



September 8, 1993

Citizens' Economy & Efficiency Commission
of Los Angeles County
Hall of Administration, Room 163
500 West Temple Street
Los Angeles, California 90012

Attn: Mr. Bruce J. Staniforth, Executive Director

Re: *COUNTY of LOS ANGELES RISK MANAGEMENT and LIABILITY COST STUDY*

To assist the Commission Task Force in studying the risk management and liability costs in Los Angeles County, we have performed further analyses of additional information obtained regarding issues discussed at the August 4, 1993 Commission meeting. The results of the additional analyses support the same conclusions and recommendations of the study as previously presented. This letter further explains the Risk Management and Liability Cost Study findings, starting with a brief review of the main points.

PRIMARY CONCLUSIONS

The major conclusions of the study highlight the primary issues of risk management in Los Angeles County. Tort liability has increased significantly in recent years for several reasons, including an increasingly litigious society, a "deep pocket defendant" theory of joint and several liability, and a general tendency of people to sue the government more frequently.

While tort liability has been growing into a substantial problem, risk management and loss control appear not to have been high priorities in Los Angeles County government. Resources have not been sufficiently available to develop the risk management program and extend it to individual departments despite plans laid out by the Chief Administrative Officer (CAO) in January 1992. He suggested programs to initiate reducing claims cost and increasing departmental responsibility and accountability for liability expense. These plans were developed at a policy level outlining solutions to the rising litigation costs faced by the County.

Several program elements have not been fully implemented, such as loss prevention and risk management information systems. Risk management activities are organizationally dispersed rather than being consolidated in a functionally coordinated program. The claims

administration, accounting, and budgeting aspects of the risk management program were transferred to County Counsel last year. Loss control and some aspects of maintaining functional risk management information remains with the Risk and Insurance Management Agency (RIMA). Claims administration and cost data are located in several places, without systems to identify and combine the information for management. The total tort liability cost must be laboriously compiled from several sources, since no integrated system of accounting or comprehensive accumulation and reporting of cost specific to this issue is available. Without complete and timely dissemination of risk management information, loss control and accountability cannot be successfully maintained at the departmental level.

We found no indication that any lawsuits have been mishandled, but we found ample opportunities for improvements to risk management and loss prevention in order to contain tort liability cost. Implementing the recommendations for consolidating risk management, improving loss prevention, enhancing claims administration, increasing subrogation, and developing information systems for risk management and departmental accountability will facilitate better cost containment of these rapidly rising liabilities. Improved loss prevention can potentially avoid millions of dollars in tort liability cost.

The primary conclusion is that an improved risk management program offers significant potential for avoidance of substantial liability cost; particularly in loss prevention, legal defense costs, and subrogation. Regardless of which historical data on liability is reviewed, the multi-million dollar costs are substantial and show sharp increases in recent years.

RECOMMENDED RISK MANAGEMENT PROGRAM

The CAO outlined policies and plans describing *what* should be established for risk management and loss control. The risk management program recommended by this study outlines *how* to develop the necessary capabilities and operating processes to address tort liability risks. This is a blueprint showing how to implement programs for proactive cost containment and loss prevention, more effective risk management, improved subrogation activities, and better information management.

A central element of this program is a consolidated functional approach with a liability program management unit to coordinate risk management activities through all departments, involving everyone in County government. The other elements of the recommended program include improved direction and procedures for claims administration, legal defense and subrogation, departmental accountability, and integrated risk management information systems.

An improved risk management and loss prevention program is the real focus and prospective contribution of this study.

TORT LIABILITY COST ANALYSIS

Tort liability cost data from all sources available to us display the same upward trend, which supports the rationale of earlier conclusions and recommendations. Overall trends are obvious and consistent regardless of which data set is analyzed, although none of the available data seems to be statistically pure.

