WISCONSIN LEGISLATIVE COUNCIL

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

TO: SENATOR DALE SCHULTZ

FROM: Laura Rose, Deputy Director

RE: Background on Patients Compensation Fund, Description of Budget Proposal, and Discussion of Constitutional Issues Surrounding the Budget Proposal

DATE: March 14, 2003

This memorandum, prepared at your request, provides information on the Patients Compensation Fund (PCF). This memorandum provides background on the creation of the PCF and major changes to the fund that have occurred since its creation; describes the structure and operation of the PCF; describes the proposal in 2003 Senate Bill 44 (the 2003-05 Biennial Budget Bill) to create a new subchapter in ch. 655 for health care provider access and availability and to transfer $200 million from PCF to the newly created program; and discusses possible constitutional issues surrounding the proposal in Senate Bill 44.

BACKGROUND

1975 Legislation

In the 1975 Legislative Session, the Legislature enacted comprehensive malpractice legislation that contained the following provisions:

- Created a mandatory health care liability risk-sharing plan under s. 619.04, Stats., known as the Wisconsin Health Care Liability Insurance Plan (WHCLIP). The WHCLIP provides professional liability insurance for physicians, hospitals, and nurse anesthetists, if such insurance was not readily available in the voluntary market.

- Required all physicians, hospitals, and nurse anesthetists to be insured in the amount of at least $100,000 per claim and $300,000 ($100,000/$300,000) per year in total claims and limited the maximum liability for malpractice for these health care providers who obtain such coverage to $200,000 per claim and $600,000 ($200,000/$600,000) per year in total claims. (These dollar amounts have been periodically revised and are now set at $1,000,000/$3,000,000.)

One East Main Street, Suite 401 • P.O. Box 2536 • Madison, WI 53701-2536
(608) 266-1304 • Fax: (608) 266-3830 • Email: leg.council@legis.state.wi.us
http://www.legis.state.wi.us/lc

- Created the PCF to pay any settlement or award which exceeded $200,000 or which, when added to previous claims paid during the year by the health care provider's insurer, caused a total of such claims against the provider to exceed $600,000. (These dollar amounts have been periodically revised and are now set at $1,000,000/$3,000,000.)

- Restricted attorney contingency fees and required an attorney to offer to charge a client on a per diem or per hour basis, instead of a contingency basis, at the time the attorney was retained.

- Required amounts for future medical expenses in excess of $25,000 in any settlement or award for a malpractice claim to be paid into the PCF and paid out periodically to the patient, as needed. (These dollar amounts have been periodically revised and are now set at $100,000.)

- Established "informal" PCF panels to review malpractice claims for $10,000 or less and formal PCF panels to review claims for more than $10,000. The cost of the panels was financed by annual fees imposed on physicians and hospitals.

1985 Wisconsin Act 340

1985 Wisconsin Act 340, the product of the Legislative Council's Special Committee on Medical Malpractice, addressed the operations and solvency of the PCF and the WHCLIP; examined the legal doctrines and professional standards relating to the determination of professional liability of health care providers; and examined the operations and effectiveness of the patient compensation panels.

Act 340 contained the following major provisions:

- Limited the total recovery for noneconomic damages for any single occurrence of medical malpractice against all health care providers covered by ch. 655 to $1 million for awards made between June 14, 1986 and December 31, 1990.

- Raised the threshold at which the fund assumed liability for payment.

- Abolished the patient compensation panels and created a malpractice mediation system. Act 340 imposed a mediation participation requirement for all parties to a medical malpractice case filed after September 1, 1986.

- Required the fund fees for physicians to be established as a four-category fee structure and placed a limit on fees set by the PCF Board of Governors for a particular fiscal year. It also required the PCF Board of Governors, in setting rates for the fund, to consider the loss and expense experience of an individual health care provider which resulted in payments from the fund or other sources.

- Removed podiatrists from the fund effective July 1, 1986; expanded the range of corporations covered by the fund and the WHCLIP; expanded the coverage of hospitals by the fund under the WHCLIP; clarified that the fund provides coverage for actions brought against health care providers or their employees acting within the scope of their employment.

