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AUTOMOBILE INSURANCE REFORM

HEARING

before the

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

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AUTOMOBILE INSURANCE REFORM

Wednesday, March 19, 1997

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
***WASHINGTON*, D.C.**

The Committee met, pursuant to notice, at 10:00 a.m., in Room 2226, Rayburn House Office Building, the Honorable Jim Saxton, Chairman of the Committee, presiding.

Present: Representatives Saxton, Doolittle and Thornberry and Senator Robb.

Also Present: Representatives LoBiondo, Pappas, Franks, and Campbell.

Staff Present: Chris Frenze, Dan Miller, Joe Engelhard, Amy Pardo, Mary Hewitt, Roni Singleton, Juanita Morgan, and Brenda Janowiak.

OPENING STATEMENT OF
REPRESENTATIVE JIM SAXTON, CHAIRMAN

Representative Saxton. I would like to welcome everyone this morning to today's session of the Joint Economic Committee, particularly Governor Christine Whitman and New Jersey's Commissioner of Insurance, Lisa Randall. We are very pleased to have you here with us today as leaders in what has really become a nationwide attempt to reform the automobile insurance programs that face our constituents each day.

Automobile insurance premiums are simply too high, and they are increasing at a rate faster than inflation. In 1995, the national average cost for insurance premiums across the country was $757. In some states with which I happen to be familiar, the average premium is much higher. In New Jersey, for instance, the premium last year was over $1,100 per car, and in some areas like Cherry Hill, which happens to be a large town in the district I represent, for an average family with two cars and one child who drives, insurance premiums cost somewhere between $2,500 and $3,500. The same Consumer Reports Auto-Choice study which pointed these facts out showed that the national average cost to insure an automobile rose 44 percent between 1987 and 1994, nearly 1-1/2 times the rate of inflation.

We are holding this hearing today to look at the causes of high insurance premiums and their rapid increase. Even more importantly, we need to examine the possible solutions that could provide American families with the much-needed relief and would save them hundreds of dollars every year.

I feel it is important to highlight the truly bipartisan, wide-ranging support for auto insurance reform that has come from individuals, advocacy groups, politicians on the right and the left, and from the Reform Party as well. The movement actually began with Michael Dukakis in Massachusetts and was promoted in the last presidential election campaign by Senator Dole and GOP candidate Steve Forbes. And several reforms have been championed at the state level as well.

We have with us today Governor Whitman, who has been a leader in this area and very outspoken on this issue. Last year, I authorized the staff of the Joint Economic Committee to study some of the problems with regard to automobile insurance. Their report has given us an insight into some of these problems and examined one proposal for reform in particular, Auto-Choice.

With Auto-Choice, nationwide, the average insurance policy would drop from $785 to about $560. That means to the average driver Auto-Choice reform would save something in the neighborhood of $225 a year for each individual. For many people, that would provide much-needed relief. In many high-liability states, however, the savings would be significantly greater. New Jersey drivers, who pay the highest insurance rates in the nation, would save an average of $417 a year.

The Joint Economic Committee study found three major causes of increasing car insurance premiums: fraud, high litigation costs, and escalating non-economic damages, sometimes called pain and suffering cases.

While the issues of high litigation cost is an obvious problem, the few studies that have focused on this problem have shown how significant transaction costs can be on the cost of automobile insurance premiums. A 1990 study by the California Department of Insurance found that over 40 cents out of every premium dollar paid for bodily injury liability and uninsured motorist costs goes to attorneys.

A second problem is fraud and abuse of the auto insurance system. After an FBI investigation of auto accident fraud, Director Louis Freeh

estimated that every American household is burdened with about $200 a year in annual insurance premiums to make up for this type of fraud.

How would Auto-Choice lower premiums? The bill would give drivers a choice between retaining their state-based insurance system—that is, maintaining their current coverage—and changing to a first-party, no fault option. I think this is a very important point.

Under the new option, drivers would recover damages from their own insurance company, so consumers would only need to protect themselves. The Auto-Choice bill calls for new, optional Personal Protection Insurance (PPI) in which drivers would receive first-party coverage with immediate payment of economic losses, regardless of fault, keeping them out of court.

In return for this immediate recovery and lower premiums, they would forego being able to recover for non-economic damages, called pain and suffering. In addition to lowering premiums, Auto-Choice would reduce incentives for fraud, reduce transaction costs, and help low-income drivers enter the insurance system.

The second option, Tort Maintenance Coverage (TMC), would be chosen by consumers who preferred to keep their current coverage. Once again, the choice is on the consumer. Under the TMC option, drivers would retain the same amount and types of coverage as provided by the insurance laws of their states unless they had an accident with a PPI driver. In that case, they would recover first-party coverage up to their own TMC policy limits.

Under both options, injured parties could sue for economic and non-economic damages against drivers who commit intentional torts or when an accident is due to alcohol or drug use. Both options would allow drivers to sue in court, on a fault basis, for economic damages that exceed their insurance policy's coverage limits.

Another significant part of Auto-Choice reform is its tremendous sensitivity to different states. All state legislatures would be given the authority to repeal the bill by a simple majority. In other words, if they didn't want to take part in the Federal program, they could opt out by passing a law permitting them to do so. Or the Federal law could be modified through changes passed by the state legislatures and our 50 state Governors.

Finally, any state insurance commissioner could prevent the law from taking effect if the commissioner could certify that the state would not experience at least a 30 percent reduction in bodily injury premiums.

As we listen to testimony this morning, the causes of increasing auto insurance premiums will become clear, and though we may not have a perfect agreement on the solution, I hope we could agree on one thing: we need reform and millions of Americans who pay exorbitant auto insurance premiums need that reform today.

I would like to say that Senator Robb just arrived. Welcome aboard, sir. And we have a contingent of my colleagues from New Jersey—Mr. Franks, Mr. LoBiondo, Mr. Pappas—and also our gentleman from Texas, Mr. Thornberry. We are pleased to have all of you here.

Let me just introduce now, one of my friends and a real leader on this issue along with a number of others, someone who says what she is going to do and gets it done, Governor Christine Todd Whitman from New Jersey. We are very pleased to have you here. And we are anxious to hear from you.

Let me just ask Senator Robb, however, if he has any statement that he would like to make before we proceed to hear from the Governor.

[The prepared statement of Representative Saxton appears in the Submissions for the Record.]

OPENING STATEMENT OF SENATOR CHARLES S. ROBB

Senator Robb. Thank you, Mr. Chairman. I have no statement. I wanted to make sure that the appearance as well as the reality of bipartisanship is maintained.

I know that this topic is extremely important to you and to your state, and with your distinguished Governor here before the Committee, I thought it was appropriate. I cannot remain for the entire hearing, but I wanted to hear as much of her opening statement as possible, so I will limit mine so that I can hear hers.

Representative Saxton. Governor Whitman, you may proceed.

STATEMENT OF CHRISTINE WHITMAN, GOVERNOR, STATE OF NEW JERSEY,

ACCOMPANIED BY LISA RANDALL, COMMISSIONER OF BANKING AND INSURANCE, STATE OF NEW JERSEY

Governor Whitman. Mr. Chairman, Members of the Committee, thank you very much for inviting me here today. I would like to introduce Lisa Randall, who is the Commissioner of Banking and Insurance in the

State of New Jersey. So when we get to the technical parts, I will throw it all to Lisa. I get to do the easy opening.

But I did want to thank you and commend you for holding the hearing on this important subject matter. And I do appreciate that it is bipartisan. This is one of those issues that affects people no matter what their party affiliation, whether they belong to one of the major parties or don't belong to any party, and the fact that you here in Congress are reaching out to the experience of the states in auto insurance is an example of the partnership that is growing between us, I appreciate that.

Mr. Chairman, let me begin by stating two basic facts about automobile insurance in New Jersey. First, it is mandatory. Every New Jersey driver is required to carry a minimum of $250,000 in medical insurance as well as coverage for some loss of wages and out-of-pocket expenses. Each driver's own policy pays, regardless of fault. It does not matter who caused the accident. In New Jersey, payment for medical bills through auto insurance is guaranteed.

Second, automobile insurance rates in New Jersey are the highest in the Nation. There are many reasons that we hold this distinction, and as you know, I like us being distinct in the Nation but not on issues like this.

New Jersey is the most densely populated state in the Nation. We also have 782 cars per square mile. New Jersey has a high cost of living, which means higher costs for medical treatment and car repairs for a car accident. More than 90 percent of New Jersey drivers choose higher liability coverage than the law requires. Consumers buy higher coverage to protect assets of higher value than they would in other parts of the country.

These demographics are unique to New Jersey and are part of what makes the state the wonderful, diverse place that it is. But the numbers also make clear that New Jersey will never have the lowest auto insurance rates in the Nation, especially given the frequency of lawsuits in our state, another distinction that I would just as soon we didn't have.

New Jersey is the most litigious state in the Nation. In 1995, we filed 819 lawsuits per 100,000 residents. The next state behind us, Nevada, had 512 lawsuits per 100,000. In fact, litigation costs account for more than $300 of every $1,000 in insurance premiums, while only $190 of that same $1,000 goes to paying medical bills for the insured.

I have proposed a major reform to New Jersey's auto insurance system which, in part, resembles the Auto-Choice plan now before Congress.

