float (the fact that the insurers collect the premium today but pay out the claims much later)¹. This is particularly true of long-tailed lines (that is, lines with a very long float, such as medical malpractice. During years of high interest rates and/or excellent insurer profits, insurance companies engage in fierce competition for premium dollars to invest for maximum return. Insurers severely underprice their policies and even insure poor risks just to get premium dollars to invest. This is known as the “soft” insurance market.

But when investment income decreases — because interest rates drop or the stock market plummets or the cumulative price cuts make profits become unbearably low — the industry responds by sharply increasing premiums and reducing coverage, creating a “hard” insurance market usually degenerating into a “liability insurance crisis.”

A hard insurance market occurred in the mid-1970s, precipitating rate hikes and coverage cutbacks, particularly with medical malpractice and product liability insurance. (This led California to enact MICRA in 1975, a law that caps non-economic damages at \$250,000 with no inflationary adjustment.) A more severe crisis took place in the mid-1980s, when most liability insurance was impacted. At that time, many more states enacted “caps” after being told by insurers that this would bring rates down and guarantee stability in the insurance market.

Again in 2001, the country began experiencing a “hard market,” this time impacting property as well as medical malpractice coverages with some lines of insurance seeing rates going up 100 percent or more.

Prior to late 2000, the industry had been in a soft market since the mid-1980s. The strong financial markets of the 1990s had expanded the length of the usual six- to-ten year economic cycle. No matter how much they cut their rates, the insurers wound up with a great profit year when investing the float on the premium in this amazing stock and bond market. (The “float” occurs during the time between when premiums are paid into the insurer and losses paid out by the insurer —*e.g.*, there is about a 15-month lag in auto insurance and a 5 to 10 year lag in medical malpractice.) Further, interest rates were relatively high in recent years as the Fed focused on inflation.

But in 2000, the market started to turn with a vengeance and the Fed cut interest rates again and again. This became a classic economic cycle bottom.

See chart below.

Federal Reserve Rate by Year, 1995-2005



It should be noted that the few medical malpractice insurance companies that did pull out of the market during this recent insurance “crisis” did so because of mismanaged underwriting practices. In 2001, one of the country’s largest medical malpractice insurance companies, St. Paul, pulled out of the medical malpractice insurance market, creating significant supply and demand problems in some states. According to a June 24, 2002, *Wall Street Journal* front-page investigative article, St. Paul, with a 20 percent share of the national market, pulled out after mismanaging its underwriting and reserves. The head of a leading medical malpractice insurer described problems in the med mal insurance market: “I don’t like to hear insurance-company executives say it’s the tort [injury-law] system – it’s self-inflicted.”²²

As one insurance industry insider also put it at the beginning of the most recent hard market in 2001: “The [medical malpractice insurance] market is in chaos.... Throughout the 1990s ... insurers were ... driven by a desire to accumulate large amounts of capital with which to turn into investment income. Regardless of the level of ... tort reform, the fact remains that if insurance policies are consistently underpriced, the insurer will lose money.”²³

The Legal System. As they do each time the market turns hard, insurers blame the legal system for the price jumps. The data has never supported this allegation.

The National Center for State Courts (NCSC) data shows that the number of medical malpractice filings dropped over the last decade preceding the most recent insurance crisis. The NCSC – which is the country’s most accurate and comprehensive overview of state court litigation statistics – found that the 1993 to 2002 trend in medical malpractice filings per 100,000 population has only fluctuated minimally, with an overall one percent decrease in per capita filings over the last five years.⁴ Similarly, the U.S. Department of Justice found that the number of medical malpractice trials “remained stable” from 1992 through 2001.⁵

Total compensation paid to victims dropped 6.9 percent from 2001 to 2002 according to National Practitioner Data Bank (NPDB) analysis by Public Citizen. When adjusted for medical services inflation, the one-year drop was even more dramatic: 11.2 percent.⁶ Between 1991 and 2004, the

median payment grew from \$125,000 in 1991 to \$146,100 in 2004 when adjusted for inflation – an average annual increase of only 1.2 percent. Moreover, the number of malpractice payments paid on behalf of doctors fell from 16,682 in 2001 to 14,441 in 2004, a drop of 13.6 percent. The 2004 number is only 5.5 percent higher than the 13,687 payments recorded for 1991.”⁷

As with its predecessors, the most recent insurance “crisis” had absolutely nothing to do with the U.S. legal system, tort laws, patients, lawyers or juries. It was driven by the insurance underwriting cycle and remedies that do not specifically address this phenomenon will fail to stop these wild price gyrations in the future.

