Contrary to conventional wisdom, the adjudication process appears to treat physicians well.

The Fairness of Malpractice Settlements

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Critics of medical malpractice litigation charge that the current system is nothing more than a judicial "lottery' in which the odds of a generous settlement payment are unrelated to the quality of care actually provided by the defendant physician. According to this account, malpractice insurers are so afraid of lay juries that they settle virtually every claim involving a serious injury, regardless of the underlying merits.

President George W. Bush stated the claim this way:

> *Doctors and hospitals realize... it is expensive to fight a lawsuit even if it doesn't have any merit. And because the system is so unpredictable, there is a constant risk of being hit by a massive jury award. So doctors end up paying tens of thousands, or even hundreds of thousands of dollars to settle claims out of court, even when they know they have done nothing wrong.*

Is this claim correct? The strongest empirical support for it comes from the 1996 findings of the researchers who directed the Harvard study of New York hospitals. They concluded that the merits of a malpractice claim have no bearing on the likelihood of a settlement. They even suggested that the entire adjudicative process is "an expensive sideshow" in which settlement is really driven by damages, not negligence.

The widespread reliance of both tort critics and the mass media on this single prestigious study is unfortunate. Its findings are decidedly inconsistent with the substantial body of empirical data accumulated over the past several decades.

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Those studies demonstrate, contrary to the Harvard study, that settlement outcomes are directly correlated with the strength of the plaintiff's case.

That finding should not be surprising. Malpractice insurers are professional claims adjusters with a clear incentive to assess accurately each claim against one of their insureds and to settle their total portfolio of claims on favorable terms. To do this, they rely on an informal peer review process that sorts the strong claims from the weak. Both they and the plaintiffs' attorneys use independent evaluations to estimate the odds of a plaintiffs' verdict. They then multiply the odds of recovery by the likely damages to determine the "settlement value or 'expected value' of the claim."

Researchers have studied the settlements that result from this process and their findings are reassuring. Weak claims fare worst, toss-ups do better, and strong claims fare best. Weak claims are not only the least likely to result in a settlement payment, but they also settle for pennies on the dollar. Strong claims are more likely to receive a settlement payment, and the average payment is for a much larger amount. Unclear or toss-up cases fall in-between. To be sure, the fit is not perfect, yet it is surprisingly good.

To the extent that overall settlement payments depart from the recommendations of experts who have reviewed them, the discrepancies tend to favor defendants more often than plaintiffs. Researchers have found that defendants, on average, are able to settle malpractice cases for sums that are less than expected value. In toss-up cases, for example, defendants not only obtain substantial discount in the cases they settle, but they also escape payment altogether in half of the toss-up cases. Their ability to obtain favorable dispositions suggests that defendants enjoy advantages in the trial preparation and negotiating process that they can exploit in settlement negotiations.

The superior bargaining power possessed by malpractice defendants probably has several sources. Those sources include superior risk tolerance, better access to information, more experienced attorneys and insurance representatives, easier access to expert witnesses, and the incentive to fight low-odds claims vigorously. Defendants probably gain additional bargaining power from the fact that malpractice claims are very hard to win at trial, even with strong evidence of negligence. As a result, the data strongly contradict the popular assumption that defendants are treated unfairly by the settlement process.

So why do physicians feel so strongly that the outcomes are grotesquely unjust? Some of this reaction may stem from the difficulty of accepting their own fallibility. However, much may arise out of a fundamental difference between doctors and lawyers over how disputed claims should be resolved. Many physicians hold a black-and-white view of dispute resolution, in which a claim is either meritorious or not, and should either be paid in full or paid nothing. Compromise settlements seem unprincipled from this perspective. Thus, for example,

a claim with only a 35 percent chance of success on the merits should be dismissed, not settled. The fact that cases like this have genuine settlement value and often receive a (discounted) settlement payment only proves the irrationality and injustice of the system. Truth, from this perspective, is binary; settlements should be, too. Though this perspective is understandable, it is naïve and ultimately unpersuasive.

THE DATA

Over the past three decades, more than a dozen studies have examined the relationship between the strength of a plaintiff's malpractice claim and the eventual settlement of the case. I will summarize their key findings here. However, readers who would like a more detailed account of the research or who wish to examine the factual underpinnings of my summary should consult my article in the *Iowa Law Review*, which is cited at the end of this article.

Each of the empirical studies, with the notable exception of the Harvard study, has found a direct correlation between the likelihood of a settlement payment and the strength of the patient's claim. Six of the studies also looked at the size of the resulting settlements and all but one found that the size of the settlement payment was also correlated with the strength of the plaintiff's evidence. Interestingly, the Harvard study was one of them.