My proposal recognizes that the single most important thing car insurance can do for a family in the event of an accident is to pay medical bills, lost wages, and other out-of-pocket expenses promptly and without regard to fault. In New Jersey, as I mentioned, insurance is mandatory. But that should not mean it cannot be affordable and allow consumers to choose the amount of insurance that best meets their needs.

I have proposed a four-choice system that will allow drivers to keep the insurance they have today at a savings or select from other new, less expensive options. These innovative options will allow those who do not wish to pay the high cost associated with pain and suffering lawsuits to have full access to the courts for any economic loss that they suffer as victims in an accident and, at the same time, enjoy reduced rates for agreeing to sue only for economic loss and not for non-economic claims.

The first option, the Economic Choice policy, will provide coverage for medical bills up to $250,000, lost wages, and other costs. Policyholders can sue and be sued for economic loss, but agree not to sue for pain and suffering. Consumers choosing this option could save up to $250 on today's most commonly purchased New Jersey policy.

Our second proposed option, the Scheduled Benefits Policy, provides the same basic coverage as Option 1. It adds benefits for pain and suffering compensation, however, based on a predetermined schedule to be paid by one's own policy without the need for litigation. Consumers choosing this option could save up to 10 percent off today's typical policy in the State of New Jersey.

The third option, the Serious Injury policy, is most similar to today's verbal threshold policy in New Jersey, which limits the ability to sue for pain and suffering to a list of serious injuries. This verbal threshold is now chosen by 88 percent of the drivers in our state. My proposal differs from the current policy in that it will impose tighter limits on lawsuits, allowing suits only for the most serious injury. A major fault in our current verbal threshold has been the laxity of threshold on suits.

The fourth option, the Lawsuit Recovery policy, is similar to the zero threshold policy. Drivers who choose this option could sue for pain and suffering, whatever the severity of their injury.

I should note here that each of these four policy options contain sanctions for drunk drivers and illegally uninsured drivers. No matter which policy you choose, if you are hit by a drunk or an uninsured driver in New Jersey, you can sue that person for pain and suffering. And even if the drunk or uninsured driver is not the at-fault driver, he or she cannot sue for pain and suffering.

I believe that offering new choices to drivers will reduce the cost of auto insurance in the State of New Jersey. But we are doing other things to keep insurance costs down, particularly in the prevention of fraud and abuse, and they are part of the comprehensive policy that we have offered.

We know, for instance, that when insurance companies pay for unnecessary and sued over medical treatment, that drives up the cost of insurance to all drivers. So we have enacted a law that requires doctors to notify an insurance company within 21 days that they are treating injuries related to a car accident. And we have proposed establishing a peer review panel of physicians to examine instances of questionable treatment. In some cases, medical professionals would now be the ones to determine whether the course of treatment is truly necessary.

In addition, we will make sure that insurance companies comply with our state laws against insurance fraud by reporting acts of fraud, whether they are committed by auto body shops, medical professionals, lawyers, or the drivers themselves. If insurance companies allow fraud to go unreported, we are proposing to hit them with a $25,000 fine for each and every violation.

Given our plan for reform in New Jersey, I am encouraged by the direction the Congress has taken in regard to auto insurance. Last year's S. 1860 was a model of federalism in that Federal law would represent the first word rather than the last word on the subject. New Jersey and every other state would be free to modify or even repeal any elements of the bill.

In addition, under S. 1860, states would have been able to block the law from taking effect if they could demonstrate it would not lead to significant savings for their drivers.

Just as my proposal allows drivers choice, Federal legislation should allow states flexibility to address their own unique demographic, economic, and public safety concerns. What makes sense for addressing New Jersey's crowded roads, busy courts, and high cost of living may look very different from the right solution for many other states.

Mr. Chairman, I urge that this year's version of the auto insurance bill preserve these elements of federalism that allow the states maximum latitude to design insurance reform that will work best for their citizens.

Thank you very much.

[The prepared statement of Governor Whitman appears in the Submissions for the Record.]

Representative Saxton. Governor, thank you very much for your very articulate statement and for being a leader nationwide on what obviously is a very important issue.

I remember not so long ago, I think it was the summer of 1980 or 1981, former Member of Congress Dean Gallo and I, who happened to be in the state legislature at the time in New Jersey, spent the summer in your office with then-Governor Kean trying to deal with many of these same issues. And since then, each year we have noticed that New Jersey continues to have extremely high automobile insurance premiums. People today are as discouraged as they were in 1980 or 1981. So, this is not a new phenomenon for our state, unfortunately. And your effort to try to hold back on the reins of these rapid escalations in premiums is commendable.

Let me ask you: under the program that you have proposed in New Jersey, which we believe would reduce premiums, would anyone in any way be forced to change their current policy?

Governor Whitman. No, they wouldn't, actually. Option 3, as I have outlined it, is essentially today's coverage, and it is the policy chosen by fully 88 percent of those who choose auto insurance. And we still believe that with the emphasis on fraud reduction and the other initiatives contained in the legislative proposal, even for current coverage, this proposal will cost less.

Drivers can see a reduction in their auto insurance if they stick with the current policy because we will be tightening verbal threshold slightly and we will be making a major effort at fighting insurance fraud.

The other statistic that I didn't mention, which is an unfortunate one in our state, is that 40 percent of the people when polled think it is all right to commit fraud against an insurance company. I think it is partially because they think they are being ripped off by the insurance company, but unfortunately that gets reflected in everyone else's rates. By focusing on the fraud issue, we will drive down the cost.

Option 4 gives drivers the ability to get additional coverage. It is the most comprehensive of current policies, and probably even that would cost less. It wouldn't be less than the average but it would be less than drivers who have it now are paying.

In New Jersey, we have about 400,000 drivers currently driving without auto insurance coverage. By offering them the choice of the low-option policies that protect them against pain and suffering suits and allow them to recover for economic damage at a very reduced rate, we can increase the number of drivers who have coverage and have some ability to get economic reimbursement when they suffer an accident. Now they are in a position that if they have an accident they don't know if they are going to get their hospital bills covered or when, they don't know if they are going to recover lost wages, and they may never get their car repaired. By offering a full range of options we are opening up coverage for those people.

Representative Saxton. Governor, there are several Representatives of New Jersey here who all have busy schedules. I have other questions but I would like to hold them for a minute. We have also been joined by Representative Tom Campbell from California. Let me turn to Tom now.

OPENING STATEMENT OF REPRESENTATIVE TOM CAMPBELL

Representative Campbell. Mr. Chairman, I appreciate your kindness and the indulgence of my colleagues.

I applaud you. This is an excellent and farsighted approach to reducing a tremendous cost to consumers. I have three questions, and you can respond as you wish.

First is, I don't think most people understand that the bargain that a client and an attorney oftentimes reaches will give the contingent fee portion of the amount received in a tort lawsuit over to the attorney, may be as much as a third, and that the pain and suffering is, if you will, the pot from which that is most often taken. And perhaps my first question is you might be able to speak to that in New Jersey because I think it is important that consumers realize that what we are speaking about here in significant portion is money going to the attorney and not actually to the victim.

The second is I used to be an antitrust enforcement officer, as you might know, and there is an antitrust law against bundling of products. It doesn't apply to bundling of services but it seems to me that what we are

talking about is bundling whereby under present law a consumer cannot if he or she chooses get the program as he or she would prefer it, but has to buy the whole thing, including the pain and suffering. And if these were products I think there might be an antitrust concern about the compelled bundling of them. That is more of an observation, but if you had a comment I would be interested.

And the last and the third point, I do wish to know your words as a Governor of a very important state, one of our largest and most industrial and certainly successful economic comebacks under your leadership, as to the federalism issue in this legislation. If it is a good idea, surely you should pass it in New Jersey. I would like just a little bit of insight, as you might, as to why we need this as a Federal law, given that each state could adopt on its own, if it wishes. Thank you.

Governor Whitman. Congressman, let me respond to your third part, and I will ask the Commissioner to go into the first two aspects. She can give you greater detail on them.

The bill as proposed in the last session was one that allowed maximum flexibility to the states, and that is why I am comfortable in saying that I believe that is the appropriate approach. It is clear that auto insurance is an issue that affects every state in the Union. It is also very clear that the solutions are going to vary dramatically from state to state. It would not be a bad thing to have a Federal commitment or raising of the concern that states and auto insurance companies—everyone involved in this issue—should strive to insure minimum cost to the consumer, and to have the Federal Government lay out some ways to achieve that so that every state doesn't have to reinvent the wheel.

But the critical thing about the original legislation was that it did allow states to opt out if it wasn't going to meet their needs. Any future legislation that deals with this, because the Federal Government has not taken a role here in the past, the Congress has not acted on this issue, should retain that maximum flexibility. I would see it as an opportunity for the Congress to highlight the importance of addressing the concern that we should all have for those who drive uninsured because they couldn't afford insurance. In New Jersey, I have heard horror cases of people who are forced to carry policies that are worth more than their car. And they don't carry that policy, even though it is against the law for them to drive uninsured in our state.

If there is going to be any action in the Congress and at the Federal level, the important thing is that it be, as I indicated in my testimony, the first word, not the last. It should set parameters and standards and some goals but allow the states the maximum flexibility to craft policy that meets the needs of their drivers and citizens.

Representative Campbell. And maybe the Commissioner could speak on the bundling issue and the attorneys' contingent fee issues.

