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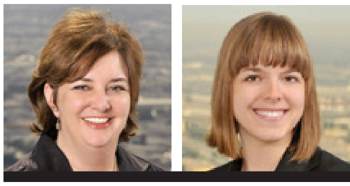
Court Sets Collateral Source Rule Straight



Erin L. Burke and Sarah G. Conway

A division among California courts in recent years had muddied the waters regarding exactly how to calculate economic damages stemming from medical services. With its August decision in *Howell v. Hamilton Meats & Provisions,* 11 C.D.O.S. 10525, the California Supreme Court resolved the conflict regarding whether a prevailing personal injury plaintiff may recover the entire amount billed for medical care or only the lesser amount actually paid by the plaintiff's insurer.

For decades, California courts limited medical expenses to the amount actually paid on behalf of the plaintiff, on the basis that allowing a plaintiff to recover more would violate tort damages principles by placing the plaintiff in a better position than she would have been otherwise. Recently, however, courts began relying on the collateral source rule to hold that plaintiffs could be entitled to the entire amount billed, reasoning that the difference between the as-billed and as-paid rate is a benefit to the insured. The *Howell* decision rejects the notion that the collateral source rule applies where the amount of the medical expenses paid by the insurer is less than the amount billed, and reaffirms that a plaintiff may recover medical expenses only in the amount of her economic loss, i.e., the actual amount paid by an insurance company for his or her benefit and accepted as payment in full by medical providers. The Supreme Court's ruling provides common sense clarity and practical benefits for defendants in personal injury cases.

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MEDICAL EXPENSES BASED ON TORT DAMAGES PRINCIPLES

The first California court to evaluate whether the "reasonable value" of medical services can exceed the amount accepted as payment in full by a service provider found that tort damages principles limit recovery to those expenses actually paid on the plaintiff's behalf. In *Hanif v. Housing Authority*, 200 Cal.App.3d 635 (1988), the court of appeals held that although an uninsured minor plaintiff was, under the collateral source rule, entitled to medical expenses paid on his behalf by Medi-Cal, the trial court had overcompensated by awarding the full amount of the medical bills. The court reasoned that because medical expenses are economic damages they must represent an actual pecuniary loss caused by defendant's wrong. The full amount of the medical bills could not represent an actual pecuniary loss because no one had ever paid that amount. Furthermore, because the instruction allowing the jury to award the "reasonable value" of medical care was a term of limitation and not aggrandizement, the plaintiff was entitled to recover no more than the actual amount spent on medical expenses.

This rule was later extended to a privately insured plaintiff in *Nishihama v. City and County of San Francisco,* 93 Cal.App.4th 298 (2001). The *Nishihama* court reiterated that medical expenses must amount to an actual pecuniary loss, which it defined as the amount actually paid, not billed. The *Nishihama* court further supported its decision by rejecting the plaintiff's argument that the hospital could enforce a lien against her for the full amount of the medical bill, thereby making her liable for more than she would receive in damages. The court held that a hospital's lien rights do not extend beyond the amount accepted from an insurance company. With this decision, it appeared the rule limiting the recovery of medical expenses to the amount actually paid was settled. But then, in recent years, courts began expanding the collateral source rule, and suddenly plaintiffs could recover more in damages for medical services than anyone ever paid.

RISE OF THE COLLATERAL SOURCE RULE

Traditionally, the collateral source rule operates in two ways: 1) by allowing a plaintiff to recover from a defendant the amount paid for medical expenses on plaintiff's behalf, and 2) by excluding evidence of collateral source payments to eliminate any improper reduction in medical expenses. The collateral source rule is premised on the idea that the benefits from the insurer-insured relationship should accrue to the insured plaintiff, not the defendant. Beginning in 2009, some California courts of appeal relied on this premise to expand the rule and allow a plaintiff to recover the full amount billed, even when less was actually paid. S*ee Howell v. Hamilton Meats & Provisions*, 09 C.D.O.S. 14062.