Researchers have found that only 10–20 percent of weak cases result in a settlement payment. Those figures may overstate the fraction of weak cases that currently result in settlements because settlement of weak cases has reportedly declined since enactment of the federal law requiring that all settlement payments be reported to a national database. The studies also show that when payment does occur in a weak case, it is heavily discounted. Often, it is only a token amount, such as forgiveness of any unpaid doctor bills.

Toss-up cases are more likely to settle. Their settlement rate, depending upon the study, generally hovers in the range of 40–65 percent. Thus, roughly half of the toss-up cases settle and half are abandoned. The studies looking at settlement size have also found that payments in the settled toss-up cases are substantially discounted to reflect the uncertainty of the patient's claim.

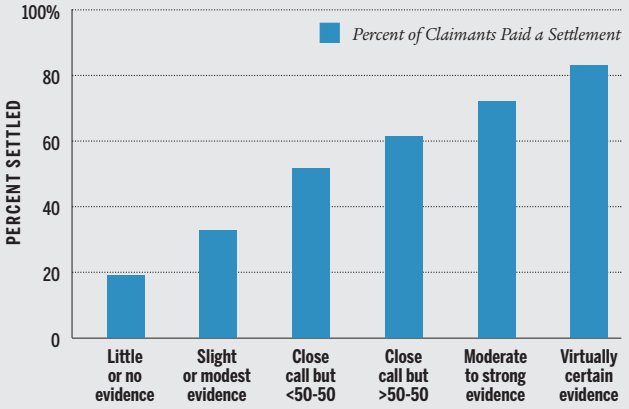
Claims backed by strong evidence of negligence settle at the highest rate of all — between 85 and 90 percent. In addition, the average payment is much larger in those cases than for cases with similar injuries and weaker evidence of negligence.

One study — the most recent — deserves further description. David Studdert and his colleagues from the Harvard School of Public Health examined 1,452 claims randomly selected from the archives of five major malpractice insurers. Physicians in the appropriate specialties were hired and trained to review the insurance companies' entire closed-claims file. The reviewers then rated the strength of each claim on a six-point scale. They found that the odds of a settlement payment were lowest in the cases with the lowest score and went up consistently as the score increased. Figure 1 displays their findings. Given those findings, the authors concluded that "the malpractice system performs reasonably well in its function of separating claims without merit from those with merit and compensating the latter."

Figure 1

Weaker Claims, Fewer Settlements

Settlement rates by strength of claim



SOURCE: *"Claims, Errors, and Compensation Payments in Medical Malpractice Litigation," by David M. Studdert et al.* New England Journal of Medicine, *Vol. 354 (2006).*

The authors of this study are not alone in their favorable evaluation of the settlement process. Mark Taragin and his coauthors concluded that "the defensibility of the case and not the severity of patient injury predominantly influences whether any payment is made. Our findings suggest that unjustified payments are probably uncommon." Frank Sloan and his colleagues also felt their findings were inconsistent with the view that the tort system is a "lottery." Rosenblatt and Hurst stated that their findings should "help to reassure physicians who are concerned that the tort process itself is unjust."

HARVARD STUDY Why then did the Harvard study fail to find any evidence that the merits of the case matter? The answer probably lies in a combination of three factors. The first is the study's design. Its many methodological biases have been outlined by Tom Baker and others, and it surely stacked the deck against a finding that settlement outcomes were related to evidence of negligence. For example, when the two reviewers were evenly split on the issue of negligence, the case was classified as a no-liability case. The decision to treat all "toss-up" cases as weak claims virtually guaranteed a finding that settlement payments are commonly made in so-called weak cases.

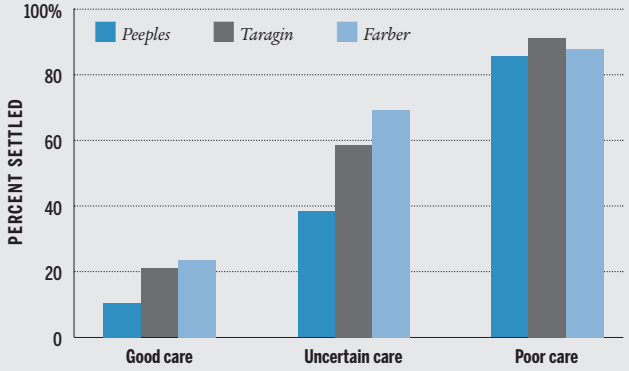
Secondly, the study was only a tiny part of a much larger study constructed with very different epidemiological purposes in mind. The number of settled cases that the authors were able to extract from the larger study was very small. The small sample size may account for the inability to detect a correlation between settlement outcome and claim quality.