Ms. Randall. Yes, Congressman Campbell, you make a very interesting observation about the notion of the application of antitrust principles to the lack of choice in the current system. And certainly in New Jersey right now, the two choices that exist, both compel the driver to choose among two choices, both of which have a mandatory factor for pain and suffering. And we don't have enough choice, and, in fact, I think that is what our proposal in the state is all about, is perhaps doing the unbundling that you suggest.

And with regard to your comment about attorneys' fees, generally I would certainly tend to agree that there are many instances in which consumers are not aware of the extent to which their award, their jury award or their settlement will be impacted by a cut off the top that is compensation for the attorney. And it could be as high as a third in some instances, as you note.

I think one of the things we are trying to do with our proposal is to make sure that consumers are very adequately informed about what exactly happens when you enter the system. And that is why the Governor feels that, along with Choice, there should be provisions that are indicative of the requirement that choices should be explained in plain language and the impact of choosing a pain and suffering option with its attendant payment for attorneys, consumers should be made aware of.

Representative Campbell. Mr. Chairman, I would say in closing on my first round of questions, I am grateful you invited me to attend the panel today. I have the highest regard for Governor Whitman and the highest regard for Mike Horowitz and his work on this issue. A model that might work on the federalism issue is that at the Federal Trade Commission, the Federal Trade Commission, Federal agency, required states when they gave prescriptions for eyeglasses to separate the prescription from the actual diagnosis of the myopia or the eyeglasses, to unbundle. But it is state regulation. That is a local issue but it was upheld

on the authority of the Federal Trade Commission's general jurisdiction statute over commerce that the unbundling occur.

And I think this is a model here, that it is a Federal mandate for unbundling and then how the consumer makes her or his choice in each state, that is, for the protection of the consumer. But the unbundling was held to be Federal authority in the eyeglasses ruling. Just an argument for your federalism ruling.

Representative Saxton. Mr. Pappas.

OPENING STATEMENT OF REPRESENTATIVE MICHAEL PAPPAS

Representative Pappas. Governor, welcome. It has been 10 years since we were on the Somerset Freeholder Board together. Things have changed, haven't they?

Governor Whitman. Just a little.

Representative Pappas. And congratulations, I am not sure, Commissioner, this is the first time you have been down here in this capacity. Certainly the first time I have had a chance to speak to you in this capacity, certainly at a committee meeting.

This is for the Governor, and maybe for both of you. There are a lot of, have been over the years, since Chairman Saxton's days in the New Jersey legislature with former Governor Kean, lots of different proposals to address the issue of reforming auto insurance, and I am just wondering if you could give us some feel for your reasoning behind this specific approach.

Governor Whitman. Certainly. Congressman, what we have seen before in the State of New Jersey when we have approached the reform of auto insurance is the attitude still at the basis of it that Trenton knows best. And while we have reformed at the margins, we have still maintained an overall very prescriptive approach to auto insurance in terms of what we mandate as basic coverage.

The proposal that we are putting forward allows the consumer choice. Yes, we do still require auto insurance. Yes, we do still require a mandatory personal injury coverage of $250,000 reflective of the facts and the road situation in New Jersey. But after that we throw it wide open to people to determine different levels of coverage particularly in regard to pain and suffering, which is where we see some of the highest costs

associated with car insurance. I never like to lay blame at any one community's door. There have been a lot of people that have been part of the problem. But we have definitely tried to maintain a prescriptive approach to auto insurance.

As you know, we had two major efforts that resulted in the Market Transition Facility and the JUA, both of which ran up huge deficits in the State of New Jersey. We inherited and have been able to do away with that deficit without having it come out of the policy premiums of good drivers. But it did not allow us to really reform auto insurance. And we have not been in a position to offer a plan that would allow consumers the option of lowering their costs.

We feel that by giving consumers choice—and I do not fear at any point in time giving the public choice. I think that is the important thing here—we are allowing people to make decisions about their own lives and their own needs. It makes no sense to require someone to carry auto insurance that costs them more than their car is worth, and that is the situation in which we find ourselves. Or if someone doesn't drive more than a couple of hundred miles a year they should be able to reflect that in the type of coverage that they choose for themselves. We haven't allowed that kind of flexibility in the past, and this proposal does. And I turn it over to the Commissioner.

Ms. Randall. I would only add to what the Governor indicated is that we have looked to other states and seen what has been noteworthy and successful in other states which might be helpful to us in New Jersey. And, for example, the proposed tightening of the verbal threshold is something that we have seen be fairly successful in the State of Michigan, and we feel it is translatable and could be of help to us in New Jersey.

Similarly, in terms of some of our medical cost containment proposals that the Governor has set forth, we have seen that Pennsylvania has achieved some savings. So we have looked to other states to see what in the last decade or so has worked for them. And we have taken that which we feel will be helpful to us and applicable to New Jersey.

Representative Pappas. I would commend you, Governor; in your opening remarks you spoke of how physicians will have a greater decision-making role, and I think that goes to the issue of the public's confidence in insurance generally, and I am a strong believer in empowering patients and physicians for making more decisions.

Governor Whitman. Congressman, to me it just seems common sense when you are determining medical protocol or treatment it should be the physicians that determine that and not the lawyers, with all due respect to the lawyers.

Representative Pappas. Just a couple of other questions, if I could, Mr. Chairman.

New Jersey is very urbanized, as certainly we know. Certain areas are very rural, but certainly it is the most densely populated state. How do you think this approach will benefit people in the urban areas as well as businesses in our cities?

Governor Whitman. Again I will let the Commissioner speak to the details of it, but there is a very specific part of this proposal that goes towards the needs in the urban communities. While I would not call the problem that we have had exactly redlining, we have clearly a problem of lack of carriers and those available to sell auto insurance to people living in our inner cities, and it is addressed specifically under our proposal.

Ms. Randall. As the Governor has often noted, we have one New Jersey, and to the extent that we have seen a diminution in the use of agents in urban areas, we are seeking to reverse that, and a very specific portion of the Governor's proposal seeks to bring those insurance companies back into our urban areas and allow them to enter into desirable contracts which would be beneficial to both the urban agent and the company, and it will thus provide more access to automobile insurance to our urban residents.

Governor Whitman. Congressman, it is modeled on our very successful Urban Enterprise Zone program for our inner cities.

Representative Pappas. I am glad to hear that. I have heard that from people in the state that some of the cities that you drive through and it is difficult to find insurance agencies located. I am glad that that is addressed.

My last question, Mr. Chairman and Governor, is I am wondering if—you made some comments about attorneys, and there are some very, very good attorneys that are not part of the problem, and I know that we all recognize that. What has been the response or has there been a response from the bar association with regard to these proposals that you have put forth?

Governor Whitman. Congressman, I am very hopeful that we are going to continue to work with the bar association to come to some

agreement that they can support. The American Trial Lawyer's Association (ATLA) has started a new defense fund, with a minimum contribution of a thousand dollars, to fight this proposal. They have already indicated that they do not feel comfortable with taking some of the legal options away. We are, though, still reaching out to the bar association, and I hope to be able to work with them. As I say, the trial lawyers at this point in time have indicated that they want to fight this and they do have a special fund that they are developing in order to put their resources toward it.

But as you point out, there are a number of lawyers who are very important to this process. It is key that people continue to be able to have access to the courts. This proposal in no way stops that. What it does, though, is give people more choice and ability to decide if in fact they want that option or if they feel it is necessary.

Again, I am not at all afraid of the public's ability to make intelligent decisions. They can do it with health insurance. They can do it with home insurance policies. They can, in a whole realm of areas, make very important decisions over their lives, but not in auto insurance. I have never understood that, and that is why this proposal is based on choice.

Lisa, you have had more recent conversations with the bar association.

Ms. Randall. It certainly appears that the trial lawyers, as a separate group of lawyers, feel somehow that consumers will not understand the choices, and we have invited them to the table to work with us and craft the kind of plain language requirements and consumer protection provisions that we think would go a long way towards satisfying their notion that somehow consumers aren't capable of understanding the choice. Clearly, we think they are capable.

Representative Pappas. I just commend you, Governor, for this initiative. I am glad you are here to really help us all draw attention to what is a critically important issue to the people of our country but specifically to the people of New Jersey, and your leadership is something that we all can be very thankful for.

Governor Whitman. Thank you.

Representative Saxton. Governor, let me just explore one part of this issue, which I happen to think is quite important, and that is the effect your proposal might have on lower income families.

In addressing a number of issues, we often talk about the regressive nature of certain costs that we pass on to consumers, particularly in the area of taxes. In this area it seems to me that the current lack of choices tends to support a regressive system in which lower income people pay a real price.

In other words, if a family of four is faced with a $3,000-a-year insurance premium bill, if that family of four has high income, that $2,500 or $3,000 charge becomes a relatively small slice of their total family income. On the other hand, for a low-income person faced with the same amount of premium, it becomes a relatively large portion of their family income.

Is this analysis correct and what would be the effect on lower income families?

