

## **The Collateral Source Rule: How to Avoid a Windfall for Plaintiffs**

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The healthcare industry's business model has changed as profoundly and rapidly as the technology with which it treats patients. Given the fundamental shift to private and public insurance, the clear majority of patients no longer directly reimburse their health care providers for services rendered. There is a volume discount inherent in a group's bargaining power. This discount takes the form of write-offs, adjustments, and contractually set prices for services. At issue in this article is the manner in which different jurisdictions handle the evidentiary issue of special damages arising out of medical bills, particularly those already satisfied by a collateral source. A tension arises where a bill is satisfied in full for an amount less than the amount billed. This can occur due to contractually set reimbursement rates for certain services. A majority of states allow a plaintiff to recover the entire amount billed for his or her medical treatment, and do not limit that recovery to the amount actually paid to satisfy the bill. *Arthur v. Catour*, 833 N.E. 2d 847, 858 (Sup. Ct. Illinois 2005). A firm grasp on how a particular jurisdiction handles this issue informs the valuation of a case as well as provides the practitioner an opportunity to reduce the special damages a plaintiff can present, and therefore the likely verdict.

### **The Collateral Source Rule**

"The traditional approach is to treat [the collateral source rule] as having substantive and evidentiary components. The substantive component is a rule of damages. This component bars a defendant from reducing the plaintiff's compensatory award by the amount the plaintiff received from the collateral source. The evidentiary component bars admission of evidence of the existence of the collateral source or the receipt of benefits. The concern here is that the trier of fact may use that evidence improperly to deny the plaintiff the full recovery to which he is entitled." J. Fisher, *Understanding the Remedies* § (a), at 77 (1999).

The collateral source rule therefore protects collateral payments made to or benefits conferred on the plaintiff by denying the defendant any corresponding offset or credit. *Arthur v. Catour*, 833 N.E. 2d at 851. Such collateral benefits do not reduce the defendant's tort liability, even though they reduce the plaintiff's loss. *Id.* The most common rationale for the collateral source rule is that the defendant should not benefit from the plaintiff's foresight in acquiring insurance. *Note, Unreason in the Law of Damages: The Collateral Source Rule*, 77 Harv. L. Rev. 741, 741 n.3 (1964). Put differently, the plaintiff should reap the benefit of the bargain he or she had made for insurance. Should this benefit be shifted instead to the defendant, the plaintiff is in a worse financial situation than if they had not acquired insurance coverage. *Helpend v. S. Cal. Rapid Transit Dist. P.* 2d 61, 66 (Cal. 1970). Of course this rationale does not apply where the services rendered were gratuitous, or where the plaintiff's medical bills were satisfied by a public aid source for which

the plaintiff did not contribute. Therefore, a second rationale for the collateral source rule is that if anyone receives a windfall, it is best that it should be the injured party, rather than the tortfeasor. *Grayson v. Williams*, 256 F.2d 61, 65 (10th Cir. 1958). Additionally, allowing the windfall to shift to the defendant would relieve the defendant of the full responsibility for his wrongdoing. *Id.* The collateral source rule has also avoids the arguably unjust outcome where a defendant's potential liability was reduced based only on whether the injured party could afford insurance. *Brandon HMA, Inc. v. Bradshaw*, 809 So. 2d 611, 619 (Miss. 2001).

Numerous scholars, practitioners, and politicians have been critical of the collateral source rule, particularly its perceived punitive effect on defendants and the windfall effect it has for plaintiffs. *Harper & James, The Law of Torts* (1968 Supp.) §25.22, at 152. Opponents of the collateral source rule contend that it is inconsistent with the general policy of modern tort law: that damages are compensatory and not punitive. *Peterson v. Lou Bachrodt Chevrolet Co.* 392 N.E. 2d 1, 5 (Sup. Ct. Illinois 1979). *See also Restatement (Second) of Torts §903, comment a (1979).*

### Medical Bill Discounts

As noted above, as medical insurance became more prevalent, the amount paid for medical services became akin to the sticker price on a car. It is commonly understood that few medical bills are satisfied for the amount initially charged (the sticker price). Rather, the amount of money paid for a particular service is linked to who the payer is as much or more than who the medical provider is. By way of example, Insurance companies in Illinois received an average discount of 40% for their customer's hospital bills. *Brief for Illinois Association of Defense Trial Counsel as Amicus Curiae Supporting Defendants-Appellants at 12, Arthur v. Catour*, 216 Ill. 2d 72 (2005). Thereby, a new question has arisen with respect to the collateral source rule: may a plaintiff recover the billed amount or are the medical damages limited to the amount actually paid?