Citing the "marketplace realities" of the health care industry, courts characterized the difference, or discount, between the amount paid by insurance and the amount billed by the medical provider as a pecuniary saving financed by a plaintiff's premium dollars. The courts viewed this discount as a collateral benefit that should accrue to the plaintiff. Although courts did not hold that the as-billed amount constituted per se reasonable medical expense damages, they did vastly increase the amount of potential liability faced by defendants.

Through this expansion of the collateral source rule, the courts essentially created an exception to the traditional tort damages principles limiting recovery for economic damages to actual pecuniary losses. They did not, however, explicitly overrule the *Hanif*/*Nishihama* holdings limiting recovery to the as-paid amount. Given the two conflicting lines of cases, it was unsurprising that the California Supreme Court granted certification of the collateral source rule cases to provide clarity.

THE FALL OF THE COLLATERAL SOURCE RULE FRAMEWORK

In its August 2010 decision in *Howell*, the California Supreme Court rejected the expansion of the collateral source rule and reverted to the traditional tort damages analysis applied by *Hanif* and *Nishihama*. The Supreme Court firmly established that, to be recoverable, a plaintiff's medical expenses must be actually incurred and reasonable. The Supreme Court's decision largely revolved around its determination that the insured plaintiff is never liable for the full amount billed by a medical provider because insurers and health care providers negotiate the discounted rates before a plaintiff ever seeks treatment. Therefore, the Supreme Court held that when demonstrating damages for medical expenses, parties should present evidence of the amount actually paid to fully satisfy the bill, without reference to who paid. The amount billed is no longer relevant evidence.

Allowing a plaintiff to recover only the amount spent on her behalf does not prevent a plaintiff from realizing the benefits of her insurance policy. The plaintiff pays premiums so that his or her medical bills are paid; the amount of those bills is of no consequence to the plaintiff so long as they are covered. The Supreme Court noted that if the medical bills were undiscounted, a plaintiff's premiums would actually be higher to cover the more expensive treatments. In that sense, any discounted rate negotiated by the insurer and the medical providers cannot be considered a collateral benefit to a plaintiff because premiums do not account for the discount.

The Supreme Court recognized that its ruling incorporates an element of fortuity to compensatory damages. A prevailing uninsured plaintiff, whose as-billed and as-paid amounts are the same, may recover more than an insured plaintiff. But such fortuity cannot be avoided in litigation and is not a reason to allow a plaintiff to recover more than the damages actually incurred. Moreover, the Supreme Court found that limiting recovery of medical expenses to only those costs actually paid does not constitute a windfall to the defendant. As noted by the court, many health care providers, knowing that they must negotiate lower rates with insurance companies, compensate by raising their as-billed rates. Therefore, one cannot know categorically that the as-billed amount is a more accurate reflection of the reasonable value of the medical services than the as-paid amount. Without such categorical knowledge, refusing to allow a plaintiff to recover more than the amount actually paid on her behalf cannot be seen as a windfall to a defendant. Allowing a plaintiff to recover more than the damages actually suffered, on the other hand, indisputably constitutes a windfall to that plaintiff.

PRACTICAL CONSIDERATIONS AND CONCLUSION

The benefits of the *Howell* decision can be realized through some practical tactics:

- During discovery, do not settle merely for medical bills, but make sure to obtain documents that show the amount paid to satisfy those medical bills in full.
- At trial, present evidence of the amount actually paid and object to any attempt to present evidence showing the total amount billed by the medical provider.
- Consider entering into a stipulation regarding the amount of medical expenses paid — there should be little dispute about the amount, even if there is dispute about the reasonableness or necessity of those medical services.
- Use verdict forms that require enough specificity from the jury to show whether the jury awarded more for medical expenses than the amount paid.

By returning California to an economic loss framework, the Supreme Court has brought common sense back to determining medical expense damages.