The third shortcoming of the Harvard study is the lack of sensitivity in its claims evaluation process. It asked the reviewers to sort the claims into only two categories of claim strength: negligent and not negligent. By contrast, the better studies have added a third category for toss-up cases and the Studdert study commendably used six. A two-category design is flawed because it forces reviewers to push all of the toss-up cases into the two available categories. Doing this pushes

Figure 2

More Categories, Different Settlement Rates

Malpractice settlement rates reported in three-category studies

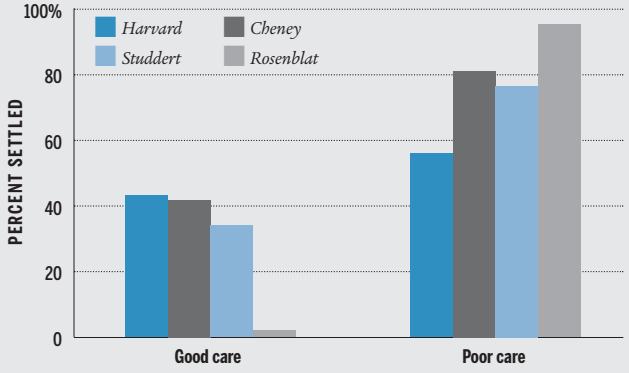


SOURCES: *Named studies*

Figure 3

The Harvard Study and Other Studies

Malpractice settlement rates reported in two-category studies



SOURCES: *Named studies*

some genuinely credible cases into the group of ostensibly weak cases, while at the same time forcing some claims of uncertain quality into the set of purportedly meritorious claims. In theory and in fact, this design pushes up the settlement rate detected in the purportedly weak cases and pushes down the settlement rate for the ostensibly strong cases. A consequence of this compression is that two-category studies consistently find a smaller difference between the settlement rates of the weak and strong claims than studies that use three categories. Figures 2 and 3 illustrate the contrast.

The Harvard study's two-category design, thus, reduced the odds that it would show a relationship between negligence and settlement rate. The combination of this design choice along with the study's small sample size and serious methodological biases probably accounts for the study's failure to detect a statistically significant correlation between negligence and probability of settlement. Whatever the explanation, it is now apparent that its findings were aberrant. It is time to stop relying on the Harvard study's findings.

The existence of both two-category and three-category studies is serendipitous, however. When combined, they provide a five-category picture that is very informative, as shown in Figure 4. When the findings are consolidated in this manner, the correlation between settlement rates and claim strength is quite striking.

Double discounting In addition to finding that the probability of settlement is related to the evidence of negligent medical treatment, the studies also have found that the size of the payment made when a settlement occurs is also discounted to reflect the odds of success at trial. In other words, malpractice defendants have sufficient bargaining power to demand a second, or "double," discount.

To illustrate why this is a double discount, consider the typical toss-up case in which the plaintiff has received borderline care that reasonable experts are as likely to condemn as to excuse. Fully informed lawyers for each side conclude that the settlement value of this case is roughly half of the plaintiff's damages. As long as the 50–50 assessment is a fair reflection of the underlying merits of the case, then settlement for this sum is both a rational settlement figure and a fair recovery for the plaintiff. In fact, if all toss-up cases were discounted in this fashion, we would expect a settlement rate of nearly 100 percent. That is because the 50 percent discount is all that fairness requires.

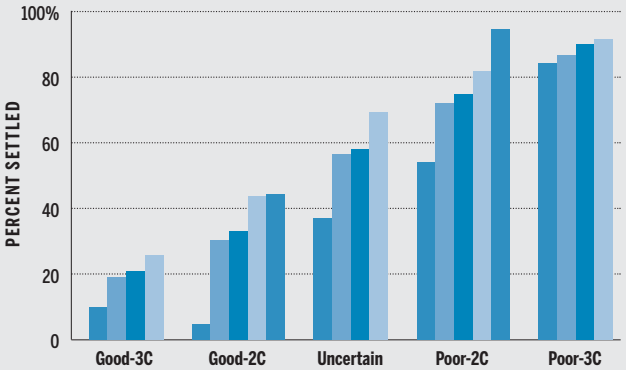
Yet, 35–60 percent of the toss-up cases are abandoned or dismissed without a penny of payment. This is a deeper discount than the evidence warrants and amounts to a double discount. In effect, those claims are discounted 100 percent, rather than 50 percent. The claimants receive nothing despite the fact that experts are as likely to say that the claims are meritorious as to say the claims lack merit.

