Legislative Fiscal Bureau

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June 8, 2007 | Joint Committee on Finance | Paper #377

Injured Patients and Families Compensation Fund Transfer (Insurance)

Bill Agency

[LFB 2007-09 Budget Summary: Page 357, #2]

CURRENT LAW

The Injured Patients and Families Compensation Fund (the fund) was created in 1975 to provide excess medical malpractice insurance for Wisconsin health care providers in excess of their primary coverage limits. Most physicians practicing full time in Wisconsin, as well as other health care providers and organizations, are required to participate in the fund. To participate, a health care provider must have their own primary layer of medical malpractice insurance (currently $1 million per occurrence and $3 million aggregate per year), and they must pay an annual assessment to the fund. If they satisfy these requirements, the fund provides the health care provider unlimited medical malpractice insurance in excess of their primary layer of coverage. As of December 31, 2006, there were 14,308 participants in the fund. Physicians constituted 84% of the total number of those participants, with hospitals, corporations, partnerships, nurse anesthetists, and other health care providers comprising the balance.

The fund is governed by a 13-member Board of Governors that consists of three representatives of the insurance industry appointed by the Commissioner of Insurance, a person named by the State Bar Association, a person named by the Wisconsin Academy of Trial Lawyers, two people named by the Wisconsin Medical Society, a person named by the Wisconsin Hospital Association, the Commissioner of Insurance or his delegate who serves as Chairperson of the Board, and four members of the public appointed by the Governor, at least two of whom are not lawyers and are not associated with any hospital or insurance company. The Board's duties include, among other things, approving the annual assessments charged to participating health care providers. The Board is assisted in its responsibilities by staff provided by the Commissioner of Insurance, by committees of the Board, such as its actuarial and underwriting committee, and by outside service providers.

The fund is financed through annual assessments paid by providers and by investment income earned by the fund's assets. With respect to the assessments paid by physicians, there are four assessment classes, with physicians grouped by specialties or types of practice that are similar in their degree of exposure to loss. Class 1 includes specialties with the lowest risk, and those providers pay the lowest assessments. Class 4 includes physicians in the highest risk specialties, and those providers pay the highest assessments. Factors that influence the level of assessments include an actuarial analysis of the fund's expected loss exposure based on prior years' experience, and the fund's overall financial position. Annually, the fund's actuary provides information on these matters to the fund's actuarial and underwriting committee, which advises the fund's Board of Governors. The Board of Governors approves the fee assessment levels for the upcoming year, and then, with the assistance of the Commissioner of Insurance, submits a fund fee administrative rule to the Legislature for approval.

The fund's investments are managed by the State of Wisconsin Investment Board, whose objectives are to invest moneys held in the fund in investments with maturities and liquidity that are appropriate for the needs of the fund. According to the fund's 2006 Functional and Progress Report (2006 Report), the fund's total assets as of June 30, 2006 were approximately $746 million. The 2006 Report also reports the fund's total liabilities. The fund's loss liabilities are estimated based on recommendations by the fund's actuary and are discounted to the extent they are matched by cash and invested assets. The loss liabilities include individual case estimates for reported losses, estimates for losses that have been incurred but not reported (IBNR) based upon the projected ultimate losses recommended by the fund's actuary, and a provision for the estimated future payment of costs related to the settlement of claims. According to the 2006 Report, the fund's total liabilities as of June 30, 2006 were $687 million. The fund's reported net equity as of June 30, 2006, which represents the fund's total assets less its total liabilities, was $59.9 million.

GOVERNOR

Transfer $175 million in 2007-08 from the fund to the health care quality fund (HCQF), which would be created under the Governor's bill.

DISCUSSION POINTS

1. This item would represent a one-time transfer of assets from the fund in 2007-08 to the HCQF. Under the Governor's bill, the HCQF would fund, among other things, medical assistance (MA) benefits, an increase in MA hospital rates, and increased funding for tobacco use control grants.

Background of the Fund

2. When Wisconsin's patients compensation fund was established in 1975, it operated for several years on a cash basis, meaning that providers were assessed based on actual payout amounts for claims in a given year. During the 1980's, the fund switched to accrual accounting. Under the accrual method, providers are assessed based on estimates of what all claims will total over time for incidents that occurred in a given year, rather than on the amount of losses actually paid that year. Accrual accounting attempts to ensure that the fund has sufficient assets to pay any outstanding liabilities, including claims incurred but not yet reported, if the fund was discontinued.

3. The Board of Governors uses information provided by the actuary regarding the fund's loss liabilities and overall financial condition to establish annual provider assessment rates. Table 1 shows the overall percentage change in assessment rates approved by the fund's Board of Governors during the period 1997-98 through 2006-07. Table 1 also summarizes the total amount of assessment revenues collected by the fund during that period. The source of the information contained in Table 1 is the Legislative Audit Bureau's March, 2007, Report on the fund (LAB 2007 Report). For 2007-08, the Board of Governors has approved a 5% increase in assessments.