Governor Whitman. Mr. Chairman, it is absolutely correct. One of the things that annoys me the most is when I hear people say that by offering consumers choice we are somehow taking away the ability of lower income people to be protected through auto insurance. We have 400,000 people driving our roads today who don't carry auto insurance. They tend to be the lower income people who simply cannot afford it, but yet they are putting themselves in a position of, A, breaking the law, because it is the law in the state that you carry auto insurance, and, B, if they have an accident, having no recourse at all—no protection at all against being sued for pain and suffering, for recovery of their medical bills, against loss of wages, or against repair bills that are going to be necessary. They are out there completely on their own because we don't offer a policy that they can afford.

The range that we have offered in these proposals, the four choices, allow them to get some coverage. And I think that is very important. I have heard it said that what we are doing is offering them less coverage.

These people have no coverage at all. We are offering them the opportunity to get into the market so there is no excuse to drive uninsured in the State of New Jersey. And they will be protected against pain and suffering suits. They will be indemnified against that even under the Economic Choice policy, and they get their coverage for economic loss. That is critically important.

We have tried not just to lower the overall cost of auto insurance, as important as that is to those who currently carry it, but also to bring in

those who cannot afford to carry any auto insurance because it is so important to their long-term economic health.

Representative Saxton. Let me just pursue this concept one step further. I can remember conversations with former Governor Kean, and we oftentimes talked about the ability of people to get to work and the lack of ability to get to work in terms of job performance, the welfare rolls, and all of those kinds of things. I would suspect that getting people insured and getting them behind the wheel, so to speak, and making that affordable would also have some positive effect with regard to those other kinds of ancillary issues that would be equally important.

Governor Whitman. Well, Congressman, as you well know, and particularly from your district and part of the state, the automobile is important as a way to get to and from work. We are constantly trying to ensure that we provide other options in mass transit because of our concerns about clean air. We want to ensure that we are offering the maximum opportunity for mass transit and other options for getting to and from work, but the car is the only alternative in many parts of New Jersey, and I know that is true in many states across the Nation. So making it possible for people to drive legally in the State of New Jersey has ramifications far beyond just auto insurance.

Representative Saxton. Governor, we have been joined by Representative John Doolittle. I don't know if you have any questions at this point.

OPENING STATEMENT OF REPRESENTATIVE JOHN DOOLITTLE

Representative Doolittle. I apologize for arriving here late but I am pleased to hear the portion of your testimony that I did, Governor, and I look forward to looking at what you are doing in New Jersey.

Representative Saxton. Governor, we have to move on. We have a lengthy hearing this morning which we have to wrap up by noon. We thank you very much for being with us and sharing with us the experiences that you have had with regard to this very important subject.

Governor Whitman. Thank you very much, Mr. Chairman. Good luck with your hearings.

Representative Saxton. Our next panel consists of individuals who are well versed in automobile insurance. They include Dr. Stephen J. Carroll, Senior Economist at RAND; Professor Jeffrey O'Connell from the

University of Virginia School of Law; Michael Horowitz, who is from the Hudson Institute; and Mr. J. Robert Hunter, Director of Insurance for the Consumer Federation. We thank you all for being here.

We will begin with Mr. Carroll.

STATEMENT OF DR. STEPHEN J. CARROLL, SENIOR ECONOMIST, RAND INSTITUTE OF CIVIL JUSTICE

Mr. Carroll. Mr. Chairman, Members of the Committee, I thank you for the opportunity to appear before you.

My name is Stephen Carroll. I am a senior economist at RAND. I am going to report to you today some of the results of some research I have conducted in the Institute for Civil Justice at RAND. However, I must note that the views I express are my own and not those of RAND, the Institute, its Board or research sponsors.

We conducted detailed empirical analyses of the Choice plan proposed by Jeffrey O'Connell and by Michael Horowitz in 1993. My written testimony covers some of the details of our analysis, and I have provided your staff with a detailed research report outlining the full methodology.

I would like to, in my oral remarks today, simply point to three of what we believe are the major results of this analysis.

First, we have looked at what is likely to happen to the cost of insuring drivers who, under an Auto-Choice plan, opt for the no-fault option. We estimate that, on average, over all drivers who make that option, the cost of insurance for their personal injury coverages, BI, UM, et cetera, will decline by about 60 percent.

Now, that is an overall average. We expect that, obviously, there would be differences from driver to driver, depending upon driving record, where they lived in the state and so on and so forth. If other ratios in the insurance arena stay the same—if the profit rate is the same, the rate of return on investment income is the same—a 60 percent reduction in the cost of injury coverages would translate into approximately a 30 percent reduction in the total premium.

Second, the Auto-Choice plan is designed to allow drivers the option of retaining their tort rights if they choose, not being forced to do no-fault, as is the case in most current no-fault plans.

We also looked at what would happen to the cost of insuring drivers who elected to stay in their state's current system. Results there are that the plan would have relatively little effect, on the order of zero effect, on the costs of insuring those drivers and consequently their premiums. In other words, it does seem to be the case, as far as our analysis can discover, that drivers who elect to stay within the current system will not be affected by the fact that other drivers in the system are offered a choice and elect that choice.

Thirdly, we tried to look at where these savings would come from. We find for drivers that would be insured there would be some—not a large, but some—increase in the amounts paid to them for economic loss, a reduction of about 50 percent in the amounts paid for noneconomic loss —that is where most of the savings come from—a reduction of approximately a third in the transactions costs. That is the costs insurers incur in defense costs and in handling claims and the like. There would also be a reduction in the compensation provided to uninsured motorists.

The testimony I have submitted contains a couple of charts to give details of all of this; but, in the interest of time, I think those are the major findings of our study.

I thank you.

[The prepared statement of Mr. Carroll appears in the Submissions for the Record, along with RAND study, "The Effects of a Choice Automobile Insurance Plan Under Consideration by the Joint Economic Committee of the United States Congress."]

Representative Saxton. Thank you very much.

Mr. O'Connell?

STATEMENT OF JEFFREY O'CONNELL, UNIVERSITY OF VIRGINIA SCHOOL OF LAW

Mr. O'Connell. Mr. Chairman, I have been involved in this struggle to try to make more sense out of our insurance for well over 30 years.

You may recall, one of the key figures in the early days of this issue in the Congress was Bill Cahill, who pushed very hard while he was a Congressman and then when he became Governor of New Jersey was very active on this issue. So the history of New Jersey on this issue goes back a long way through Cahill and then, of course, through Kean, as you suggested, and now through the present governor.

One of the objections that is sometimes made, by Bob Hunter who may make it again: Let me say that I have enormous respect for Bob Hunter. I think he is very knowledgeable. He is obviously public spirited, and his views ought to be carefully considered, and I am sure they will be. The objection is sometimes made under this proposal that all the bill does is match the financial responsibility limits that present states have.

Mike Horowitz can speak to the wisdom of that from a Federalism point of view, but it was done for this reason: When you get very large amounts of health insurance and disability insurance mandated across the population spectrum, the costs are unpredictable. Michigan is pointed to as a good model, except that if you look at Michigan and see the number of uninsured—in Detroit, for example, they are huge and horrendous.

The Governor made the point, that if you mandate that everybody buy a Cadillac, people who can't afford a Cadillac and indeed want a second- or third-hand Chevrolet don't get any transportation.

So what this bill does is to say, we will take the present level of mandated bodily injury limits; and we will give people the option of making more sense for them at that limit. If they want to buy more, just as if they want today to buy more liability insurance than the limits mandate, they can do so. So that is the premise.

If you look across the spectrum of desiderata for insurance, I would not think it makes sense to mandate that people carry unlimited or many hundreds of thousands of dollars of medical insurance for auto accidents when we don't require any health insurance at all of people. That does not seem to me to be a wise choice from a public policy standpoint. We now have in place state laws that do mandate limits for auto insurance, and we can give people a chance to make more sense of those limits for themselves.

Let me make a point about Choice. The argument is sometimes made that to allow people to give up their common-law rights against other drivers is somehow immoral or certainly highly suspect. Well, this bill does preserve the right to claim based on fault. It is true you make the claim against your own insurer, but it is based on the same common-law rights.

Let me also suggest about Choice that one of the most precious items in the law is the right to jury trial, especially the right to criminal jury trial. But we allow people to waive their rights to jury trial, both civil and

criminal. Allowing people to waive their rights to be paid for pain and suffering seems to me a relatively modest step compared to that.

Representative Saxton. Thank you very much Mr. O'Connell.

Mr. Michael Horowitz, who actually began this process with our Committee, is also here with us today to express his point of view on this subject.

[The prepared statement of Mr. O'Connell appears in the Submissions for the Record.]

STATEMENT OF MICHAEL HOROWITZ, SENIOR FELLOW AND DIRECTOR, PROJECT FOR CIVIL JUSTICE REFORM AT THE HUDSON INSTITUTE

Mr. Horowitz. Thank you, Mr. Chairman.

As I look at Jeff's condition and mine, I see why the witness stand is so far away from you. It protects you all from our germs.

Thanks for the opportunity to testify on what you point out to be a bipartisan bill. This is a bill that has been endorsed by *The Washington Post* and National Review. It is a bill introduced and supported in the last Congress by Bob Dole, Mitch McConnell, Joe Lieberman and Pat Moynihan.

I am hopeful that, on the House side, perhaps with your assistance and leadership, Mr. Chairman, similar bipartisan coalitions can emerge.