The bargaining power that enabled defendants to extract this deep discount in nearly half of the toss-up cases probably enables them to settle strong claims at a discount as well. Unfortunately, the existing body of research does not provide the data needed to answer this question. Nevertheless, there

Figure 4

Malpractice Settlement Rates and Quality of Care

Two- and three-category (C) studies shown together



SOURCES: *Study results, compiled by author*

are clues suggesting that defendants do, indeed, have generally superior bargaining power that they can and do exercise across the entire range of claims. For example, the Studdert study found that erroneous nonpayment was more common than erroneous payment. Other studies have found that the total amount paid to settle malpractice disputes is less than the expected value of the claims. Those findings suggest that malpractice defendants possess superior bargaining power and that they use it to extract favorable settlements.

SETTLEMENT OF FRIVOLOUS CLAIMS

Despite those generally favorable findings, many physicians are likely to be upset by the evidence that settlements are paid in 10–20 percent of the cases that experts rate as defensible. As one advocate of health courts puts it, a justice system that errs in one of every four cases is unacceptable.

However, there are three good reasons why it is wrong to assume that most of the payments made in those cases are erroneous. First, researchers have found that a certain amount of disagreement is inevitable whenever multiple individuals are asked to rate the quality of another person's past performance. Part of that disagreement is caused by the difficulty of reconstructing past events accurately. This is especially true when each of the people evaluating the events has access to a different portion of the factual record, as often occurs when claims are reviewed, on the one hand, by independent reviewers (sometimes early in the life of the case) and, on the other hand, by the lawyers who are negotiating settlement and have access to interview notes, depositions, document production, and expert opinions. In medicine, the potential for disagreement between reviewers is further expanded by the frequent uncertainty that exists among physicians about the accepted response to a given patient's presentation.

Subjectivity is another source of inter-rater disagreement. It is impossible to reach perfect agreement when making subjective judgments about the reasonableness of another person's conduct. Reasonable professionals often reach different conclusions about the same evidence. In a definitive study of inter-reviewer agreement, Shari Diamond found that the disagreement rate for scientists engaged in peer review was 25 percent, the rate for employment interviewers was 30 percent, the rate for psychiatrists diagnosing psychiatric illness was 30 percent, and the rate for physicians diagnosing physical illness was 23–34 percent. Diamond and Hans Zeisel found a similar rate of disagreement among judges. Researchers who study how often physicians agree with each other in their post hoc performance evaluations have found discrepancy rates in the same range. When malpractice settlements are measured against the benchmark of inter-expert disagreement rates of 25–30 percent, the 10–20 percent discrepancy between expert opinion and settlement outcome found in both weak and strong malpractice claims seems remarkably good. In fact, the evidence that experts consistently disagree a quarter of the time may mean it is unrealistic to expect a settlement discrepancy rate that is substantially lower, even if we implement radical reforms like the adoption of a specialized health court.

Furthermore, it is important to emphasize that the disagreements produced by these processes are merely disagreements. They do not necessarily or even probably constitute errors. Some nontrivial amount of discrepancy must simply be expected. Moreover, discrepancy can sometimes be desirable, as it is when the parties reached a settlement on the basis of information that was not available to the expert reviewer.

Beyond inter-rater disagreement, there is a second reason for suspecting that payment is sometimes appropriate in cases that were rated as weak. Researchers have found that physicians have a "pronounced reluctance" to label treatment decisions as negligent even when the care was "clearly erroneous." When faced with scenarios that had been previously judged by a panel of senior physicians to be clearly negligent, only 30 percent said that the patients should receive compensation. As a consequence, the settlement of some cases rated as defensible may simply mean that the parties reached a less biased assessment of the claim's merits.

Finally, the fact that a low-odds case has been settled may not mean that the plaintiff received a windfall. The studies suggest that most of these payments are heavily discounted, sometimes to a token or face-saving amount. When that occurs, the settlement may be a genuinely fair resolution of the claim. Rate data alone cannot provide this information.

ALL-OR-NOTHING I suspect that some physicians, perhaps many, would reject the suggestion that settlement of a weak claim, even for a heavily discounted amount, is a fair outcome. Instead, they are likely to believe that this is a form of judicial blackmail. From this perspective, every settlement of a weak claim, no matter how modest in amount, constitutes an unjust outcome. The fact that a compromise settlement may be a rational business decision within the context of the civil justice system simply confirms their belief that the system is fundamentally flawed.