The purpose of the study was to identify operational improvements and potential cost savings; not to conduct an audit verifying accounting classification. Cost analysis is used as an indicator to point out problems and opportunities for potential improvement, but is only one factor in developing conclusions and recommendations. Information was gathered primarily by interview. The data utilized for analysis was provided from County records by County agencies. Tort liability cost data was compiled from the expenditure summaries provided by the Executive Office of the Board of Supervisors and the office of County Counsel, as well as two third-party claims administrators (TPA). These summaries are a function of the accounting classifications within them. The sources and attributes of the cost data to which we were originally directed appear appropriate to indicate possible areas for risk management improvements and cost savings, but we understand that these summaries include items other than tort costs, such as search and rescue expenses and breach of contract settlements. The financial exposure for liability of specific claims is reviewed and accumulated by County Counsel staff and provided to the Auditor/Controller's office in recognition of contingent liability, who is aware of GASB Rule 10 exposure draft and is prepared to act in accordance.

Since they have reservations about the data previously analyzed, County Counsel staff has submitted alternative data focusing primarily on tort lawsuits. In cooperation with the County staff, we compiled tort liability cost data by adding claims administration and settlement cost to the tort lawsuit data defined by County Counsel. The additional information obtained for review from County Counsel staff and County budget documents has been analyzed in the same manner as earlier information. This review leads consistently to the same conclusions and recommendations as before.

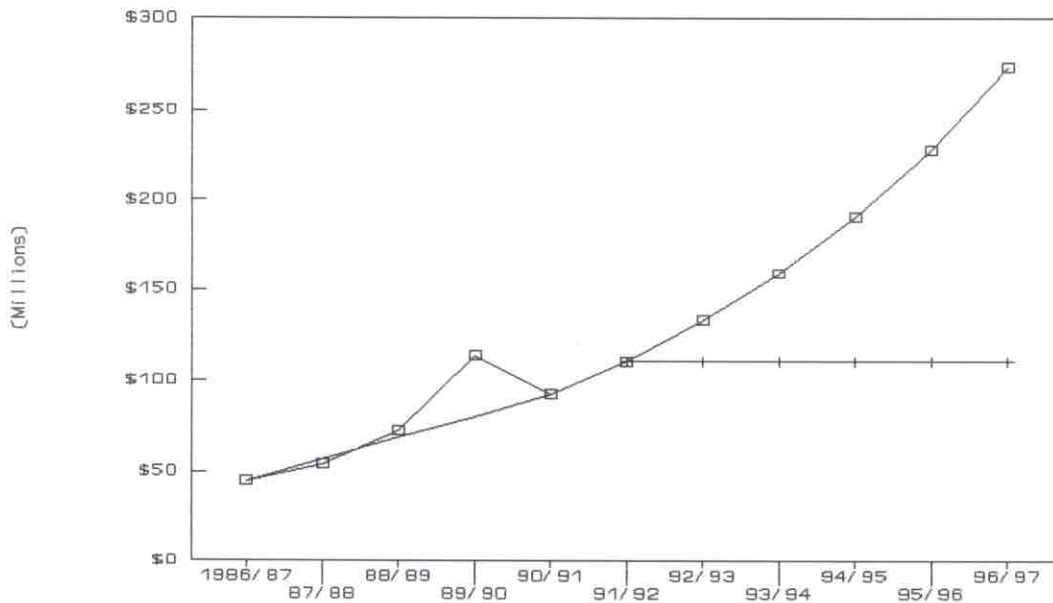
Trend Lines (Figure 1)

The Judgments & Damages/Insurance (JDI) Budget Unit reflects funding for payment of judgments & settlements of uninsured claims against the County as well as litigation costs and purchase of insurance policies. This budget unit includes expenditures for items other than for tort liability, although the majority appear to be tort costs, so it is a more reasonable indication of overall costs associated with risk management than of just tort liability. The actual JDI budget unit expenditures show the general trend of overall costs. Analysis of the costs from fiscal year (FY) 1986/87 through FY 1991/92 finds a consistently increasing trend of substantial expenditures as documented in the County Budget and shown

in Figure 1. The historical experience from FY 1986/87 to FY 1991/92 definitely correlates to the smooth trend line, except for a random spike to over \$113.7 million in FY 1989/90.