TABLE 1

Change in Fund Assessment Rates
1997-98 through 2006-07

Policy Year	Overall Percentage Change in Assessment Rates Approved by Fund's Board of Governors	Total Annual Assessments
1997-98	-17.7%	$49,884,800
1998-99	0.0	50,621,700
1999-00	-7.0	47,879,300
2000-01	-25.0	36,795,100
2001-02	-20.0	29,556,000
2002-03	-5.0	29,463,700
2003-04	5.0	32,065,000
2004-05	-20.0	26,547,000
2005-06	-30.0	18,930,800
2006-07	25.0	Not Available

4. As Table 1 indicates, the total amount of assessment revenue collected annually by the fund declined from $49.9 million in 1997-98, to $18.9 million in 2005-06. Assessment revenue is expected to increase in 2006-07, consistent with the Board of Governors' approval of a 25% increase in the level of provider assessments. Table 2 shows the annual fees for the fund's four classes of physicians, as well for certified registered nurse anesthetists, during the period 1997-98 through 2006-07.

TABLE 2

Annual Fees for Physicians and Certified Registered Nurse Anesthetists 1997-98 through 2006-07

Year	Physicians Class 1*	Class 2*	Class 3*	Class 4*	Certified Registered Nurse Anesthetists
1997-98	$2,647	$5,294	$11,392	$15,882	$678
1998-99	2,721	5,170	11,292	16,326	678
1999-00	2,531	4,809	10,504	15,186	631
2000-01	1,898	3,606	7,877	11,388	475
2001-02	1,538	2,769	6,384	9,231	378
2002-03	1,461	2,630	6,063	8,766	359
2003-04	1,534	2,761	6,366	9,204	377
2004-05	1,227	2,209	5,092	7,362	302
2005-06	859	1,546	3,565	5,154	211
2006-07	1,074	1,933	4,457	6,444	264

* Indicated rates are for providers for whom Wisconsin is their primary place of practice. Other rates apply to providers for whom Wisconsin is not the primary place of practice.

5. Even though the assessment revenue collected annually by the fund has declined during the past 10 years, the fund's total assets increased from $377 million as of June 30, 1997, to $746 million as of June 30, 2006. That growth is attributable to the fact that revenues collected in the form of provider assessments, coupled with the investment returns earned by the fund's assets, exceeded the amount of money the fund paid out in claims and other expenses during that period.

6. According to the LAB 2007 Report, the fund has paid more than $633.6 million in claims since it was created in 1975. The losses paid in any given year relate to events that occurred in previous years. That is because there is typically a period of time, in some cases a significant period of time, between when an incident of medical malpractice occurs and when the claim associated with that occurrence is reported, settled, and ultimately paid by the fund. Table 3 shows the actual losses paid by the fund in each fiscal year during the period 1996-97 through 2005-06.

TABLE 3

Actual Losses Paid by Fund
1996-97 through 2005-06

Year	Actual Losses Paid
1996-97	$34,679,300
1997-98	18,718,500
1998-99	19,930,000
1999-00	19,657,300
2000-01	39,636,300
2001-02	35,304,800
2002-03	22,074,600
2003-04	19,497,000
2004-05	20,316,500
2005-06	32,340,700

7. An aspect of the fund's financial condition not directly reflected in its total assets, or in the actual losses paid in any given year, is its total liabilities. During the period June 30, 1997, through June 30, 2006, the fund's total liabilities, as initially reported in the fund's year-end financial reports, increased from $421 million to $687 million. The fund's total liabilities include individual case estimates for reported losses, estimates for losses that have been incurred but not reported (IBNR) based upon the projected ultimate losses recommended by the fund's consulting actuary, and a provision for the estimated future payment of costs related to the settlement of claims, reported on a discounted basis.

8. Estimating the fund's IBNR losses is difficult because of the nature of medical malpractice coverage, where there is an extended period of time over which claims can be reported and eventually settled, and because of the particular nature of the fund, with its unlimited excess liability coverage over the participating health care providers' primary coverage. Changes in the state's medical malpractice legal environment, deviations from expected payment patterns, and changes in interest rates (which can impact the income earned by the fund's assets, which in turn is used to discount the fund's liabilities), can complicate these actuarial estimates. In addition, a small number of large claims can disproportionately impact the fund's net financial position. The fund's managers and the fund's actuary continually review these factors, as well as the fund's ongoing loss experience, and adjust the fund's estimated liabilities when necessary.

9. Subtracting the fund's total liabilities from its total assets yields the fund's surplus or deficit. Beginning with the fiscal year ending June 30, 1999, the fund has reported a year-end surplus. Prior to that time, the fund had generally reported fiscal year-end deficits. Table 4 shows the fund's year-end total assets, total liabilities, and surplus (or deficit) as initially reported by the fund as of June 30 for each fiscal year during the period 1996-97 through 2005-06.