I think this bill should be seen not as tort reform, that old broccoli which takes rights away from consumers. As often formulated here in Washington, the reform is closer to what is on the front pages of the papers every day—a tax cut. The JEC study costs the reform out as saving consumers and businesses $42 billion in insurance rates for 1997 alone, $335 billion over a five-year period; and the JEC chart shows what the distributions and savings will be on a state-by-state basis.

Now, I think this is a tax cut not simply because it puts these massive sums of money into consumers' pockets—more than the 105th Congress will even be remotely able to consider giving to consumers before it faces the voters again. As Governor Whitman and Representative Tom Campbell pointed out, what really goes out here is that we are unbundling, which is to say repealing the tort tax that requires the purchase of a form of insurance protection that, given its price, very few people would buy if given the choice.

Tom Campbell's point was also very, very telling about the relationship between attorneys' fees, and pain and suffering damages. The leading legal ethics case book, *Wolfram on Ethics*, defines pain and suffering insurance as "an inflated element of damages tolerated by the courts as a rough measure of"—I am sure you can fill in the blank, Mr. Chairman—"the plaintiff's attorney's fee."

That is what pain and suffering really is. But it is worse than that, because of how this subjective damage is calculated. It is figured as a multiple of medical bills—three times your medical bills as a rough rule of thumb.

So every time I get hit in an accident and injured and see a chiropractor, for which my health insurance pays, me and my lawyer, mostly my lawyer, get three dollars. It is no wonder that, as Governor Whitman points out, that the pain and suffering element is at the heart of hit-me-I-need-the-money fraud and medical waste and overutilization that is so deeply associated with our auto tort system.

Senator Lieberman points out that he is an advocate of this bill, Mr. Chairman, because most Americans confront the auto insurance system more than any other aspect of our legal system. The cynicism about our legal system, about the rule of law itself, that this hit-me-I-need-the-money, fraud-inducing pain and suffering mechanism engenders is, it seems to me, an independent and powerful reason for support of the bill.

Now, to be able to get a $335 billion tax cut without deficit impact is pretty darn good, particularly when you are also offering consumers faster payment for all injuries they sustain up to the level of their own insurance policies.

The question was asked about the progressivity, and Governor Whitman and her insurance commissioner answered it, but there are powerful points that can supplement the answers they gave.

As the JEC study points out, in response to your question, Mr. Chairman, the savings under the bill would be, on average, 28 percent of the total policy cost of all American drivers and 44.9 percent of the policy costs for low-income drivers.

Let me cite an even more stunning statistic for those that would defend the pain and suffering mechanism, in the name of the poor no less. In the Maricopa County, Arizona study cited in the JEC report, they took the people at the lowest half of the poverty income level, the true working poor of this country, and found, Mr. Chairman, that those in Arizona,

which is a state that pressures people to buy mandatory insurance, those who bought auto insurance who were in the lower half of the poverty level spent 30.6 percent of disposable income to buy auto insurance the study found that for people at twice the poverty level, making $27,000 a year and less, 44 percent had to defer major purchases of food and medicine in order to buy pain and suffering coverages for themselves under the bundled mandatory buy of such coverage.

Well, I think that the American public can figure out how to spend $335 billion of its own dollars over the next five years for better things than pain and suffering insurance. But if anybody wants to buy it, as you point out Mr. Chairman, what Governor Whitman's reform does and what the federal bill does, is say, buy it for the same price and you essentially get the same protection.

One last point. The bill is often called a no-fault bill, and I don't like that term. Yes, it is true that consumers are permitted and do, under the reform option, automatically recover for their economic injuries and without regard to fault up to the level of their own policies. And that, by the way, Mr. Chairman, is a highly progressive result, because poor people who don't have money have got to settle for peanuts, whatever dollars get thrown their way, because they need cash immediately. The current system exploits this need, and anything that provides for more rapid payment is very much in the interest of poor people.

But the essence of this bill, though, Mr. Chairman, is if you are a negligent driver you better watch out because you are going to be sued down to the last penny for any economic injury you cause to anybody that you injure that exceeds his policy limit. Because under the right to sue for the costs of injuries that somebody negligently causes under State law is fully preserved by this statute.

So, Mr. Chairman, I thank you for having this hearing; and I hope that what I think will be a historic legal reform and tax cut can be enacted by this 105th Congress.

Thank you.

[The prepared statement of Mr. Horowitz appears in the Submissions for the Record.]

Representative Saxton. Thank you, Mr. Horowitz. Let me clarify one point.

The number you used we believe is correct, $335 billion; but just so anybody listening understands fully, that is savings over a seven-year period.

Mr. Horowitz. I think the $335 is over a seven-year period. That is right. The $42 billion or so is the 1997 figure. That is correct, Mr. Chairman.

Representative Saxton. Thank you very much.

Mr. Hunter.

STATEMENT OF J. ROBERT HUNTER, DIRECTOR OF INSURANCE, CONSUMER FEDERATION OF AMERICA

Mr. Hunter. Thank you very much. I appreciate your leadership on this very much.

You have a sort of a stacked panel here, because we are all no-fault advocates and have been for a long time.

Jeff and I have gone back right to the beginning. I worked as Chief Actuary of the Federal Insurance Administration on the Department of Transportation study of no-fault back decades ago in response to his book with Professor Keeton, and I have been a long-time advocate.

When I was Federal Insurance Administrator under Presidents Ford and Carter, we were able to get both of those Presidents to support national approaches to no-fault. So you really don't have anyone before you today that is opposed to no-fault.

However, the Consumer Federation does oppose the Choice version of no-fault. We like the Michigan version, as was mentioned. We think that is a very rich benefit version. We believe that the right to sue is an important right in America, and we don't believe that consumers should have that taken away from them without a rich *quid pro quo* of a benefit such as in Michigan, which has unlimited medical and rehabilitation costs and very rich wage loss benefits if you are injured in an auto accident, even if you are uninsured.

We have heard a lot about poor people, but poor people also are victims of injury. Today many of them are uninsured; and when they are not at fault, they are still collecting under the current system. So no-fault is very acceptable to consumers and consumer groups if rich benefits are part of the trade-off to giving up the right to sue.

The reason CFA has opposed Choice for many years, this has been before the States, Choice, for years and has been rejected. The reason consumer groups have opposed it is not because we oppose the no-fault concept but we oppose the trade-off of giving up the right to sue for very limited benefits and because the right to sue for pain and suffering, for example, is eliminated completely.

The second reason that we have opposed Choice is because it is really no choice. It is two forms of no-fault. It is a no-fault without a pain and suffering benefit, and it is a no-fault with a pain and suffering benefit.

If I am hit as a driver who has chosen tort by someone who has chosen no-fault, I don't get the right to sue that person. I retain my traditional rights; but I can't sue that person, I can't go to the jury trial, I have to go to my insurance company, and I have to pay the premium to cover it. So I have lost the right to sue, even under the so-called tort option. The bill immunizes the driver who selects no-fault. You cannot go after them.

The third reason CFA opposes Choice is that no-fault promises prompt claims benefit, and that is true, but what if an insurer delays or denies claims? There is no option to go after that insurer except the insurer can force you into arbitration.

Fourth, Choice is confusing. The bill before the Congress immunizes the agents and the insurance companies in case someone makes the wrong choice. If someone is later in an accident and it was the wrong choice, you can't sue the insurance company or the agent who gave you the wrong information.

Therefore, I think there are ample reasons to not go toward the Choice direction, since it is really no choice, but to go in the direction of a very rich benefit such as Michigan. That would be a wonderful approach. Michigan works.

The Choice bill gives a benefit—a significant benefit cut to people, but it only produces savings of 30 percent or more in 22 states, according to your own statistics. So, therefore, the question is, why are we pushing a national approach that only saves your goal of 30 percent in only 22 states?

The exhibits attached to my testimony shows that the breakdown of the premium dollar make its clear that the reason Choice lowers cost is because it lowers benefits—very significantly. Only about 3 percent of the savings comes from efficiencies in the system. Perhaps about 10 percent

comes from the lawyers' pockets. I have no problem with that. Do that with Michigan. But at least half of the savings comes from the victims' pockets, and that is the concern that I have about low-benefit no-fault.

The second exhibit shows that price increases over recent years are roughly the same in states with no-fault and those with tort. So no-fault does not hold down cost escalation. But it also shows that, relative to the collision premiums, no-fault states tend to cost more than fault states. The one major exception is Michigan, where the collision premiums ranked fourth highest in the Nation. But the very rich, unlimited no-fault benefits, the cost ranks 26th in the Nation.

Michigan works to hold down costs and deliver rich benefits so the Consumer Federation urges Congress to move in the direction of no-fault, to encourage the states to move in that direction, but to hold as the model something like Michigan, something with rich benefits, something that really gives people a reason to give up their right to sue in exchange for something that really helps them when they are victims. The bill does not mislead people into believing that they have a real choice of keeping tort when they don't. A bill like Michigan, something like that we could be very happy to support; and we would love to work with you on moving in that direction, Mr. Chairman.

[The prepared statement of Mr. Hunter appears in the Submissions for the Record.]

Representative Saxton. Mr. Hunter, thank you very much.

Let me ask what I think is a very interesting question that was referred to by Mr. Campbell while he was here. But this is a rather unique situation in which the Congress finds itself delving into an issue that has primarily and traditionally been dealt with by states. Here is a Federal bill which would have a significant impact.