- Made various changes to the health care provider discipline provisions in ch. 448 and also created a statutory presumption of good faith on the part of any person participating in peer review activities. The fund also was expanded to provide coverage for a liability relating to peer review activities of health care providers covered by the fund.

1995 Wisconsin Act 10

1995 Wisconsin Act 10 made several changes to the medical malpractice laws, as follows:

- Recreated a provision relating to the periodic payment of future medical expenses, which was part of the original medical malpractice law of 1975, and was sunset by 1985 Wisconsin Act 340.

- Created a new limitation on noneconomic damages for all health care providers that applies to acts or omissions occurring on or after the effective date of 1995 Wisconsin Act 10. This limit, originally established as $1 million in 1985 Wisconsin Act 340, was reduced to $350,000 and indexed for inflation.

- Reinstated a periodic payment provision for fund liability of $1 million or more applicable to acts or omissions occurring on or after May 25, 1995.

- Provided that damages recoverable in a wrongful death action against a health care provider and employees of health care providers are subject to the provisions of s. 895.04 (4), Stats., the $150,000 wrongful death limit for loss of society and companionship (the limit is now $500,000 in the case of a deceased minor and $350,000 for a deceased adult). Further, if damages in excess of the limit are found, the court must make any necessary reductions for contributory negligence and award the lesser of the reduced amount or the limit under s. 895.04 (4), Stats.

DESCRIPTION OF THE PCF

Board of Governors

Subchapter IV of Chapter 655, Stats., governs the PCF. The PCF Board of Governors consists of 13 members: three representatives of the insurance industry appointed and serving at the pleasure of the Commissioner of Insurance; a person named by the Wisconsin Bar Association; a person named by the Wisconsin Academy of Trial Lawyers; two persons named by the Wisconsin Medical Society; a person named by the Wisconsin Hospital Association; the Commissioner of Insurance or designee employed by the Office of the Commissioner; and four public members, at least two of whom are not attorneys or physicians and are not professionally affiliated with any hospital or insurance company, appointed by the Governor for staggered three-year terms. The Commissioner of Insurance is the chairperson of the Board of Governors. The Board of Governors governs the PCF, as well as the WHCLIP under s. 619.04, Stats.

Participating Providers

Participation in the PCF and in the WHCLIP is mandatory among the following classes of health care providers:

- Physicians and osteopaths licensed under ch. 448, Stats.;
- Registered nurses licensed under ch. 441, Stats., who are certified nurse anesthetists;
- Corporations or partnerships comprised of physicians or nurse anesthetists organized and operating in Wisconsin for the primary purpose of providing medical services of physicians or nurse anesthetists;
- A cooperative sickness care association;
- An ambulatory surgery center operating in Wisconsin;
- A hospital operating in Wisconsin;
- An entity operating in this state that is an affiliate of a hospital and that provides diagnosis or treatment of, or care for, patients at the hospital; and
- A nursing home whose operations are combined as a single entity with a hospital, whether or not the nursing home operations are physically separate from the operations.

Employees of health care providers are also covered by the PCF.

Mandatory Malpractice Coverage

Health care providers covered by ch. 655 must insure their liability by a health care liability policy in the amounts of $1 million for each occurrence and $3 million for all occurrences in any one policy year for occurrence coverage; or $1 million for each claim arising for an occurrence and $3 million for all claims in any one recording year for claims-made coverage. (Insurance on an occurrence basis covers all claims that arise out of ***services provided*** during the year in which insurance coverage is provided; claims-made coverage covers ***claims that are filed*** during a year in which coverage is provided.) A provider may also self-insure for those same amounts. Health care providers covered under ch. 655 must comply with these requirements before being permitted to operate under their licenses.

PCF Assessments

The purpose of the PCF is to pay that portion of a medical malpractice claim which is in excess of these limits or the maximum liability for which a health care provider is insured, whichever limit is greater. The fund provides occurrence coverage for claims against health care providers and against employees of those health care providers, reasonable and necessary expenses incurred in payment of claims, and PCF administrative expenses.