TABLE 4

Fund's Reported Total Assets, Total Liabilities, and Surplus (Deficit)
1996-97 through 2005-06

Year	Total Assets	Total Liabilities	Surplus (Deficit)
1996-97	$376,830,700	$420,924,900	($44,094,200)
1997-98	462,415,800	481,799,700	(19,383,900)
1998-99	501,134,200	492,554,400	8,579,800
1999-00	542,594,300	515,383,300	27,211,000
2000-01	576,533,300	547,808,400	28,725,000
2001-02	586,969,800	582,081,700	4,888,100
2002-03	667,445,900	659,513,500	7,932,300
2003-04	741,282,900	716,666,600	24,616,300
2004-05	758,681,100	726,974,900	31,706,200
2005-06	746,398,200	686,538,100	59,860,100

10. Over the past several years, the fund's actuary has consistently reduced its past estimates of loss liabilities, relative to the amounts initially reported in the fund's year-end financial statements, to reflect an additional year's experience. For instance, when estimating total liabilities for purposes of the fund's June 30, 2006, financial statements, the fund's actuary revised downward by approximately $79 million (on an undiscounted basis) its previous estimates of unpaid losses and loss adjustment expenses for claims occurring prior to June 30, 2005. These "hindsight" adjustments have led some to suggest that the fund's actuary has been overly conservative in estimating the fund's loss liabilities. For instance, in an independent actuarial opinion dated April 4, 2005, and prepared at the administration's request, Aon Risk Consultants estimated that the fund's surplus as of September 30, 2004, was several hundred million dollars higher than estimated by the fund's actuary. A subsequent actuarial audit, however, prepared by Tillinghast-Towers Perrin and dated July, 2005, concluded that the fund's reported loss liabilities were reasonable, although conservative. In its March, 2007, Report, the Legislative Audit Bureau stated that, "from both an actuarial and accounting perspective, conservative estimates are considered more prudent than those that are overly optimistic."

11. The July, 2005, Tillinghast report recommended that going forward, the fund's actuary develop best estimates of expected loss experience, and then explicitly specify a risk margin that would represent the risk that the fund's actual losses could exceed that best estimate. Prior to the Tillinghast report, the fund's actuary had incorporated an implicit risk margin of 33% when estimating the fund's loss liabilities. The fund's 2006 Report incorporates an explicit risk margin of 5%. The fund's Board of Governors adopted that lower risk margin following the Wisconsin Supreme Court's *Ferdon* decision in July, 2005. In *Ferdon*, the court held that Wisconsin's statutory cap on the recovery of noneconomic damages for medical malpractice claims violated the equal protection guarantees of the Wisconsin Constitution. That $350,000 cap, which had been adjusted annually for inflation, had been in place since 1995 (an earlier statutory limit on noneconomic

damages expired on December 31, 1990).

12. The risk that Wisconsin's statutory limit on noneconomic damages would be overturned was one reason the fund's actuary had been using an implicit risk margin of 33%. Because the *Ferdon* decision removed that uncertainty, the fund's Board of Governor's approved the lower, explicit risk margin of 5%. The impact of lowering the fund's risk margin to 5% was to reduce the fund's estimated loss liabilities by approximately $240 million as of June 30, 2006, relative to what those estimated liabilities would have been under an implicit risk margin of 33%.

13. In addition to reducing the fund's estimated loss liabilities as of June 30, 2006, it is expected that the Board of Governor's adoption of the 5% risk margin will make the fund's actuarial estimates less conservative going forward.

14. At the same time, the *Ferdon* decision also caused the fund's actuary to increase its estimate of the fund's undiscounted loss liabilities by $173 million. The actuary made that adjustment because *Ferdon*, as indicated, removed the statutory cap on the recovery of noneconomic damages that had been in effect since 1995. The fund's June 30, 2006, year-end report, which indicates a fund surplus of $59.9 million, reflects the estimated total net impact of the *Ferdon* decision on the fund's financial position.

15. Subsequent to *Ferdon*, 2005 Wisconsin Act 183 established a $750,000 limit on noneconomic damages for medical malpractice incidents that occur after April 6, 2006. This new statutory limit on noneconomic damages may reduce the fund's future losses, compared to the period January 1, 1991 through April 6, 2006, for which no statutory cap on noneconomic damages exists. The fund's management intends to monitor any challenges to the new $750,000 damages cap if they arise, and to adjust the fund's estimated liabilities accordingly.

Projected Impact of the Governor's Recommendation to Transfer $175 Million from the Fund

16. The fund's actuary estimates that the Governor's recommendation to transfer $175 million from the fund to the HCQF would reduce the fund's surplus by $235.1 million. That impact includes the initial transfer of $175 million in assets, as well as $65.1 million in reduced investment income that would have been generated by those assets. According to these actuarial estimates, the transfer, if approved, would cause the fund to report a net deficit of $233.1 million as of June 30, 2008.

17. If approved, the recommended transfer would occur at a time when, according to the most recent actuarial projections, the fund is already about to revert to a net deficit position. Table 5 shows the fund's projected year-end financial position for the years 2006-07 through 2011-12. These actuarial projections incorporate an assumption that the fund's annual assessments will increase by 25% per year during the indicated period. If the fund's assessments increase by less than 25% (such as the 5% assessment increase approved by the Board of Governors for 2007-08), the fund's projected deficits would be greater than indicated in Table 5. Note that the actuarial

projections in Table 5 do not include the estimated impact of the Governor's recommendation to transfer $175 million from the fund in 2007-08.