One, why is it that you think we need or do not need this bill passed by the Congress? And two, are you fearful that the rights of states to formulate and adopt their own insurance programs would be affected in any way?

Mr. Horowitz, Mr. O'Connell?

Mr. Horowitz. Well, I am quite confident that Governor Whitman is a pretty vigorous guardian of state prerogatives, Mr. Chairman; and she was perfectly comfortable with it in precisely the sense that Congressman Campbell alluded to. That the reform sets the ground rules. It unbundles

economic from non-economic coverage but otherwise leaves matters to the states.

When I was in the government as General Counsel to the Office of Management and Budget, I headed the Federalism Working Group. I saw Federal bills pass with far less basis for Federal involvement on a one-size-fits-all, Uncle-Sam-knows-best basis. This bill is, as Governor Whitman says, a model for Federalism.

Representative Saxton. Let me stop you here and ask you to explain, if you would, the approach that the McConnell bill would take. What would the McConnell bill mean in practicalities to the states?

Mr. Horowitz. Well, it would preserve state substantive law pretty much intact.

Representative Saxton. Would it force a Federal program on any state?

Mr. Horowitz. No, because there would be two respects in which the states could change it. One, as Governor Whitman points out, any state which did not like any aspect of the Federal bill could repeal or modify any or all of the Federal package. That really is almost historic, the idea of the Federal Government enacting nonpreemptive legislation in an area of such enormous Federal interest.

As a historical point, Mr. Chairman, it should be noted that during the 1970s, and Bob Hunter referred to it, a major drive of the consumer movement was to have a so-called Federal no-fault bill which would have been totally preemptive of state law, one-size-fits-all, in order to replace this system. Phillip Hart got off of his deathbed to vote for it in the United States Senate. Albert Gore supported it enthusiastically at the time. The whole consumer movement supported it, and that was one Federal law that essentially swept away state law. The reform discussed at today's hearing is something that merely sets a basic ground rule and even allows the states to repeal that ground rule.

Representative Saxton. So this preserves the rights of states to conduct their own insurance program?

Mr. Horowitz. Absolutely. And I would say two other things Mr. Chairman.

Representative Saxton. Let me just finish, if I may.

Mr. Horowitz. I am sorry.

Representative Saxton. Regarding Mr. Hunter's favorite program, which has been adopted by the State of Michigan—if the State of New Jersey chose under the Federal guideline to adopt a program similar to the State of Michigan, the State of New Jersey would have that option. Is that correct?

Mr. Horowitz. That is correct. And I may say, ironically, that I spent two hours with Governor Engler just the other day discussing this very proposal, and I can tell you that he is deeply troubled by the point Professor O'Connell made about the debacle of uninsured motorists in the City of Detroit and the widespread number of uninsured motorists, given the high cost of Michigan premiums.

So, of course, any state would have the choice—one in the old bill of last year and a new one that Congressman Campbell has been significantly responsible for adding to what I think will be the 105th Congress version: If there is not a 30 percent average statewide reduction of bodily injury premiums under the bill, a state insurance commissioner can block it.

Now, Mr. Hunter was perhaps inadvertently in error in saying that only 22 of the 50 states would have the reduction. That only underscores how we have understated the dramatic significance and value of this program. We have scored the 28 percent and 45 percent reductions in terms of total insurance premiums. The bodily injury portion of premiums is only about 50 percent of your total premium. So that we estimate 48, 49 states will have, easily, a 30 percent average statewide bodily injury reduction as a result of this reform. That option will be out there to voters.

This takes care of this bogus notion that no-fault, which opponents call this reform, causes premiums to increase. If it does under this reform, it can be blocked from taking effect.

The second point, urged by Mr. Campbell, is that if any state insurance commissioner can show that under state practices the Choice option would be substantially misleading to consumers, the state insurance commissioner can block the Federal law from going into effect in that state.

The reform couldn't be more sensitive on the score of Federalism.

Representative Saxton. Mr. Hunter, I appreciate your perspective on this, but I have—Mr. Horowitz has just carefully explained what I believe to be the case. That is, that no state is forced under any circumstances to adopt anything they do not want to adopt or change their

program. In fact, they can leave it the same or adopt whatever program they wish.

I have difficulty understanding why you would oppose that?

Mr. Hunter. It is not as benign as, say, a Joint Resolution that encourages the states to change the rules. It changes the rules unless the states act; and it changes, therefore, the dynamics of the game at the political level.

Now I support no-fault. I would much rather see the rules change, in my view, properly. I am not opposing the idea of moving in the direction of no-fault. Not at all. I am not opposing that.

I am opposing the specifics of the Choice bill that we have before us. I think it is not a proper trade-off. It is designed obviously by people who want to minimize benefits to victims because it is designed right where pain and suffering benefits in excess of economic damages tend to occur below $25,000.

If I have a $1,000 injury, I tend to get $3,000 or $4,000. If I have a $100,000 injury, I tend to get $25,000 to $50,000. I get a fraction.

The place where these two lines cross are where this bill is designed. It is cutting off all the benefits of pain and suffering. They are real injuries. If you are burned or hurt you are really hurt. You are losing those rights, but you are not gaining anything in the area where today you are undercompensated. That is, in my view, a serious problem with the bill; and I think it can be worked out.

Representative Saxton. Excuse me, please permit me to get back to the question. And your answer, I think, begins to shed light on this. You indicate that the bill would change the dynamics under which the states are making decisions relative to insurance.

Mr. Hunter. Correct.

Representative Saxton. I have here a study that was done by the Star Ledger-Eagleton poll, and one of the first conclusions that it comes to after surveying 800 New Jersey adults, presumably drivers, is that 65 percent of those surveyed said that they are not at all satisfied with the current New Jersey program. And yet, for some reason—and I think you and I know what it is—the New Jersey legislature has been unable to deal effectively with this because of the dynamics that exist in my state currently. The dynamics are heavily weighted against change because of some special interest folks.

So the precise objection that I think you have (i.e., changing the dynamics) is precisely what the bill is intended to do in order to enable states to productively and efficiently make change that people would want.

Mr. Hunter. Mr. Chairman, respectfully, I think you misunderstand my testimony. I am not against changing the dynamics. I am against changing the dynamics in favor of a Choice no-fault plan that is not a choice, that takes away benefits and gives nothing in return. I am for changing the dynamics in favor of something like the Michigan no-fault plan.

Mr. O'Connell. Let me suggest what the Michigan plan would do in New Jersey. New Jersey now has $250,000 of no-fault benefits. That is an awful lot of money. That is five times what New York has. New York has $50,000. New Jersey allows people to choose the same threshold that exists in New York, and it is very similar to what exists in Michigan.

Mr. Hunter. It is much more open in Michigan.

Mr. O'Connell. They have to suffer death and serious bodily impairment, so you can have a lot of games played by lawyers.

But the point is, if, in fact, you provided in New Jersey today unlimited medical benefits, can you imagine the deeper dissatisfaction that would exist in New Jersey because you still preserve the right to sue for pain and suffering? As the Governor indicated, there are an awful lot of suits for pain and suffering in New Jersey. And even in Michigan, which Mr. Hunter points to with pride, the Governor of Michigan says they are facing huge costs with these tort claims that we allowed. And your data from the JEC study indicates that, in Michigan, there are huge savings to be gained by giving people the choice to say I don't want to sue for pain and suffering, even above Michigan's threshold.

Representative Saxton. How many uninsured drivers are there in the country? Does anyone have that information?

Mr. Hunter. About 20 percent.

Mr. O'Connell. Yes, I would agree with that. But in urban areas you would find that it is 70, 80 percent.

Mr. Hunter. It gets much higher for places like Miami or Los Angeles, places where poor people tend to congregate and the rates are high.

Representative Saxton. So when I leave here and drive back to New Jersey, for every 10 cars I meet coming at me, eight have insurance on average, and two don't?

Mr. Hunter. That is correct.

Mr. Horowitz. No, Mr. Chairman, not if you have to drive through Washington, D.C., it isn't. The likelihood is that the driver you are hit by is as likely to not be insured. So if he injures you and he is drunk, you are more than likely on your own, Mr. Chairman.

We are talking about urban centers here, Mr. Chairman. And that, too, is an element of this bill. Your colleague from New Jersey asked that of Governor Whitman what the bill does for cities. Mayor Giuliani has testified on that score. Once again, you get to this pain and suffering mechanism, this thing that says if you say you are hit and you go to a chiropractor, Medicaid might paid for the chiropractor or your insurance might pay, but you get a three dollar bonus for pain and suffering.

Mr. Hunter. Only if you are hurt a little bit. If you are hurt a lot, you don't get anything. It is a scratch-card game, not a lottery.

Mr. Horowitz. Excuse me, Mr. Hunter. You call it a lottery in written statements.

Mr. Hunter. I am for no-fault.

Mr. Horowitz. Let me say about this bill, Mr. Chairman, the fraud levels in the cities are so much higher. There is not an American city where a hard-working taxpaying resident cannot put $300 to $1,000 in his pocket by moving to an adjacent suburb. Not only is this a tort tax, it is a profound urban tax, and the current system is one of the elements that helps create a fiscal death spiral of cities—because you may pay $1,000 more to drive a car if you live in a city. That differential begins to disappear when the cause of the fraud, were pain and suffering mechanism that gives you a bonus every time you see a chiropractor, is of the system after you choose to get out of that regime. This is what Governor Whitman seeks for drivers.