The Impact Of “Tort Reform” On Insurance Rates

Rates for doctors are now stabilizing, whether or not a state has enacted a “cap” on compensation for patients. Here are a few examples:

Connecticut (no cap): “Rate increases are even slowing or stopping in some states that have not limited awards for pain and suffering, including Connecticut, where premium increases in the past have soared as much as 90 percent in a single year.”⁸

Maryland (cap since 1986): “[T]he state’s largest malpractice insurer said it does not need a rate increase for next year, leading some to question whether the much-debated malpractice crisis ever existed.”⁹

Pennsylvania (no cap): “Pennsylvania’s largest medical-malpractice insurer has announced it will not raise premiums in 2006, breaking a string of annual double-digit rate increases that symbolized an insurance market physicians said was increasingly unaffordable.”¹⁰

Arkansas (cap on punitive damages): “The cost of malpractice insurance for Arkansas doctors didn’t rise as much this year, but a new law limiting damages in liability suits isn’t getting the credit.”¹¹

Washington (no cap): “Physicians Insurance, which is owned by doctors, has proposed a 7.7 percent cut in medical malpractice rates.”¹²

Texas (hard cap, recently passed): “JUA now joins the host of insurers that are part of this turnaround in the last year and half, either through reducing rates or re-entering the medical liability market.”¹³

Massachusetts (cap with exceptions since 1986): “[T]he state’s largest malpractice insurer said it will not raise doctors’ premiums...”¹⁴

Illinois (prior to passage of cap): “ISMIE Mutual Insurance Company said that for the first time since 1999, rates won’t increase for the policy year beginning July 1.”¹⁵

What the Studies Show. Most studies reject the notion that enactment of caps on damages will lower insurance rates. Weiss Ratings, an independent insurance-rating agency, found that between 1991 and 2002, states with caps on noneconomic damage awards saw median doctors' malpractice insurance premiums rise 48 percent – a greater increase than in states without caps. In states without caps, median premiums increased only 36 percent.¹⁶

A study by law professors at the University of Texas, Columbia University and the University of Illinois based on closed claim data compiled by the Texas Department of Insurance since 1988 reached similar conclusions. That study found that “the rapid changes in insurance premiums that sparked the crisis appear to reflect insurance market dynamics, largely disconnected from claim outcomes.”¹⁷

Similarly, an econometric analysis of the malpractice market by two Dartmouth economists found that “past and present malpractice payments do not seem to be the driving force behind increases in premiums,” and that premium growth may be affected by many factors beyond increases in claims payments, such as industry competition and the insurance underwriting cycle. They found, “There is a fairly weak relationship between malpractice payments (for judgments and settlements) and premiums – both overall and by specialty.” Also, “past and present malpractice payments do not seem to be the driving force behind increases in premiums. Premium growth may be affected by many factors beyond increases in payments, such as industry competition and the insurance underwriting cycle.”¹⁸

Indeed, “tort reform” advocates have long rejected the notion that enactment of caps on damages would lower insurance rates. The American Insurance Association (AIA) and the American Tort Reform Association (ATRA) admitted long ago in published statements that lawmakers who enact “tort reforms” should not expect insurance rates to drop, with the AIA declaring at the start of the most recent hard market, “[T]he insurance industry never promised that tort reform would achieve specific premium savings.”¹⁹

Past Experience With “Tort Reform”: Rate Hikes, not Decreases. In the midst of the last insurance “crisis” in the mid-1980s, state lawmakers enacted often-severe tort restrictions on patients' rights after being told this was how to reduce insurance rates. These laws had absolutely no impact on insurance rates. Some states that resisted enacting any “tort reform” experienced low increases in insurance rates or loss costs relative to the national trends, and some states that enacted major “tort reform” packages saw very high rate or loss cost increases relative to the national trends. In other words, there was no correlation between “tort reform” and insurance rates.²⁰