Each health care provider participating in the fund must pay an annual assessment. The assessments are deposited into the fund to pay claims and to pay the costs of the PCF Peer Review Council. The assessments are based on:

- Past and prospective loss and expense experience in different types of practice;

- Past and prospective loss and expense experience of the fund;

- The loss and expense experience of the individual health care provider which resulted in the payment of money, from the fund or other sources, for damages arising out of the rendering of medical care by the health care provider or an employee of the health care provider. An adjustment to a health care provider's fees may not be made under this provision prior to the receipt of the recommendation of the PCF Peer Review Council, the expiration of the time period for the health care provider to comment on the recommendations, or prior to the expiration of the time period under s. 655.275, Stats.;

- Risk factors for persons who are semi-retired or part-time professionals; and

- For corporations or partnerships of physicians and nurse anesthetists, and cooperative sickness care associations, risk factors and past and prospective loss and expense experience attributable to employees of that health care provider other than employees licensed as a physician or nurse anesthetist.

The fees are set by the Commissioner of Insurance by administrative rule. The fees are divided into four payment classifications based on the amount of surgery performed in the risk of diagnostic and therapeutic services provided or procedures performed.

Automatic increases in a health care provider's fees are provided for if the loss and expense experience of the fund and other sources with respect to the health care provider or a health care provider's employee exceed either a number or dollar volume of claims paid threshold. Both of these thresholds are established by rule. The fees assessed by rule may not exceed the greatest of the following:

- The estimated total dollar amount of claims to be paid during that particular fiscal year.

- The fees assessed for the fiscal year preceding that particular fiscal year, adjusted by the Commissioner of Insurance to reflect changes in the Consumer Price Index for the medical care group.

- 200% of the total dollar amount disbursed for claims during the calendar year preceding that particular fiscal year.

Use of PCF Moneys; Payment of Claims

The statutes provide that the PCF shall be held in trust for the purposes of ch. 655 and may not be used for purposes other than those of ch. 655.

Any patient or patient's representative having a claim, or any spouse, parent, minor sibling, or child of a patient having a derivative claim for injury or death on account of malpractice is bound by ch. 655. Any person filing a claim may recover from the PCF only if the health care provider or employee of the health care provider has coverage under the PCF, the PCF is named as a party in the action and the action against the PCF is commenced within the same time limitation within which the action against the health care provider or employee of the health care provider must be commenced. If, after reviewing the facts of the claim or action, it appears probable that damages paid will exceed the $1 million/$3 million limits, the PCF may appear and actively defend itself when named as a party in an action against a provider covered under the PCF. The PCF is also permitted to retain counsel and pay attorneys fees out of the fund.

Moneys may be withdrawn from the fund by the Commissioner only upon vouchers approved and authorized by the Board of Governors. The Board of Governors must furnish an annual financial report to the Commissioner. (A copy of the most recent report of the Commissioner on the PCF is attached to this memorandum.) The report must be prepared in accordance with accepted accounting procedures and must include the present value of all claim reserves including those for incurred but not reported claims as determined by accepted actuarial principles and such other information as may be required by the Commissioner. The State Investment Board is required to invest the moneys held in the PCF in investments with maturities and liquidity that are appropriate for the needs of the fund as reported by the Board of Governors in its quarterly report. All income derived from these investments are credited to the PCF.

The person who has recovered a final judgment or settlement approved by the Board of Governors against a health care provider or an employee of a health care provider that has coverage under the PCF may file a claim with the Board of Governors to recover that portion of the judgment that exceeds the $1 million/$3 million limits or the maximum liability limit for which the health care provider is insured, whichever limit is greater.

Peer Review Council; Mediation

Chapter 655 sets up the PCF Peer Review Council. The purpose of this council is to review, within one year of the date of the first payment on a claim, each claim that is paid by the fund, by the WHCLIP, a private health care liability insurer, or a self-insurer for damages arising out of the rendering of medical care by a health care provider or a provider's employee. The Peer Review Council also makes recommendations regarding PCF fee adjustments to the Commissioner of Insurance and the PCF Board of Governors, as well as for premiums assessed against a physician under the WHCLIP and premiums assessed by a private health care liability insurer against a physician covered by private insurance.

Chapter 655 also establishes a mediation system in which participation is mandatory prior to court action. The statute of limitations for filing a medical malpractice cause of action is tolled during the period of time in which mediation is occurring.