FIGURE 1

**COUNTY OF LOS ANGELES
Judgments & Damages/Insurance Budget Unit (JDI)
Actual Expenditures and Projected Cost Trends**



Costs of \$110.9 million in FY 1991/92 were 247% of the FY 1986/87 costs of \$44.9 million, showing a 147% increase. If budget unit costs can be held to the FY 1991/92 level, cumulative net potential cost avoidance is \$406 million for the four years including FY 1993/94 through FY 1996/97.

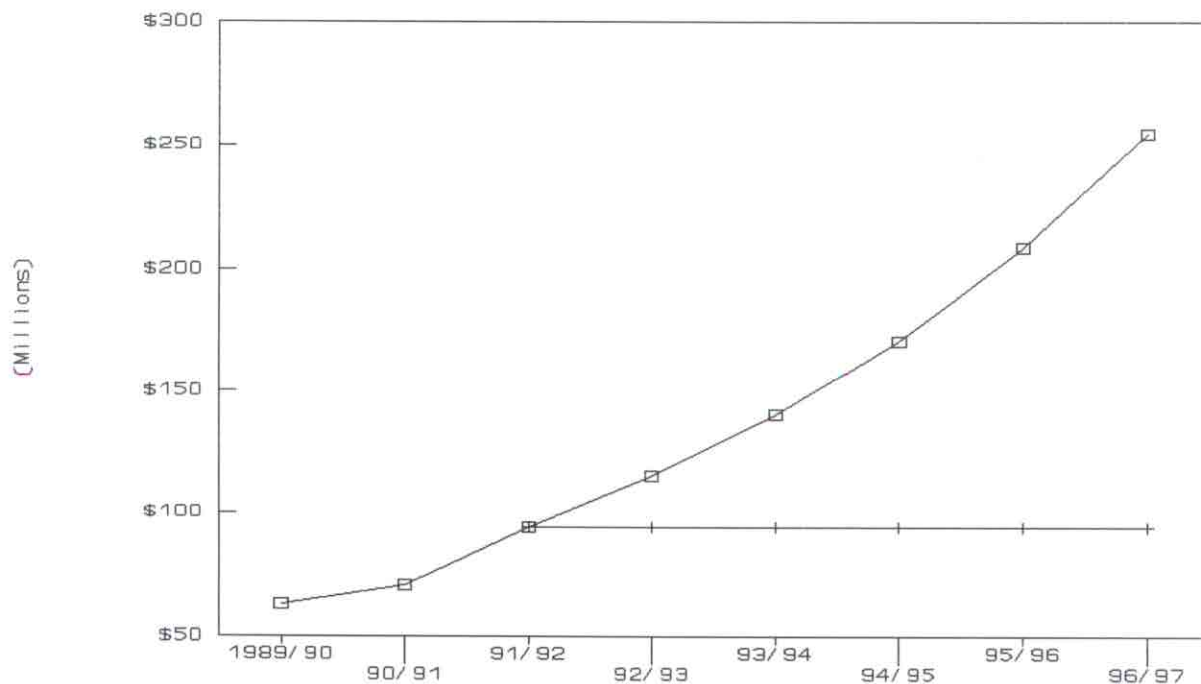
Potential Cost Avoidance (Figures 2 and 3)

Upon analyzing the compiled data, an upward trend in tort liability costs similar to Figure 1 can be observed in Figure 2. This trend line is used to project possible future costs for the *theoretically worst case scenario, i.e., that tort liability cost continues to increase at previous rates with no abatement of the trend.* Potential cost avoidance is projected in Figure 2 by assuming cost containment at the FY 1991/92 level as a base line alternative, i.e., the horizontal line compared to the growth curve. The distance between the two lines is the

potential cost avoidance in each year. The cumulative cost avoidance is the total vertical distance for the four years combined.