Maryland and Missouri are both examples of states that enacted severe caps on damages in the mid-1980s, only to be hit with huge rate hikes during the last hard market. For example, Maryland, an American Medical Association (AMA) “problem state”²¹ and a “crisis state” according to the American College of Obstetricians and Gynecologists,²² has had a cap on non-economic damages since 1986, originally \$350,000 but later increased somewhat.²³ Despite the cap, the state recently experienced premiums that “rose by more than 70 percent.”²⁴

Missouri, identified by the AMA as a so-called “crisis state,”²⁵ has had a cap on non-economic damages since 1986. The cap started at \$350,000 and has been adjusted annually for inflation, reaching \$557,000 in 2003.²⁶ “New medical malpractice claims dropped 14 percent in 2003 to what the [Missouri Department of Insurance] said was a record low, and total payouts to medical malpractice plaintiffs fell to \$93.5 million in 2003, a drop of about 21 percent from the previous year.” And “the National Practitioner Data Bank, a federally mandated database of malpractice claims against physicians, found that the number of paid claims in Missouri fell by about 30 percent since 1991. The insurance department’s database found that paid claims against physicians fell 42.3 percent during the same time period.” Yet doctors’ malpractice insurance premiums rose by 121 percent between 2000 and 2003.²⁷

In California, 13 years after the state’s severe \$250,000 cap on damages was enacted, “doctors’ premiums had increased by 450 percent and reached an all-time high in California.” But, in 1988 California voters passed a stringent insurance regulatory law, Proposition 103, which “reduced California doctors’ premiums by 20 per within three years,” and stabilized rates.²⁸ In the thirteen years after MICRA, but before the insurance reforms of Prop. 103, California medical malpractice premiums rose faster than the national average. In the 12 years after Prop. 103 (1988-2000), malpractice premiums dropped 8 percent in California, while nationally they were up 25 percent.²⁹ Moreover, the law has led to public hearings on recent rate requests by medical malpractice insurers in California, which resulted in rate hikes being lowered three times in the last two years.³⁰

History is clear on this matter: legislative attempts to reduce insurance rates by taking away the rights of the most seriously injured in our society has been and continues to be a failed public policy.

Conclusion

In 1989, Michael Hatch, then Commerce Commissioner of Minnesota (and now Attorney General), released an investigation of two malpractice insurers including the country’s then largest, St. Paul. Hatch found that during the prior six years, at the time of America’s last insurance “crisis,” these companies had increased doctors’ malpractice premiums some 300 percent. Yet the number of claims against doctors had not gone up, the amount paid out by insurance companies had not increased, and the number of frivolous claims had not increased.

In response to a question by ABC’s *Nightline* as to how this could happen, Hatch responded, “Because they had the opportunity to do it. There was a limited market. People need coverage. The companies knew they had a corner on it, and they raised their rates accordingly.”

Sadly, not much has changed in the world of insurance. Over the last few years, the medical lobbies and the insurance industry and other large corporations blamed the insurance crisis that doctors’ had been experiencing on the legal system and lobbied extensively for what they called “tort reform” – laws that restrict the rights of injured patients to obtain compensation for deaths and injuries. They claimed that enactment of “tort reform” would cause insurance rates to stabilize and even fall.

However, as this most recent data shows, the “crisis” was caused not by legal system excesses but by the economic cycle of the insurance industry. Following large rate increases and cut backs in coverage that started in the years 2001 and 2002, the insurance cycle has now turned again and prices are falling. The nation is now enjoying a relatively “soft” insurance market with rates of liability insurance not only stable but down. And the “tort reform” remedy pushed by these advocates failed to do anything except hurt patients.