DESCRIPTION OF BUDGET PROPOSAL

2003 Senate Bill 44, introduced by Governor Doyle, on February 20, 2003, makes the following changes to the PCF:

- Creates subch. VIII of ch. 655, the health care provider availability and cost control fund. The purposes of the fund are to assist in the education and training of health care providers; ensure that Medical Assistance health care providers and providers for other health care programs established by this state receive sufficient reimbursement rates to retain their participation in the programs; and defray the cost of other health-related programs that the Secretary of Health and Family Services determines are effective in ensuring the availability of health care providers in this state, and controlling the cost of health care services.

- Funds the health care availability and cost control fund with the transfer of $200 million in fiscal year 2003-04 from the PCF to the health care provider availability and cost control fund.

- Establishes a sum-sufficient appropriation for the payment of any portion of a claim for damages arising out of the rendering of health care services that the PCF is required to pay under ch. 655 but that the PCF is unable to pay because of insufficient moneys.

- Provides for the administration of the health care availability and cost control fund by the State Investment Board.

POSSIBLE CONSTITUTIONAL ISSUES SURROUNDING THE PCF PROPOSAL

Two possible constitutional issues may be raised with respect to the proposal in 2003 Senate Bill 44, relating to transfer of funds from the PCF reserves to the newly created health care provider availability and cost control fund: the taking of property without just compensation and impairment of contracts. It should be noted that it is beyond the scope of the memorandum to speculate on the effects of the Senate Bill 44 proposal on fees paid by participating PCF providers or on the PCF's ability to pay claims. This information may be a factor in evaluating these legal arguments.

Taking of Property

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 therefor."

In *Wisconsin Professional Police Association, Inc. v. Lightbourn*, 243 Wis. 2d 512, 627 N.W.2d 807 (S. Ct. Wis. 2001), Justice Prosser set forth the initial steps in analyzing a taking claim: whether a private property interest exists, and whether the private property has been taken. 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. *Wisconsin Retired Teachers Assn. v. Employee Trust Funds Board*, 207 Wis. 2d 1, 558 N.W.2d 83 (1997).

Property Interest

An accrued claim for medical malpractice is a property interest. *Aicher v. Wisconsin Patients Compensation Fund*, 237 Wis. 2d 99, at 143 (S. Ct. 2000). An individual who receives a malpractice award has a property right in having their claim paid by the PCF if it exceeds the limits for which the liable health care provider is insured. If the Senate Bill 44 proposal jeopardized the payment of a claimant's award by the PCF, it could be seen as a taking of property without due process of law.

It might also be possible to assert that participating PCF providers, if required to pay higher fees as a result of the Senate Bill 44 proposal, had their property taken because they did not agree to fund the health care provider availability and cost control fund created in Senate Bill 44 with their PCF fees.

It could be argued, however, that the cash reserves in the PCF are ***not*** private property. In *Great Lakes Higher Education Corporation v. U.S. Department of Education*, 911 F. 2d 10 (7th Cir. 1990), 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. 911 F. 2d 10 at 14. 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. 911 F. 2d 10, at 13-14.

Taking of a Property Interest

If it is determined that private property interests exist, the next question is whether: (1) the proposal in 2003 Senate Bill 44 to create a new fund in ch. 655 and transfer $200,000,000 from the PCF reserves jeopardizes the payment of any accrued claims under the PCF; or (2) the proposal will result in an increase in PCF provider fees, and those fees are taken for a use not contemplated by Assembly Bill 655.

A component of the proposal is to create a sum-sufficient general purpose revenue fund in the Office of the Commissioner of Insurance under s. 20.145 (2) (a). SECTION 299 of Senate Bill 44 provides as follows:

> 20.145 **(2)** (a) Claims payable by patients compensation fund. A sum sufficient for paying any portion of a claim for damages arising out of the rendering of health care services that the patients compensation fund under

> s. 655.27 is required to pay under ch. 655 but that the patients compensation fund is unable to pay because of insufficient moneys.

This provision indicates intent to ensure that malpractice claims brought against the PCF are paid in full. Because this appropriation is drafted as a sum-sufficient fund, this ensures that funds will be available to pay claims if the PCF determines that the $200,000,000 transfer leaves it with insufficient moneys to pay claims.