TABLE 5

Fund's Projected Year-End Surplus (Deficit)
2006-07 through 2011-12
Without Governor's Recommended Transfer

Year	Projected Year-End Fund Surplus (Deficit)
2006-07	$66,900,000
2007-08	2,000,000
2008-09	(60,000,000)
2009-10	(115,000,000)
2010-11	(165,000,000)
2011-12	(208,000,000)

18. One reason the fund's actuary is currently projecting that the fund will begin reporting year-end deficits in 2008-09 is that the fund's Board of Governors has in recent years approved assessment levels lower than the "break even" point estimated by the fund's actuary. The "break even" point is the point at which the assessments collected during the year are equal to all expected claim payments for incidents that occur during that year, regardless of when the claims associated with those incidents are paid. The recent assessment levels approved by the Board are consistent with its policy to maintain the fund's surplus at or near zero. According to the fund's 2006 Report, this policy is due to the nature of the fund, "the fact that it operates as a risk-sharing pool and that participation in the Fund is mandatory." With respect to this policy, the fund's 2006 Report states the following:

> Because of this policy, the Fund is currently collecting fees in an amount less than the amount being paid out for claims and expenses. As a result, investment income that was expected to be used to discount reserves is being used to pay claims and expenses. Ultimately, without significant adjustments to fees or reserves, this will result in a deficit for the Fund. Due to the long tail nature of the Fund, this expected deficit may not be reflected on the financial statements for another year or two. Fund management will closely monitor the financial position of the Fund and provide updated information in future reports.

19. The estimated impact of the Governor's recommended transfer would be to increase the fund deficits that are already being projected by an additional $235.1 million. Table 6 shows the actuary's current projections for fund years 2006-07 through 2011-12 when the estimated impact of the Governor's recommended $175 million transfer is incorporated into those projections.

TABLE 6

Fund's Projected Year-End Surplus (Deficit)
2006-07 through 2011-12
With Governor's Recommended Transfer

Year	Projected Year-End Fund Surplus (Deficit)
2006-07	$66,900,000
2007-08	(233,100,000)
2008-09	(295,100,000)
2009-10	(350,100,000)
2010-11	(400,100,000)
2011-12	(443,100,000)

20. The actuarial estimates shown in Tables 5 and 6 should be viewed in light of the recognized difficulties inherent in estimating the fund's loss liabilities. Economic and/or legal developments could occur that may cause the fund's actuary to revise its estimates, positively or negatively. In addition, the Committee may consider these projections in the context of the fund's previous "hindsight" adjustments, which have consistently reduced the fund's past estimates of loss liabilities. In that regard, the fund's actuary has provided the fund's actuarial committee a hindsight analysis, based on an additional year's experience, that would have increased the fund's surplus as of June 30, 2006, to $123 million, rather than the $59.9 million surplus initially reported as of that date. Whether such hindsight adjustments will continue to occur in the future, and what the magnitude of such adjustments might be, cannot be predicted.

21. The projected deficits shown in Tables 5 and 6 are larger than previous deficits reported by the fund, the greatest of which was $122.7 million as of June 30, 1988. In response to the deficits reported during that period, the fund's Board of Governors implemented a long-term plan to restore the fund's financial integrity that included a series of assessment increases phased in over time. By the late 1990s, the fund began reporting surpluses, in part because of those assessment increases, but also in large part because of the fund's better-than-anticipated loss experience during that period.

22. The fund's Board of Governors has not indicated what specific measures it would implement in the event the Governor's recommendation to transfer $175 million from the fund is approved, although fund management has indicated that the Board is required to operate the fund in a fiscally responsible manner. One option, presumably, would be to increase provider assessments. The magnitude of any such increases, and the period of time over which they would be implemented, is not known at this time.

23. In a memorandum to Members of the Joint Committee on Finance, dated March 20, 2007, the Wisconsin Medical Society stated its opposition to the Governor's recommended transfer.

In addition, by letter to the Co-Chairs of the Joint Committee on Finance dated March 22, 2007, OCI informed the Co-Chairs of the following resolution passed unanimously by the fund's Board of Governor's (with the Commissioner of Insurance abstaining):

> The Injured Patients and Families Compensation Fund Board of Governors, as trustees, opposes any attempt to use Injured Patients and Families Compensation Fund fund's money for any use beyond the original legislative intent developed in 1975 and further strengthened and defined by 2003 Wis. Act 111. Injured Patients and Families Compensation Fund trust fund monies, under statutes in Chapter 655, are held in irrevocable trust to be used only for purposes of medical liability claims beyond the primary insurance limits.

24. The Board of Governors' resolution references 2003 Wisconsin Act 111, which, among other things, repealed and recreated s. 655.27(6) of the statutes to provide as follows:

> The fund is established to curb the rising costs of health care by financing part of the liability incurred by health care providers as a result of medical malpractice claims and to ensure that proper claims are satisfied. The fund, including any net worth of the fund, is held in irrevocable trust for the sole benefit of health care providers participating in the fund and proper claimants. Moneys in the fund may not be used for any other purpose of the state.