Representative Saxton. Is there any estimate—on average, what would be the effect on insured versus uninsured motorists if the states adopted a Choice plan similar to the one that you favor?

Mr. Horowitz. Well, uninsured versus uninsured, as Governor Whitman points out, the bill's savings would allow states to begin insisting that drivers pay their insurance bills.

I have to say that state after state—contrary to what Mr. Hunter says, where he says now if you are uninsured you can still sue under state law —the voters of California just passed what I would regard as a Draconian initiative that says if you are uninsured you can't sue for pain and suffering. That means that uninsured people are not likely to get lawyers when they are hit.

What we are saying here is that if you have the rates down low enough so that they are affordable, you can begin to get at the uninsured motorist problem.

Mr. O'Connell. I can say that I think your question is a very profound one. No one knows how many people can be lured back into the system by much lower rates. But when we have the huge numbers of uninsured today, it clearly is likely that many of them can be drawn into the insurance pool if, in fact, they can pay half of what they would otherwise pay.

Let me also say that the virtue of providing these PIP benefits, these benefits payable by your own company without reference to fault, do away with the need for uninsured motorist coverage in large measure.

Under the tort system today if you and I collide and you are uninsured, I don't have any remedy at all, so I have to pay an extra premium to cover your liability to me. But once I am insuring myself on a PIP basis, I am indifferent to whether you are insured, because I am being paid by my own insurer, irrespective of whether you have insurance.

Mr. Hunter. There are a lot of uninsured motorists in no-fault states with low benefits even in cities. It is unclear whether you would attract many back in. I would say that in several no-fault states you have above average percentages uninsured—Massachusetts, other places like that, D.C. It is not a panacea for the uninsured motorist.

Mr. Horowitz. Mr. Hunter, calling a state like Massachusetts a no-fault state and comparing it to what Governor Whitman wants in New Jersey and what this bill will do is, to say the least—people talk about calling apples, oranges, this is calling apples, skyscrapers.

On the one hand, what you have got in a state like Massachusetts is —a so-called no-fault state—is they say all you need to do is run up $2,000 worth of medical bills. Then you can sue for pain and suffering. But it is no-fault until that. All Massachusetts-type states do is create incentives for people to run up $2,000 worth of chiropractor bills, which

they routinely do. Those kinds of comparisons have nothing to do with what is proposed.

What we are talking about in terms of uninsured motorists, Mr. Chairman, is the same policy that in Simi Valley costs $300, costs $1,500 in central Los Angeles. And here is the reason: The fender-bender to whiplash ratio numbers, the fraud numbers generated by the pain and suffering mechanisms, are really at the heart of it all.

In California, for example, for every fender-bender, you now have the staggeringly high 45 percent of the drivers say oh, my goodness, I've got soft tissue injury. We have a system in this country where even though the number of accidents has declined, cars have gotten safer, we drive in urban areas so we drive more slowly, despite a decline in accidents of 12 percent, we have increase in claims for bodily injury of 17 percent. So there is a 45 to 100 ratio in California as a whole, but in metropolitan Los Angeles, Mr. Chairman, it is 98.8 per 100 fender- bender to whiplash ratio.

The fender-bender to whiplash ratio in Connecticut, it is 25 for the state; in New Haven, 50 percent. For every nick of a car, you have got half of the people saying, oh, I got a whiplash injury. Why? Because you have a system that says for every chiropractor visit you and your lawyer, mostly your lawyer, get three dollars. It is a crazy system.

Also, Mr. Chairman, you are sitting here groaning as a Member of Congress under the burden of having to deal with our health care system. The RAND Corporation has estimated and others have estimated that, independent of its impact on auto insurance rates, you have got multibillion dollar additional costs in health care for waste and fraud that the pain and suffering mechanism generates.

That is the sort of thing that consumers ought to have a chance not to buy. That is all that the reform does. And if low-income people and urban people don't have to buy it, suddenly central Los Angeles people will have rates close to what Simi Valley people now have. You are going to get a lot of poor people who will join the system, as Professor O'Connell says.

Mr. Hunter. Mr. Chairman, I just wanted to make one point. Mr. Horowitz makes the best argument I ever heard against Choice just then. He said, it is not a no-fault state if it has a $2,000 benefit, but the bill would allow a $10,000 state to have a $10,000 benefit. It would become a target, just as the $2,000 has become.

The bill is faulty no-fault, just like we find in Massachusetts. I agree with them that the fault with many no fault plans is faulty no-fault. The

fault with Choice no-fault is it is faulty no-fault. But the way to fix it is to come up with a plan similar to Michigan.

Representative Saxton. Dr. Carroll, Mr. Horowitz just referred to the subject of other health insurance carriers. In your testimony, or in your report, you note that estimates of automobile insurance costs do not take into account the role of collateral benefit sources, such as other private insurance like workers' compensation or other government or private health insurance costs and benefits. Would you expand on that for us?

Mr. Carroll. That is correct, sir. The data I used to make my study or to perform our analysis only tell us about the compensation an individual received from automobile insurance. It does not identify any compensation that same individual may have received from other sources of coverage, including private health care, employer-paid sick pay which would have covered work loss, perhaps, public programs, worker's compensation, Medicare, Medicaid, et cetera, et cetera. My data did not identify those sources, so I would not capable of including them.

So all of my estimates assume that auto insurance pays from dollar one; and my savings estimates are the estimates of the savings that would obtain if auto insurance continued to pay from dollar one for medical, although I understand that the bill that Jeff and Michael have designed would, under some circumstances, have auto insurance secondary to other sources of compensation, in which case the savings would be greater to the degree that individuals would not receive double payment as is sometimes the case today.

Representative Saxton. Well, thank you very much.

I want to thank each of you for being here with us today, for what I believe was a very thorough discussion of a proposal that has been made in the Senate. We will proceed to disseminate this information to others who may be interested. As this topic heats up, you can all be sure that your comments will be taken into account.

Do you have any closing remarks that you would like to make before we leave?

Mr. O'Connell. I guess I would reply to Bob Hunter very briefly that this bill preserves the defects of current state law. It is true it does. That is, if the people stay in the tort system, they will still be able to use their medical expenses and pump up their medical expenses to get a tort claim. But that is the virtue of the scheme. If a state wants to keep what

it is doing, it can do so; but it gives the consumer the option of getting out of that game.

Mr. Horowitz. The one New Jersey—this has been a New Jersey-oriented hearing, because you do lead the Nation in this unhappy respect.

One of the things that provoked our interest in this reform was the famous ghost rider incident that you will recall—the New Jersey bus situation where they had these teams of dishonest lawyers and chiropractors, and they would use these inevitably poor ghetto people, and every time there was the report of a bus accident on the New Jersey turnpike, the lawyers would rush a poor person down to get on the bus. Your rates were going sky high for buses. The fraud was captured.

And, of course, as long as you pay somebody three dollars every time he runs up a dollar's worth of chiropractor bills, you are going to have the kind of ghost-rider-type fraud that you had in New Jersey.

That is what is exciting about what Governor Whitman wants to do. You take away incentive for fraud. Nobody wants to visit a chiropractor 58 times—that is the average number of Hawaii visits per auto accident —if there is not a cash bonus associated with the visit. Under the reform, people won't go to chiropractors unless they really need chiropractic treatment.

So we can do away with things like the ghost rider problem, which generated fraud and higher bus rates in New Jersey, by allowing people to opt out of the pain and suffering regime which, as Congressman Campbell says, does little else but pay lawyers' fees. You don't need lawyers' fees if the system automatically pays you for economic injuries.

Representative Saxton. Thank you very much.

I think it is important, on a closing note, to make sure that we all understand if the Federal bill passes and becomes law, there will be a variety of options that states in developing their own individual auto insurance programs can opt into or out of. And then, if they develop a choice system, individuals will have the opportunity to opt into or out of a variety of programs, such as those that Governor Whitman chose to include in her proposal.

So it is a series of options that we are looking at. We thank you very much for helping us to better understand these issues, and we will look forward to hearing from you in the future.

Thank you very much.

[Whereupon, at 11:45 a.m., the Committee was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF

REPRESENTATIVE JIM SAXTON, CHAIRMAN

Today we are having a hearing before the Joint Economic Committee to discuss automobile insurance and tort reform. Every American who drives a car and pays automobile insurance faces a very serious and growing problem. The problem is two-fold: the very high and ever increasing cost of automobile insurance, and second, the failure of the current legal system to promptly and fully protect those injured in an accident.

Auto insurance premiums are too high today and they are increasing faster than the rate of inflation. In 1995, the national average cost for insurance premiums was $757, the last year data are available. In some states, the average premium is much higher. For instance, in the state of New Jersey the average automobile insurance premium was over $1,100. Consumer Reports magazine reported earlier this year that for a family in Cherry Hill with two cars and one child who drives, insurance premiums cost somewhere between $2,500 to $3,500. The same Consumer Reports study showed that the national average cost to insure an automobile rose 44 percent between 1987 and 1994, nearly one and a half times the rate of inflation.

We are holding this hearing today to look in to the causes of high insurance premiums and their rapid increase. Even more importantly, we need to examine the possible solutions that could provide American families with much needed relief and would save them hundreds of dollars every year.