APPENDIX

OVERALL PROPERTY/CASUALTY LINES – 2001 THROUGH 2005

	<u>2001</u>	<u>2Q</u> <u>2002</u>	<u>3Q</u> <u>2002</u>	<u>4Q</u> <u>2002</u>	<u>1Q</u> <u>2003</u>	<u>2Q</u> <u>2003</u>	<u>3Q</u> <u>2003</u>	<u>4Q</u> <u>2003</u>	<u>1Q</u> <u>2004</u>	<u>3Q</u> <u>2004</u>	<u>4Q</u> <u>2004</u>	<u>1Q</u> <u>2005</u>	<u>2Q</u> <u>2005</u>	<u>3Q</u> <u>2005</u>	<u>4Q</u> <u>2005</u>
Small Comm. Accounts	21%	20%	15%	8%	11%	7%	4%	4%	3%	-3%	-3%	-5%	-5%	-5%	-3%
Mid-size Comm. Accounts	32%	27%	22%	19%	14%	8%	5%	5%	1%	-6%	-6%	-9%	10%	-8%	-5%
Large Comm. Accounts	36%	34%	25%	21%	15%	8%	4%	4%	-3%	-9%	-9%	10%	11%	-9%	-5%

SPECIFIC LINES – 2001 THROUGH 2005

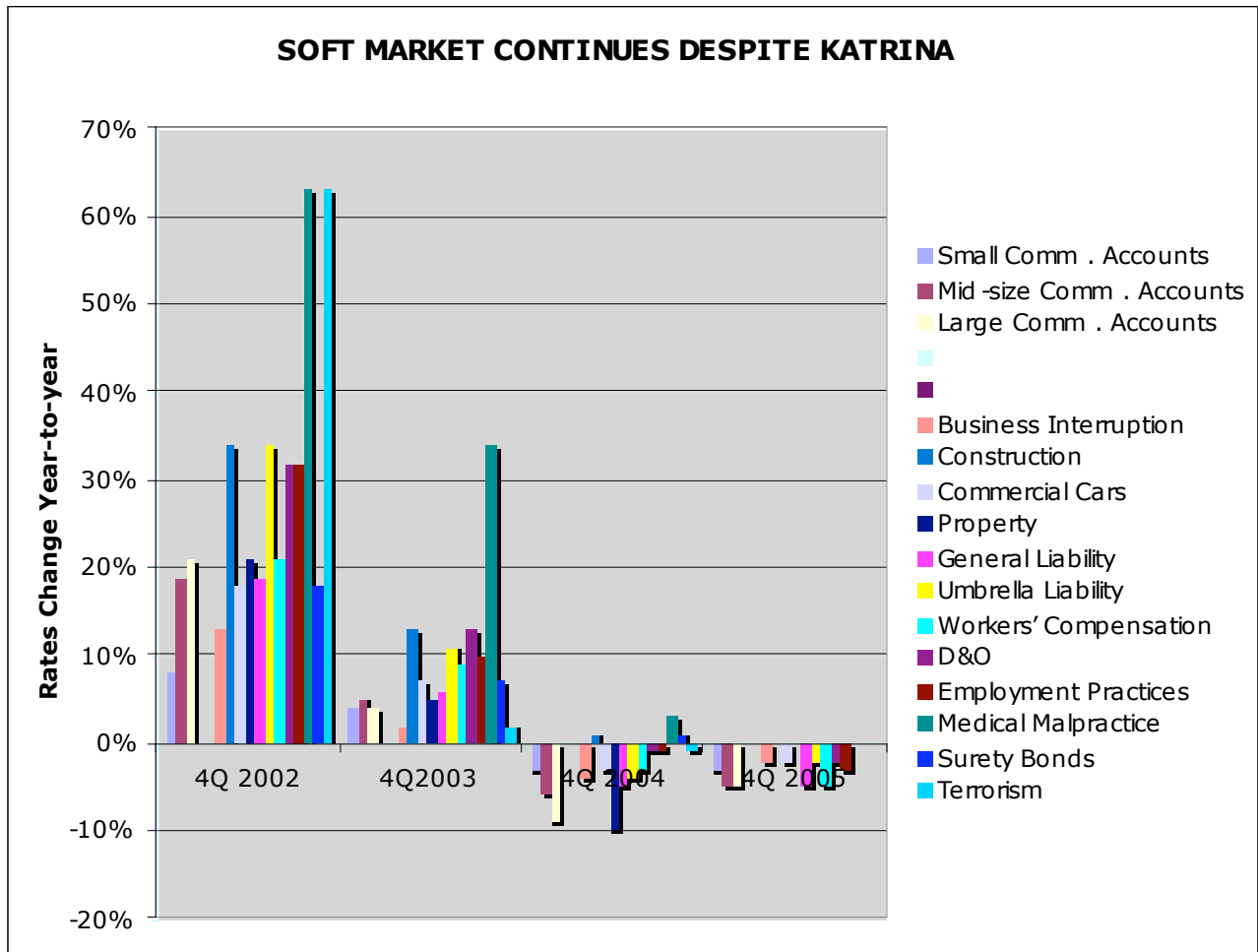
	<u>2001</u>	<u>2Q</u> <u>2002</u>	<u>3Q</u> <u>2002</u>	<u>4Q</u> <u>2002</u>	<u>1Q</u> <u>2003</u>	<u>2Q</u> <u>2003</u>	<u>3Q</u> <u>2003</u>	<u>4Q</u> <u>2003</u>	<u>1Q</u> <u>2004</u>	<u>3Q</u> <u>2004</u>	<u>4Q</u> <u>2004</u>	<u>1Q</u> <u>2005</u>	<u>2Q</u> <u>2005</u>	<u>3Q</u> <u>2005</u>	<u>4Q</u> <u>2005</u>
Business Interruption	30%	21%	16%	13%	9%	5%	3%	2%	-1%	-5%	-4%	-7%	-6%	-5%	-2%
Construction	46%	44%	30%	34%	22%	17%	13%	13%	8%	2%	1%	-3%	-3%	-3%	0%
Commercial Cars	28%	27%	18%	18%	15%	11%	6%	7%	3%	-5%	-3%	-6%	-5%	-6%	-2%
Property	47%	42%	24%	21%	12%	6%	1%	5%	-5%	###	###	###	###	-9%	0%
General Liability	27%	24%	18%	19%	14%	11%	7%	6%	3%	-4%	-5%	-8%	-8%	-7%	-5%
Umbrella Liability	56%	52%	36%	34%	26%	18%	11%	11%	4%	-2%	-4%	-6%	-6%	-6%	-2%
Workers' Compensation	24%	26%	19%	21%	17%	15%	10%	9%	4%	-5%	-3%	-5%	-7%	-3%	-5%
D&O			35%	32%	29%	21%	16%	13%	7%	-5%	-1%	-4%	-3%	-4%	-2%
Employment Practices			19%	32%	19%	17%	12%	10%	5%	-2%	-1%	-4%	-4%	-4%	-3%
Medical Malpractice			61%	63%	54%	48%	28%	34%	19%	6%	3%	2%	2%	0%	0%
Surety Bonds			14%	18%	18%	13%	6%	7%	6%	1%	1%	0%	-6%	0%	0%
Terrorism				63%	13%	6%	2%	2%	0%	-2%	-1%	-1%	-1%	-1%	0%