25. In a memorandum dated May 24, 2007, Wisconsin Legislative Council staff addressed several legal issues related to the Governor's recommended transfer from the fund, including the following: (1) whether the recommended transfer could be deemed a taking of property without just compensation; (2) whether the recommended transfer could be deemed an impermissible impairment of contract; (3) whether the recommended transfer is consistent with the stated purposes of s. 655.27(6); and (4) how, if at all, these issues might be affected by the bill's language that the recommended transfer would occur "notwithstanding s. 655.27(6) of the statutes."

With respect to the first two issues, Legislative Council staff concluded that arguments could be made both in support of and contrary to claims that the Governor's recommended transfer constituted a taking of property without just compensation and/or an impermissible impairment of contract. Regarding the matter of legislative intent, Legislative Council staff concluded that the recommended transfer is probably not consistent with the fund's statutory purpose, but that language in the Governor's bill stating that the assets shall be transferred "notwithstanding s. 655.27(6)" has the same general effect as a statutory change that would broaden the purpose of the fund. Because the "notwithstanding" clause appears in nonstatutory language, however, its effect would extend only through the legislative session in which it was enacted. A copy of the Legislative Council staff's May 24, 2007 memorandum is attached to this paper.

26. Finally, the Committee may wish to consider the fund's role in the larger context of Wisconsin's medical malpractice liability environment. According to a report by the American Medical Association, Wisconsin is one of eight states with a "stable" medical liability environment.

At least four of those states, Wisconsin, Indiana, New Mexico, and Louisiana, have patients compensation funds, although those funds differ in key respects. For example, of those four states' funds, only Wisconsin's has mandatory participation and only Wisconsin's provides unlimited excess medical malpractice liability coverage. Each of those four states also has some form of statutory limitation on the recovery of noneconomic damages for medical malpractice claims, as do numerous other states. It is difficult to determine the fund's precise role in creating and maintaining Wisconsin's relatively stable medical liability environment, separate from such other potential factors as the statutory cap on noneconomic damages and the quality of health care services provided in Wisconsin. In an October, 2004, Report on the fund, however, the Legislative Audit Bureau stated the following: "The Injured Patients and Families Compensation Fund is often cited as an important factor in Wisconsin's relatively stable environment for health care providers in comparison to other states. Its solid financial position provides flexibility to readily respond to changes that may occur in the medical malpractice environment in the future."

27. The Committee could decide to approve the Governor's recommendation to transfer $175 million from the fund to the HCQF in 2007-08. The fund's actuary estimates the transfer would negatively impact the fund's net financial position by $235.1 million when lost investment earnings are added to the initial $175 million transfer. Table 6 shows the most current actuarial projections of what the fund's year-end surplus or deficit would be if the transfer is approved. While it is not known at this time precisely what steps the fund's Board of Governors would take if the transfer is approved, those steps presumably would include an increase in provider assessments. Approving the transfer could also expose the state to one or more of the legal issues discussed in the Legislative Council staff's May 24, 2007 memorandum.

28. The Committee could also delete the Governor's recommendation, in which case the Committee would need to identify alternative funding sources if it approves expenditures that would have been funded from the Governor's recommended transfer of fund assets.

ALTERNATIVES TO BILL

1. Approve the Governor's recommendation and transfer $175 million from the fund to the HCQF in 2007-08.

2. Delete provision.

Prepared by: Eric Peck

WISCONSIN LEGISLATIVE COUNCIL

Terry C. Anderson, Director
Laura D. Rose, Deputy Director

TO: BOB LANG, DIRECTOR, LEGISLATIVE FISCAL BUREAU

FROM: Laura Rose, Deputy Director

RE: Injured Patients and Families Compensation Fund Issues in 2007 Senate Bill 40

DATE: May 24, 2007

This memorandum addresses several questions relating to a proposal in 2007 Senate Bill 40 to transfer funds from the Injured Patients and Families Compensation Fund (IPFCF) to the proposed Health Care Quality Fund (HCQF). The memorandum first sets out the questions and brief answers, provides background on the proposal, and then provides a more detailed response to the questions.

A. QUESTIONS AND BRIEF ANSWERS

1. Can the proposed transfer of funds from the IPFCF to the HCQF be considered a taking of property without just compensation?

   Brief answer: The transfer might be considered a taking of property without just compensation if the transfer of funds from the IPFCF to the HCQF takes place and results in the IPFCF being unable to pay claims to patients, or results directly in higher assessments to participating health care providers. However, there is case law on the other side of this issue.

2. Can the proposed transfer of funds from the IPFCF to the HCQF be considered an impairment of contract?

   Brief answer: The transfer might be considered an impairment of contract if the transfer of funds from the IPFCF to the HCQF takes place and results in IPFCF provider assessments being used for purposes other than those originally contemplated when the IPFCF was created. However, arguments might be made that the public purpose behind the transfer of funds is important enough to justify any alleged impairment of contract.

3. Is the proposed transfer of funds from the IPFCF to the HCQF consistent with the purposes of the IPFCF specified in s. 655.27 (6)?