Physicians certainly can be excused for believing that a claim is either legitimate or it is not. Their all-or-nothing view of justice is completely consistent with the public norms of the civil justice system itself. The law routinely asks juries to make an all-or-nothing choice between disputing parties. Although students of the courts know that a considerable amount of compromising in the jury room may be necessary to produce a verdict, these deliberations and the fact of a compromise itself are kept secret.

To the extent that this negligent-or-not model of justice constitutes the legal gold standard, then the law itself has trained physicians and social scientists to look askance when settlements are paid to claimants whose claims are uncertain or worse. Blameless defendants are supposed to be exonerated. The weaker the plaintiff's case, the less satisfying the notion that settlement for expected value is a fair outcome.

Many of the empiricists who have studied malpractice outcomes seem to share this all-or-nothing orientation. The Harvard study labeled every case in which a settlement was paid as one resolved "for the plaintiff," even though the authors knew that many of the cases had settled for token amounts, such as forgiveness of outstanding medical expenses. Taragin and his colleagues used similar language, writing

that each defensible case in which a settlement was paid was "lost by the physician." A binary orientation is even implicit in researchers' choice to study settlement rates much more often than settlement amounts. While settlement rates tell us only whether (or not) the claimant received a payment, data about settlement amounts can reveal discounts falling anywhere between zero and 99 percent. One is binary and the other probabilistic. This orientation is even more apparent in the group of studies — happily a minority — that used only two categories to rate the evidence of medical negligence (negligent or not negligent).

At its foundation, this split between the probabilistic approach used intuitively by lawyers in settlements and the all-or-nothing approach preferred by physicians and many social scientists reflects a fundamental disagreement about the accessibility of the "truth" in hindsight. People who favor the binary approach implicitly assume that every medical judgment can be given a single, objective rating and that this rating can be accurately ascertained in hindsight. Consequently, they are dismayed by the fact that 10–20 percent of the cases rated as defensible in the three-category studies were resolved with a settlement payment. (In theory at least, they should be equally dismayed that a similar portion of cases rated as indefensible resulted in no settlement payment at all.)

Yet, this all-or-nothing orientation ignores the realities of post hoc decisionmaking. Prior to a verdict, at least, the strength of a claim is typically more a matter of probability than a certainty. The evidence of negligence in a given case can range from very weak to very strong. In a low-odds — but not frivolous — case, perhaps only two reviewers out of 10 would conclude that the defendant deviated from the standard of care. In a much stronger case, perhaps seven or eight out of 10 would reach this conclusion. In this concrete and realistic sense, the "merits" of a tort claim are probabilistic. That probability reflects the uncertainties produced by factors such as the factual limits on reconstructing the past, disagreements about the standard of care, and the inherent subjectivity involved in judgments about competence. When those factors are incorporated into a judgment about probability, the probabilistic description of a case's merits is likely to be more fine-grained and more accurate than a simple negligent-or-not assessment. It is hardly surprising that lawyers routinely use it.

Given the probabilistic nature of claim strength, the crucial question is not merely whether a weak or borderline claim was settled, but whether the payment received, if any, was fairly discounted. As long as the probabilities used to calculate the settlement value fairly reflect the underlying merits of the case, the expected value of a claim will constitute both a rational settlement figure and a fair recovery for the plaintiff. Because the settlement value of a case is proportional to the persuasiveness of the evidence of negligence, claims with weak evidence of negligence should settle for a substantially smaller amount than cases with strong evidence of negligence. Happily, the studies indicate that discounting of this sort occurs in malpractice litigation.

CONCLUSION

Over the past quarter of a century, more than a dozen studies have collected data on malpractice settlements. With only one exception, they have consistently shown that plaintiffs with strong cases are more likely to receive a settlement payment than plaintiffs with weak cases. When strong cases settle, the average payment is substantially larger than the average payment in weak cases.

Moreover, the data on malpractice settlement strongly suggests that liability insurers possess a palpable advantage in bargaining power. On average, malpractice claims settle for less than their expected value. The most likely sources of that bargaining power are the defendant's superior risk tolerance, better access to information, more experienced attorneys and insurance representatives, easier access to expert witnesses, and the incentive to fight low-odds claims vigorously. Defendants probably gain additional bargaining power from trial lawyer awareness that malpractice claims are very hard to win at trial, even with strong evidence of negligence.

The overall performance of the settlement process should be reassuring to those physicians who are willing to listen. Quality of care drives settlement outcomes. To the extent that settlement outcomes depart from the merits, the discrepancies usually favor malpractice defendants. Although physicians may find it hard to believe, it will be hard to design an evenhanded adjudicative process that treats them much better. R

Readings

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