The trend line appears similar to that of the overall JDI budget unit data. The three years of data available indicates that costs of tort liability have increased by 50% in two years, from \$62.95 million in FY 1989/90 to \$94.25 million in FY 1991/92, including a 33% increase in the last year due in part to some large cases. If this trend were to continue, the County could face tort liability costs in excess of \$254 million by FY 1996/97. The potential cost avoidance based on this accounting data accumulates to nearly \$396 million over the four years of FY 1993/94 through FY 1996/97, as shown in Figure 3.

FIGURE 2
COUNTY OF LOS ANGELES
Tort Liability Cost and Projected Trends



Judgments and settlements costs have increased \$23.7 million while legal defense costs have increased \$7.6 million in two years. The increase of payments for damages reduces the proportion of legal defense costs to below 35% of total tort liability costs, which is comparable to other agencies reviewed. Both judgments & settlements and legal defense costs have been increasing and should be targeted for reduction.

FIGURE 3

**COUNTY OF LOS ANGELES
Projected Potential Tort Liability Cost Avoidance**

<u>DESCRIPTION</u>	<u>AMOUNT</u>
Cumulative Projected Cost - FY 1993/94 to 1996/97	\$ 774,951,000
Four years @ FY 1991/92 level (\$94.25 millions/year)	<u>\$ 377,000,000</u>
Potential Cost Avoidance	\$ 397,951,000
Less program implementation cost	<u>\$ 2,415,000</u>
Cumulative Net Benefit of Cost Avoidance	<u><u>\$ 395,536,000</u></u>

Alternative Cost Avoidance (Figures 4 and 5)

An alternative projection of cost avoidance with a more conservative rationale is shown graphically in Figure 4. This scenario assumes only a five percent annual increase of tort liability along with a five percent reduction of judgments and settlements and legal defense costs for the period including FY 1993/94 through FY 1996/97, assuming the FY 1991/92 level for FY 1992/93. Figure 4 shows the possible cost avoidance and containment projection of \$9.6 million in the first year and \$94.2 million over four years for this data as outlined in Figure 5.

Claims Administration Cost

Claims administration costs for automobile and general liability are contractually controlled for the first 1,800 claims. Individual claims processed after 1,800 claims volume is exceeded are then billed on the basis of actual time required at standard charges. This is a loophole that should be closed, since additional cost will be incurred if actual cost exceeds the contractual average cost per claim. Based on revised cost data and claims volume for previous years, estimated excess costs up to as much as \$272,000 might be incurred annually. If actual costs for individual excess claims are maintained below the average contractual cost, however, no additional cost will be incurred.