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Brief Answer: The transfer is probably not consistent with the statutory purposes of the IPFCF. However, the transfer may still be permissible if justified by a public purpose.

4. If the proposed transfer of funds from the IPFCF to the HCQF is not consistent with the statutory purpose of the IPFCF, does the language in SECTION 9225 (2) of Senate Bill 40 which "notwithstands" the transfer from the restrictions on the IPFCF alleviate these problems?

Brief Answer: The nonstatutory language in the bill that "nothwithstands" the transfer from the IPFCF restrictions is an attempt to broaden the purposes of the fund to justify the proposed transfers. This language has the effect that a statutory change would have, except that the effect is temporary.

B. BACKGROUND

1. Current Law

Subchapter IV of ch. 655, Stats., creates the IPFCF. The purpose of the fund is to pay that portion of a medical malpractice claim which is in excess of the liability limits expressed in ch. 655, or in excess of the maximum liability limit for which the health care provider is insured, whichever limit is greater; paying future medical expense payments of an injured patient; and paying claims resulting from peer review activities.

Section 655.27 (6) further provides that the IPFCF "is established to curb the rising costs of health care by financing part of the liability incurred by health care providers as a result of medical malpractice claims and to ensure that proper claims are satisfied. The fund, including any net worth of the fund, is held in irrevocable trust for the sole benefit of health care providers participating in the fund and proper claimants. Moneys in the fund may not be used for any other purpose of the state."

Subchapter IV of ch. 655 establishes the governance, funding system, and structure of the IPFCF. The fund is governed by a Board of Governors and a system of assessments on health care providers covered by the IPFCF. The assessments are established by the Commissioner of Insurance after approval by the Board of Governors. The statute sets out a claims system through which injured parties can file a claim for damages arising out of the rendering of medical care and services or the operation of the peer review system.

2. Proposal in 2007 Senate Bill 40

The Legislative Fiscal Bureau Summary of 2007 Senate Bill 40 describes a proposal in the bill to create a HCQF as a separate, nonlapsible trust fund, which would consist of:

a. All revenue the state collects from the cigarette tax that exceeds $304,000,000 in 2007-08 and $305,000,000 in 2008-09 and in each subsequent year;

b. All revenue the state receives from the tobacco products tax that exceeds $18,400,000 in 2007-08 and $19,300,000 in 2008-09 and in each subsequent year;

c. All moneys received from a tax on hospital gross revenues, which would be created in the bill;

d. $50,000,000 in each fiscal year that would be transferred from the permanent endowment fund (the fund consists of all of the proceeds from the sale of the state's right to receive payments under a tobacco settlement agreement and investment earnings on the proceeds); and

e. $175,000,000 that would be transferred from the IPFCF in 2007-08.

The fund would support several programs administered by the Department of Health and Family Services, the Health Care Quality and Patient Safety Board, and the Healthy Wisconsin Authority, including: (a) a number of new health programs, including the creation of the Health Care Quality and Patient Safety Council and Grant Program; and (b) increases in funding for current programs, including MA rates and hospital reimbursement rates. In addition, the bill would replace general purpose revenue (GPR) base funding for several current programs with segregated revenue from the new fund.

With regard to the transfer from the IPFCF to the HCQF, no statutory changes are proposed, so the statutory purpose of the IPFCF as set forth in s. 655.27 (6), Stats., remains intact. However, SECTION 9225 (2) of Senate Bill 40 provides that "**Notwithstanding** s. 655.27 (6) of the statutes, there is transferred from the injured patients and families compensation fund to the health care quality fund $175,00,000 in fiscal year 2007-08" (emphasis added). Nonstatutory provisions have the effect of law, but the effect is temporary, rather than the continuing effect the provision would have if it were incorporated into the statutes. (Wisconsin LRB Drafting Manual, 2007-2008, Chapter 12.01.)

C. DETAILED DISCUSSION OF QUESTIONS

The following summarizes some possible issues that could be raised with respect to the questions outlined in the beginning of this memorandum.

1. *Taking of Property Without Just Compensation.* Section 655.27 (6), Stats., provides that the IPFCF, including any net worth of the IPFCF, is held in "irrevocable trust" for the sole benefit of health care providers participating in the fund and proper claimants, and the moneys may not be used for any other purpose of the state. Therefore, it is possible that the proposal in Senate Bill 40 to reallocate moneys from the IPFCF to the HCQF may be considered to be a taking of property without just compensation.[1]

The initial steps in analyzing a taking claim are determining whether a private property interest exists and whether the private property has been taken.[2] If private property is shown to have been taken, the next steps are to determine whether the property is taken for a valid public use, and whether just compensation is provided therefore.[3]

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[1] The U.S. Constitution, Amendment Five, provides in part: "No person shall...be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." Article I, Section 13 of the Wisconsin Constitution provides: "The property of no person shall be taken for public use without just compensation therefore."

[2] *Wisconsin Professional Police Association, Inc. v. Lightbourn*, 243 Wis. 2d 512, 627 N.W.2d 807 (S. Ct. Wis. 2001).