Several Wisconsin Supreme Court cases examined transfer of funds from state trust funds to other funds. A recent case, *Wisconsin Professional Police Association*, *supra*, held that legislation which 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, which resulted in more benefits to some classes of fund participants over others, did not constitute a taking.

Another transfer at issue in this case 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.... 243 Wis. 2d 512, at 602-603.

This case would appear to support the position that the Senate Bill 44 proposal does not constitute a taking, since the proposal attempts to ensure payment of claims if the PCF runs out of money.

Other cases that have found an unconstitutional taking upon transfer from vested retirement funds. In *Association of State Prosecutors v. Milwaukee County*, 199 Wis. 2d 549 (S. Ct. Wis. 1996), 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. This case can be distinguished from the Senate Bill 44 proposal. It appears that the funds transferred out of the PCF are intended to be replaced with state general purpose revenue to the extent that the fund is left with insufficient moneys to pay claims once the transfer is made.

An unconstitutional taking was found in *Wisconsin Retired Teachers Association, Inc. v. ETF Board*, 207 Wis. 2d 1 (S. Ct. Wis. 1997). In that case, a transfer from the retirement fund was authorized by the passage of a law that superseded the role of the ETF in making such transfers. In that case, 25% of annuitants received a special investment performance dividend as part of a $230 million

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 Employee Trust Fund in making these distributions.

That case may also be distinguished from the budget proposal in Senate Bill 44, in that the proposal amends provisions in ch. 655 to permit the $200 million transfer to the newly created fund. The purposes of ch. 655 are expanded in Senate Bill 44 to encompass this new purpose: the funding, through the PCF, of the health care provider availability and cost control fund.

The proponents of the Senate Bill 44 proposal also appear to be arguing that ch. 655 included the purposes of ensuring health care provider affordability and cost control even before the proposed expansion of the chapter in Senate Bill 44. The *Budget in Brief*, pp. 58-59, attempts to support this assertion by citing *Patients Compensation Fund v. Lutheran Hospital*, 223 Wis. 2d 439 (S. Ct. 1999) and *State ex rel. Strykowski v. Wilkie*, 81 Wis. 2d 491 (S. Ct. 1978).

However, it could also be argued that ch. 655 did not encompass these purposes at the time the reserves were accumulated, and to require PCF participating providers to finance these new purposes violates ch. 655 and constitutes a taking.

Impairment of Contract

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…."

The Wisconsin Supreme Court, in *Wisconsin Professional Police Association*, *supra*, stated that it usually follows 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. *Wisconsin Professional Police Association*, 234 Wis. 2d 512, at 593-594.

In this case, health care providers required to participate in the PCF could claim a contractual relationship with the state through the PCF: in return for payment of the mandated fees, the participating providers receive malpractice coverage for claims which exceed the amounts covered by their private malpractice insurance policies. By creating a new purpose for ch. 655 after the establishment of 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*, *supra*, 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. 911 F. 2d 10, at 12. In this case, the statutes governing the PCF do not mention that the health care providers participating in the PCF 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 PCF at any time. However, it could be questioned whether reserves that were established under current law may be bound by the new purposes proposed in Senate Bill 44.

As noted earlier, the Governor's explanation of the proposal in the *Budget in Brief*, 2003-05, pp. 58-59, however, seems to assert that the PCF could already be used for these purposes even prior to the addition of subch. VIII to ch. 655 in Senate Bill 44.

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 that allegedly gave rise to the impairment. The proponents would likely assert that using PCF reserves to maintain and increase Medical Assistance reimbursement rates is essential to maintaining the participation of health care providers in the Medical Assistance program and to ensure 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 served to lessen the supply of providers, it could be argued that the proposal does not serve a significant and legitimate public purpose. However, it is beyond the scope of this memorandum to speculate on the effect of the proposal on PCF fees.

Finally, if an impairment of contract was found, but was 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. A court would probably examine whether the establishment of the sum-sufficient fund to ensure payment of claims if the PCF might be unable to pay is a reasonable condition. It might also examine whether it is reasonable and appropriate to require mandatory PCF participants to supplement Medical Assistance provider rates with their fees and to have their fees fund the other purposes established under the health care provider availability and cost control fund.

If you have any questions or need additional information, please contact me directly at the Legislative Council staff offices.

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Attachment