Different jurisdictions have developed different substantive and evidentiary rules for handling the discrepancy between what was paid versus what was billed. Most of the jurisdictions restricting recovery to the amount paid have done so based on statutory limitations of the collateral source rule. *Robinson v. Bates*, 828 N.E. 2d 657, 669 (Ohio Ct. App. 2005). By way of example, courts in Idaho, Florida, New York, and Montana, have relied on state statutes that expressed a policy against double recoveries. *See Dyet v. McKinley*, 81 P. 3d 1236, 1239 (Idaho 2003); *Coop. Leasing Inc. v. Johnson*, 872 So. 2d 956, 960 (Fla. Dist. Ct. App. 2004); *Kastick v. U-Haul Co.*, 740 N.Y.S. 2d 167, 169 (2002); *Chapman v. Mazda Motor of Am., Inc.*, 7 F. Supp. 2d 1123 (D. Mont. 1998). Courts in California and Pennsylvania, states that do not have statutory limitations on the collateral source rule, have likewise determined that a plaintiff may not recover the discounted or written-off portions of their medical bills. *Hanif v. Housing Auth. Of Yolo County*, 200 Cal. App. 3d 365, 643-44 (Ct. App. 1988); *Moorhead v. Crozer Chester Md. Ctr.*, 765 A.2d 786, 791 (Pa. 2001). Those courts concluded that the collateral source rule simply did not apply to the discounted portions of the bills, because in truth, no collateral source actually paid those charges. *Id.*

The majority of jurisdictions, however, have allowed for the full recovery of the billed amount. This includes the District of Columbia, Georgia, Hawaii, Kansas, Louisiana, Mississippi, Missouri, New Hampshire, South Carolina, Texas, Virginia, and Wisconsin. *Robinson v. Bates*, 828 N.E. 2d at 665-69. The State of Illinois also substantively allows a plaintiff to recover the full billed amount, provided adequate foundation is made. *See Klesowitch v. Smith*, 2016 IL App

(1st) 150414. As mentioned above, some states disallow a defendant from presenting as evidence the amount written off nor the amount accepted as full satisfaction of the bill. *Radvany v. Davis*, 551 S.E. 2d 347, 348 (Va. 2001).

### **Gratuities**

One of the policy justifications often cited for the collateral source rule is that the tortfeasor should not benefit from the expenditures made by the injured party in procuring insurance. *22 Am. Jur. 2d Damages §210*, at 293-94 (1965). This rationale simply does not apply to a plaintiff who has received gratuitous medical benefits. However, few jurisdictions omit gratuities from the collateral source rule. This position is consistent with the Restatement of Torts which provides as follows:

Gratuities. This applies to cash gratuities and to the rendering of services. Thus the fact that the doctor did not charge for his services or the plaintiff was treated in a veterans' hospital does not prevent his recovery for the reasonable value of the services. *Restatement (Second) of Torts §920A, Comment c(3), at 515 (1979)*.

### **Different Approaches**

The above issues call for consistent, considered, and policy-based evidentiary and substantive rules. Generally, there are three approaches to the application of the collateral source rule: actual amount paid, benefit of the bargain, reasonable value approach. *Bozeman v. State*, 879 So. 2d 692, 701 (La. 2004).

### **Actual Amount Paid**

Courts following this approach limit the plaintiff to recovering only the amount actually paid in full settlement of the medical bill. *See Dyet v. McKinley*, 81 P. 3d 1236 (2003); *Terrell v. Nanda*, 759 So. 2d 1026 (La. App. 2000). According to these courts, the written-off amounts are not damages incurred by the plaintiff, and are therefore not recoverable. *Terrell*, 759 So. 2d at 1031. This approach is criticized for focusing the inquiry on the nature of the damages *vis-à-vis* the tort victim rather than *vis-à-vis* the tortfeasor. *See Bozeman*, 879 So. 2d at 703; *Acuar v. Letourneau*, 531 S.E. 2d 316, 322 (2000) (explaining that the “focal point of the collateral source rule is not whether an injured party has ‘incurred’ certain medical expenses. Rather it is whether a tort victim has received benefits from a collateral source that cannot be used to reduce the amount of damages owed by a tortfeasor”).

### **Benefit of the Bargain**

Courts following this approach allow a plaintiff to place into evidence the full amount of the medical expenses as billed, provided that the plaintiff has paid some consideration for the benefit of the write-off or contractual rate. The usual reasoning for this approach follows:

“[W]e conclude that [defendant] cannot deduct from that full compensation any part of the benefits [plaintiff] received from his contractual arrangement with his health insurance carrier, whether those benefits took the form of medical expense payments or amounts written off because of the agreements between his health insurance carrier and his health care providers. Those amounts written off are as much a benefit for which [plaintiff] paid consideration as are the actual cash payments made by his health insurance carrier to the health care providers. The portions of medical expenses that health care providers write off constitute ‘compensation’ or indemnity received by a tort victim from a source collateral to the tortfeasor...” *Schickling v. Aspinall*, 369 S.E. 2d 172, 174 (1988).