**OVERALL PROPERTY/CASUALTY LINES – 4TH QUARTER 2002
THROUGH 2005**

	<u>4Q 2002</u>	<u>4Q2003</u>	<u>4Q 2004</u>	<u>4Q 2005</u>
Small Comm. Accounts	8%	4%	-3%	-3%
Mid-size Comm. Accounts	19%	5%	-6%	-5%
Large Comm. Accounts	21%	4%	-9%	-5%

SPECIFIC LINES – 4TH QUARTER 2002 THROUGH 2005

	<u>4Q 2002</u>	<u>4Q2003</u>	<u>4Q 2004</u>	<u>4Q 2005</u>
Business Interruption	13%	2%	-4%	-2%
Construction	34%	13%	1%	0%
Commercial Cars	18%	7%	-3%	-2%
Property	21%	5%	-10%	0%
General Liability	19%	6%	-5%	-5%
Umbrella Liability	34%	11%	-4%	-2%
Workers' Compensation	21%	9%	-3%	-5%
D&O	32%	13%	-1%	-2%
Employment Practices	32%	10%	-1%	-3%
Medical Malpractice	63%	34%	3%	0%
Surety Bonds	18%	7%	1%	0%
Terrorism	63%	2%	-1%	0%



*Source: Council of Insurance Agents and Brokers
Commercial Property-Casualty Market Survey
By Quarter as indicated*

NOTES

¹ In fact, except for six years, the property/casualty insurers had underwriting losses in every year since 1967. *Best's Aggregates and Averages, Property/Casualty Edition, 2005*, p. 397.

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