[3] *Wisconsin Retired Teachers Assn. v. Employee Trust Funds Board*, 207 Wis. 2d 1, 558 N.W.2d 83 (1997).

An accrued claim for medical malpractice is a property interest.[4] An individual who receives a malpractice award has a property right in having the claim paid by the IPFCF if it exceeds the limits for which the liable health care provider is insured. If the Senate Bill 40 proposal were to result in jeopardizing the payment of a claimant's award by the IPFCF, it could be seen as a taking of property without due process of law.

On the other hand, it could be argued that the cash reserves in the IPFCF are ***not*** private property. In *Great Lakes Higher Education Corporation v. U.S. Department of Education*, the cash reserves of the Great Lakes Higher Education Corporation (GLHEC), a private, nonprofit corporation providing student loan guarantees, were found not to be "private property" for the purposes of the Fifth Amendment to the U.S. Constitution.[5] In that case, the U.S. Department of Education (DOE), after amendments to the statutes governing the agreements between student loan guarantee agencies such as GLHEC and DOE, recouped cash reserves from these agencies that it determined were excessive. The court said this recoupment of reserves was not a taking:

> The purpose and legal structure of Great Lakes places it in that borderline between the wholly public and wholly private instrumentality. The extensive federal regulation of the agency suggests its highly public nature.... In essence, Great Lakes is an intermediary between the United States and the lender of the student loan. The United States is the loan guarantor of last resort. Great Lakes assists the United States in performing that function. It cannot be compelled to perform that function, nor can it insist that its compensation for that service be irrevocably fixed. We, therefore, conclude that the reserve fund excess is not "private property" for purposes of the Fifth Amendment.[6]

If a court were to determine that private property interests exist in the IPFCF for claimants or payors, the next question is whether: (1) the proposal in Senate Bill 40 to create the HCQF and transfer approximately $175,000,000 from the IPFCF to the HCQF reserves jeopardizes the payment of any accrued claims under the IPFCF; or (2) the proposal will result in an increase in IPFCF provider fees, and those fees are taken for a use not contemplated by ch. 655.

Several Wisconsin Supreme Court cases examined transfer of funds from state trust funds to other funds. These cases reach seemingly different conclusions. The *Wisconsin Professional Police Association* case[7] found no taking where legislation authorized the transfer of funds from the one account in the Wisconsin Retirement System (the transaction amortization account or TAA) to the reserves and accounts in the fixed trust, and resulted in more benefits to some classes of fund participants over others.

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[4] *Aicher v. Wisconsin Patients Compensation Fund*, 237 Wis. 2d 99, at 143 (S. Ct. 2000).

[5] 911 F. 2d 10, at 14 (7th Cir. 1990).

[6] 911 F. 2d 10, at 13-14.

[7] Supra, footnote 2.

Another transfer at issue in *Wisconsin Professional Police Association* involved a distribution of $200,000,000 from the employer reserve to employers as a credit for employers against unfunded liabilities. The court stated that this was not an unconstitutional taking of property, nor was it an unconstitutional impairment of contract:

> The size of the employer reserve balance does not increase or in any way determine the contractual benefit to be received by participants. At best, the balance in the employer reserve may heighten the possibility of an increase in the formula multiplier or the benefit caps in a future vote by the state legislature.... No one in this litigation suggests that Act 11 abrogates the statutory and constitutional obligation of employers to fulfill benefit commitments to participants. These "benefits accrued" for "service rendered" are the essence of the property right enjoyed by participants. There is no taking of property or impairment of contract when everyone concedes that accrued benefits must be paid....[8]

Other cases have found an unconstitutional taking upon a transfer from vested retirement funds. In *Association of State Prosecutors v. Milwaukee County,*[9] the court determined that it was an unconstitutional taking to give retirement service credits to district attorneys transferred from the Milwaukee County system to the state system and fund the transferred credits by transferring moneys out of the county pension fund, instead of paying for the credits with state moneys.

An unconstitutional taking was also found in *Wisconsin Retired Teachers Association, Inc. v. ETF Board.*[10] In that case, a transfer from the retirement fund was authorized by the passage of a law that superseded the role of the Employee Trust Fund (ETF) in making such transfers. In that case, 25% of annuitants received a special investment performance dividend as part of a $230,000,000 distribution from the TAA, while 75% of annuitants received no dividend. This distribution violated many of the statutory provisions in ch. 40 and superseded the statutory role of the ETF in making these distributions.

2. *Impairment of Contract.* The proposal to reallocate moneys from the IPFCF to the HCQF created in the Governor's budget bill may be considered to constitute an impairment of contract, which is prohibited by both the U.S. and Wisconsin Constitutions.[11] If the IPFCF is contractually limited to

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[8] 243 Wis. 2d 512, at 602-603.

[9] 199 Wis. 2d 549 (S. Ct. Wis. 1996).

[10] 207 Wis. 2d 1 (S. Ct. Wis. 1997).