This approach however has been criticized for setting apart classes of plaintiffs based on the type of insurance applicable to them. Those with private insurance may recover the full billed amount of their medical treatment, whereas those whose bills were paid by Medicaid may not, and their recovery is limited to the amount actually paid by Medicaid. See G. Zorogastua, Comment, *Improperly Divorced From Its Roots: The Rationales of the Collateral Source Rule and Their Implications for Medicare and Medicaid Write-Offs*, 55 U. Kan. L. Rev., 463, 491-93 (2007).

### Reasonable Value

Most courts follow the reasonable value approach. These courts hold that a plaintiff is entitled to recover the reasonable value of the services rendered, and do not distinguish between a plaintiff with private insurance versus one covered by the government. However, it should be noted that a minority of the courts employing this approach hold that the reasonable value of the medical service rendered is the amount actually paid. See *Cooperative Leasing, Inc. v. Johnson*, 872 So. 2d 956 (Fla. App. 2004). The vast majority of courts employing a reasonable value approach hold that the plaintiff may seek to recover the amount originally billed regardless of the amount that the bill was settled for. See, e.g. *McMullin v. United States*, 515 F. Supp. 2d 904 (E.D. Ark. 2007) (applying Arkansas law); *Pipkins v. TA Operating Corp.*, 466 F. Supp. 2d 1255 (D.N.M. 2006)(applying New Mexico Law); *Papke v. Harbert*, 738 N.W. 2d 510 (S.D. 2007); *Robinson v. Bates*, 857 N.E. 2d 1195 (Ohio 2006); *Baptist Healthcare Systems, Inc. v. Miller*, 117 S.W. 3d 676 (Ky. 2005); *Haselden v. Davis*, 579 S.E. 2d 293 (2003); *Brandon HMA, Inc. v. Bradshaw*, 809 So. 2d 611 (Miss. 2001); *Koffman v. Leichfuss*, 630 N.W. 2d 201 (Wisconsin 2001); *Olariu v. Marrero*, 549 S.E. 2d 201 (Georgia 2001); *Texarkana Memorial Hospital, Inc. v. Murdock*, 903 S.W. 2d 868 (Tex. App. 1995); *Brown v. Van Noy*, 879 S.W. 2d 667 (Mo. App 1994).

As noted above, this approach is subject to the criticism that it leads to a windfall for the plaintiff. This approach may lead to an outcome where the plaintiff is placed in a better position than he or she would have been had the wrong not been done. *Hanif v. Housing Authority*, 200 Cal. App. 3d 635 (1988). However, it must be noted, that many jurisdictions, while disallowing introduction of the write off, will allow the defense to cross-examine on the reasonable value, or proffer affirmative evidence of the reasonable value of the services. See *Klesowitch v. Smith*, 2016 IL App (1<sup>st</sup>) 150414.

### Conclusion

There can be no doubt that a plaintiff's special damages provide a jury with a barometer for the plaintiff's injury as well as an anchor point for any eventual award. A nuanced understanding of a practitioner's law on the introduction of medical bills and the implications of that jurisdiction's approach to the collateral source rule informs the value of a case and may allow for a reduced verdict through insisting that the plaintiff prove their case as to damages.

It also behooves the practitioner or insurance claims professional in the pre-suit stage to know which collateral source approach has been adopted in the jurisdiction where suit is likely to be filed. Aggrieved parties will often make a claim for damages or give notice of their intent to file suit before actually doing so. This is especially common in the professional liability context, as practically all practitioners carry liability insurance. This pre-suit notice creates an opportunity to discuss potential settlement before each party invests its resources into litigation. Negotiations at this early stage encourage tempered settlements that more accurately reflect the true value of an injury, as the discussions are not tainted by considerations of sunken costs, procedural posture or unexpected turns in the course of litigation.

Medical specials serve as an anchor point in pre-suit settlement discussions just as they do in jury deliberations. Claimant attorneys will predictably submit demands that are calculated based on the full billed amount, regardless of which approach the jurisdiction employs on the collateral source rule. A scrupulous advocate for the alleged tortfeasor will recognize when limitations apply to the admissibility of collateral sources and use that to drive down the demand. Claims professionals are particularly obliged to stay mindful of the jurisdictional landscape, as they commonly handle matters arising from numerous states, if not across the entire country, and are typically the first ones with an opportunity to resolve a claim.

Whether a particular jurisdiction follows the majority rule and allows recovery of the entire billed amount, or is in the minority and allows only the amount actually paid by an insurer, a defense advocate in pre-suit discussions can point to the amount that the *injured party* actually paid—that is, his or her out-of-pocket costs, as an argument for negotiated down the demand, particularly when couched in the context of making the claimant whole.

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