FIGURE 4

**COUNTY OF LOS ANGELES
 Alternative Tort Liability Cost Projection**

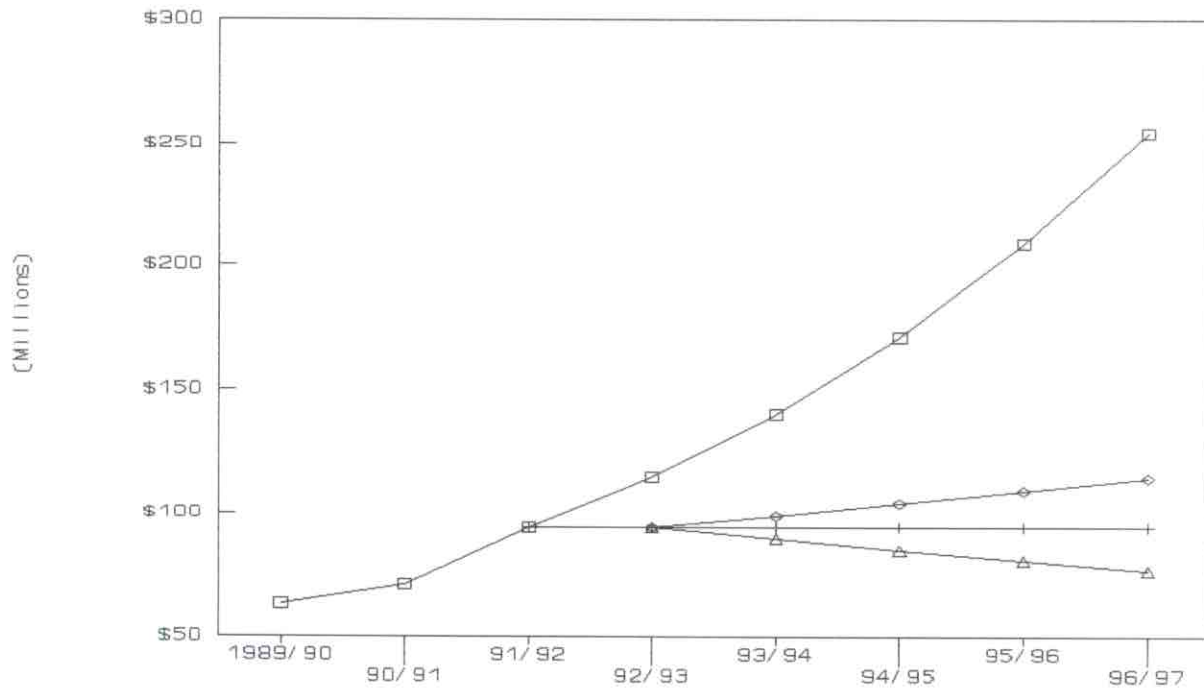


FIGURE 5

**COUNTY OF LOS ANGELES
 Alternative Projection of Potential Cost Avoidance**

DESCRIPTION	1993/94	1994/95	1995/96	1996/97	TOTAL
Defense costs	3,298,750	6,597,500	9,904,500	13,228,000	33,028,750
Judgments & Settlements	6,126,250	12,252,500	18,394,000	24,566,250	61,339,000
Claims administration	272,000	272,000	272,000	272,000	1,088,000
Subrogation	250,000	250,000	250,000	250,000	1,000,000
Staff consolidation	36,700	36,700	36,700	36,700	146,800
Projected cost avoidance	9,983,700	19,408,700	28,857,200	38,352,950	96,602,550
Less net costs added	<u>423,000</u>	<u>624,000</u>	<u>693,000</u>	<u>675,000</u>	<u>2,415,000</u>
Net cost containment per year	<u>9,560,700</u>	<u>18,784,700</u>	<u>28,164,200</u>	<u>37,677,950</u>	<u>94,187,550</u>
Cumulative cost containment	<u>9,560,700</u>	<u>28,345,400</u>	<u>56,509,600</u>	<u>94,187,550</u>	

Cost Containment

Using more conservative assumptions to define projected cost containment, it may be assumed that total costs going forward will not escalate beyond the FY 1991/92 levels and, further, that combined costs of judgments & settlements and legal defense costs will be reduced five percent by improved risk management. Cost containment would then accumulate to about \$44.6 million over the four years of FY 1993/94 through FY 1996/97, starting with over \$4.8 million in the first year.

SYNOPSIS

The circumstances regarding risk management and tort liability reflect complex and multifaceted problems involving many people; thus, this is certainly not a situation for asserting blame. It is an opportunity to take action for improvement of risk management and loss control by preventing the liability before it happens. The benefits of accomplishing that goal will be very substantial to Los Angeles County in both monetary and social terms.

McGladrey & Pullen and Advanced Risk Management Techniques, Inc., wish to thank the Task Force and staff of the Citizens' Economy & Efficiency Commission and the County of Los Angeles for their courtesy and cooperation; and particularly to thank the staff of RIMA, County Counsel, Department of Public Works, Sheriff's Department and the TPA organizations for their assistance in this important project.

Yours very truly,

McGLADREY & PULLEN



L. Michael Lynch
Director of Consulting Services