[11] Article I, Section 10 of the U.S. Constitution provides, in part, as follows: "No state shall...pass any...law impairing the obligations of contracts...." Article I, Section 12 of the Wisconsin Constitution, provides, in part, as follows: "No bill of attainder, ex post facto law, nor any law impairing the obligation of contracts, shall ever be passed...."

paying part of health care provider liability for medical malpractice claims to further the purpose of curbing the rising costs of health care by financing part of the liability, then using the funds for unrelated purposes could be deemed an impairment of contract.

The Wisconsin Supreme Court, in *Wisconsin Professional Police Association,*[12] outlined a three-step methodology developed by the U.S. Supreme Court in analyzing impairment of contract claims: first, to inquire whether the challenged statute has operated as a substantial impairment of a contractual relationship; second, if the legislation is found to substantially impair a contractual relationship, whether there exists a significant and legitimate public purpose behind the legislation; and third, if such a public purpose exists, whether the challenged legislation is based upon reasonable conditions and is of a character appropriate to the public purpose justifying the legislation's adoption.

In this case, health care providers required to participate in the IPFCF could possibly claim a contractual relationship with the state through the IPFCF: in return for payment of the mandated fees, the participating providers receive malpractice coverage for claims which exceed the amounts covered by private malpractice insurance policies. If the Governor and the Legislature created a new purpose for ch. 655 after establishing the initial contractual relationship, these providers could assert that they did not agree to have their fees used for this broader statutory purpose.

If this proposal were to be enacted into law and subsequently challenged in court, the court would first analyze whether this change in the purpose of ch. 655 operated as a significant impairment of contract. In *Great Lakes Higher Education Corporation v. U.S. Department of Education,*[13] the court found no impairment of contract when the agreement between GLHEC and the U.S. DOE was altered by statutory amendments to permit the recoupment of cash reserves. However, in that case, the original enabling legislation specifically stated that GLHEC agreed to conform both to the existing federal statutes and regulations and to new obligations that Congress or the Secretary of Education might impose in the future. GLHEC consented to these terms in the insurance program agreement.

In this case, the statutes governing the IPFCF do not mention that the health care providers participating in the IPFCF agree to be bound by new obligations that the Legislature might impose on the fund in the future. Of course, the Legislature is free to amend the purpose of the IPFCF at any time. However, it could be questioned whether reserves that were established under current law, especially those that have accrued since the law was changed under 2003 Wisconsin Act 111, may be bound by the new purposes proposed in Senate Bill 40 (i.e., funding the HCQF).

If a court found an impairment of contract, a court would then examine whether there is a significant and legitimate public purpose behind the legislation allegedly giving rise to the impairment. The proponents would likely assert that using IPFCF reserves to supplement MA costs is essential to maintaining the participation of health care providers in the MA program and to ensuring the availability of health care providers to serve low-income persons in this state. Alternatively, if the transfer of funds were to somehow result in an unacceptable fee increase for participating providers that resulted in lessening the supply of providers, it could be argued that the proposal does not serve a significant and

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[12] *Wisconsin Professional Police Association*, 234 Wis. 2d 512, at 593-594.

[13] Supra, footnote 5.

legitimate public purpose. However, it is beyond the scope of this memorandum to speculate on the effect of the proposal on IPFCF fees.

Finally, if an impairment of contract is found, but justified by a legitimate public purpose, a court would examine whether the legislation is based upon reasonable conditions and is of a character appropriate to the public purpose justifying the legislation's adoption. It might also examine whether it is reasonable and appropriate to require mandatory IPFCF participants to supplement MA costs with their fees, as well as funding the other purposes established under the HCQF.

3. *Purposes of the Fund.* The purpose of the IPFCF as stated in s. 655.27 (6), Stats., is "to curb the rising costs of health care by financing part of the liability incurred by health care providers as a result of medical malpractice claims and to ensure that proper claims are satisfied." Senate Bill 40 proposes a transfer from the IPFCF to the HCQF for various other purposes. None of the purposes of the HCQF include the purpose of the IPFCF outlined in s. 655.27 (6).

Although it could be argued that the creation of the Health Care Quality and Patient Safety Council and Grant Program within the HCQF could ultimately reduce medical malpractice claims by reducing medical errors and increasing patient safety, this council and grant program do not finance medical malpractice claims liability, as expressed in s. 655.27 (6).

Even if the proposed transfer is not within the purpose of s. 655.27 (6), this does not necessarily mean it is legally impermissible. This would require a determination of the public interest served by the transfer, balanced against the private interests in maintaining the integrity of the IPFCF. These issues were discussed in the prior sections relating to the taking of property without just compensation, and the impairment of contracts issue.

4. *Effect of Nonstatutory Language on the Permissibility of the Transfer.* The inclusion of nonstatutory language that "nothwithstands" the language in s. 655.27 (6), Stats., when making the transfer, has the same general effect as a statutory change that would broaden the purpose of the fund. The only difference is that nonstatutory language has a temporary effect extending only for the duration of the session in which it is enacted, whereas a statutory change would be in effect until repealed or sunset by the Legislature.

If you have any questions on the issues raised in this memorandum, please contact me directly at the Legislative Council staff offices. My telephone number is 266-9791.

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