I feel it is important to highlight the truly bipartisan and wide-ranging support for auto insurance reform that has come from individuals, advocacy groups, politicians on the right and left (and the Reform party). This movement began with reformers such as Michael Dukakis in Massachusetts, and was promoted in the last presidential election by Senator Dole and by GOP presidential candidate Steve Forbes. And several reforms have been championed at the state level, led by such Governors as Christine Todd Whitman, who recently proposed a version of Auto-Choice for her State of New Jersey.

In this session of Congress, Senator Mitch McConnell (KY) a Republican, is introducing an Auto-Choice bill together with two Democrat Senators, Daniel Patrick Moynihan (NY) and Joseph Lieberman (CT). Their Auto-Choice reform efforts have received favorable reviews from the editorial boards of *The New York Times*, *USA Today*, and *The Washington Post*. At a time when partisan bickering and personal attacks have soured the political atmosphere in Washington, it is refreshing to find an issue where politicians and groups from across the political spectrum can find common ground.

Last year I authorized the staff of the Joint Economic Committee to study some of the problems with automobile insurance. Their report has given us an insight into some of these problems and examined one proposal for reform, called Auto-Choice.

The economic benefits of the Auto-Choice reform are tremendous. The JEC has estimated that the potential savings from Auto-Choice reform could total around $42 billion in 1997 alone. The total available savings would grow larger each subsequent year, so the $42 billion savings in 1997 would have increased to $52.4 billion by 2001. Over that five-year period, Auto-Choice would make available to American consumers over $235 billion in savings.

Nationwide, the average insurance policy would drop from $785 to $562. That means for the average driver, Auto-Choice reform would save them $223 on their auto insurance payment each year. For many people, that would provide much needed relief. In many high-liability states, however, the savings would be significantly greater. New Jersey drivers, who pay the highest insurance rates in the Nation, would save an average of $417 a year.

I would like to emphasize that Auto-Choice reform would be especially beneficial for low-income drivers. Research done by RAND indicates that low-income drivers would save significantly more on auto insurance than the average driver. While the average driver could see savings around 28 percent, low-income drivers would experience, on average, a 45 percent reduction in their premiums.

The JEC study found three major causes of increasing car insurance premiums: fraud, high litigation costs and escalating non-economic damages. While the issue of high litigation costs is an obvious problem, the few studies that have focused on this topic have shown how significant transaction costs can be on the cost of automobile insurance premiums. A

1990 study by the California Department of Insurance found that over 40 cents out of every premium dollar paid for bodily injury liability and uninsured motorist coverage goes to attorneys.

A second problem is fraud and abuse of the auto insurance system. After an FBI investigation into auto accident fraud, Director Louis Freeh estimated that "every American household is burdened with more than $200 annually in additional insurance premiums to make up for this type of fraud."

The bipartisan bill that will be introduced in the Senate by Senators Mitch McConnell, Joseph Lieberman and Daniel Moynihan attempts to resolve several of these problems in the current auto insurance market. Their Auto-Choice reform is a Federal solution that would change the insurance laws to allow individuals to select from two types of auto insurance coverage. Under the current system everyone is required to buy third-party insurance coverage for economic damages (property, medical, and lost wages) and non-economic damages (punitive awards and pain and suffering).

How does Auto-Choice lower premiums? The Auto-Choice bill would give drivers a choice between retaining their state-based insurance system or changing to a first-party, no fault insurance option. Under the new option, drivers would recover damages from their own insurance company, so consumers would only need to protect themselves and their property.

The Auto-Choice bill calls the new option Personal Protection Insurance (PPI), in which drivers would receive first-party coverage with immediate, full payment of economic losses regardless of fault. In return for this immediate recovery and lower premiums, they would opt not to be able to recover for non-economic damages. In addition to the lower premiums, Auto-Choice would reduce incentives for fraud, reduce transaction costs, and help low-income drivers enter the insurance system.

The second option, Tort Maintenance Coverage (TMC), would be chosen by consumers who prefer their current state's laws for recovery of economic and non-economic losses (37 states have fault-based, the rest have different forms of no fault). Under the TMC option, drivers would retain the same amount or types of recovery as provided in the insurance laws of their state, unless they had an accident with a PPI driver. In that case, they would receive first-party coverage up to their own TMC policy limits.

Under both options, injured parties could sue for economic and non-economic damages against drivers who commit intentional torts or when the accident is due to alcohol or drugs. And both options would allow drivers to sue in court, on a fault basis, for economic damages that exceed their insurance policy's coverage limits.

Another significant part of the Auto-Choice reform bill was the tremendous sensitivity and deference paid to the states. All state legislatures would be given the ability to repeal the bill by a simple majority. Or the Federal law could be modified by passing changes in that state's legislature. Finally, the state insurance commissioner could prevent the law from taking effect in a state if the commissioner could certify the state would not experience a 30 percent reduction in bodily injury premiums.

As we listen to the testimony this morning, the causes of increasing auto insurance premiums will become clearer. And though we may not have perfect agreement on the solution, I hope we will all agree on one thing: We need reform, and the millions of Americans paying exorbitant auto insurance premiums need reform NOW.

Statement of Rep. Pete Stark

before the Joint Economic Committee

March 19, 1997

Mr. Chairman, I appreciate this opportunity to express my views about the high costs of automobile insurance. In California, automobiles are essential, so the cost of automobile insurance is matter of great concern to the people in my district.

However, I'm perplexed as to why this hearing is being held in this committee, at this time. The need for the Federal government to intervene in the automobile insurance market is questionable, and certainly much less important than other insurance reforms, such as health insurance, which have far greater impacts on our society and a much closer federal nexus. Even assuming that automobile insurance market is an area for federal action, the particular remedy being considered--No-Fault or No Fault/Choice--has hardly been a panacea. No fault states have among the highest insurance rates in the nation, and have inflated claims and higher costs. During the recent debate on no-fault in California, much was made of the fact that this proposal is different from any that has ever been tried. In my opinion, that is the best possible argument for caution, rather than a signal that this proposal is better than the failed no-fault experiments of the 1970s.

The passage in 1988 of Proposition 103 showed the way to really reduce auto insurance rates. Through mandatory rollbacks and strict insurance regulation, Californians have received savings estimated at $12 billion, with more than a billion more in premium refunds. California auto insurance rates are far more stable than before this law passed.

On the other hand, last year, the people of my state resoundingly rejected a no-fault proposal. It seems clear that the hype surrounding No-Fault/Choice is part of a well-orchestrated campaign by the insurance industry to increase their profits, at the expense of the American consumer, by holding out a false promise of savings.

I will be interested in the results of this hearing, although I understand that most of the witnesses support some form of No-Fault insurance. I wish to submit for the record this letter, addressed to the Chairman and the Members of the Joint Economic Committee, by Harvey Rosenfield, who heads Prop. 103 Enforcement Project, and also the accompanying material.

I thank the Chairman.

PROPOSITION 103 ENFORCEMENT PROJECT

1750 Ocean Park Blvd., #200
Santa Monica, CA 90405
(310) 392-0522
FAX (310) 392-8874

March 17, 1997

The Honorable H. James Saxton, Chairman
Joint Economic Committee
United States House of Representatives
Washington, D.C. 20515

Re: No Fault Insurance Hearing

Dear Mr. Saxton:

We are disappointed to learn that the committee hearing on auto insurance reform scheduled for Wednesday, March 19, will feature only supporters of no fault auto insurance. To our knowledge, no critics of no fault have been invited to attend, nor have advocates of alternative reforms that have succeeded in lowering auto insurance premiums – in stark contrast to no fault's abysmal track record.

Attached you will find testimony we prepared for the Senate Commerce Committee last fall which examines in detail the following points:

(1) No fault increases premiums, fraud, litigation and possibly even accidents. According to data compiled by the National Association of Insurance Commissioners, premiums in mandatory no fault states rose 45.6% between 1989 and 1994, a third higher than the average in liability states (33.7% increase). In 1994, six of the top ten most expensive states (including D.C.) had no fault systems. States that repeal no fault obtain immediate rate decreases. No fault benefit systems cost more to provide, encourage inflation of claims and fraud, and lead to more litigation against insurance companies for failure to pay claims. Moreover, studies show that no fault laws encourage drunk driving and car crashes.

(2) The insurance industry's newly repackaged no fault proposal offers the deceptive promise of a "choice" that is an illusion. When a bad driver "chooses" to be fault-free, that decision overrides a good driver's choice to hold the bad driver accountable under the tort system.

(3) The California electorate has rejected no fault proposals twice in eight years, most recently in March of 1996, after a $15 million campaign which attempted to mislead the public about the origins, sponsorship and impact of the legislation. Federal preemption of the right of states to determine

their own auto insurance system is an inappropriate intrusion in the traditional sovereignty of the states in this arena.

(4) The passage of a ballot initiative in California in 1988 succeeded in lowering insurance premiums by mandating rollbacks and stringent regulation of insurance profits and expenses, saving California motorists an estimated $12 billion, in addition to $1.2 billion in premium refunds.

We ask that you include a complete copy of the testimony and appendices in the printed record of this hearing. If you would find it useful to educate the committee on these points, we would be pleased to accept an invitation to participate in any future hearings on the subject.

Sincerely,

Harvey Rosenfield

cc: Members of the Joint Economic Committee

PROPOSITION 103 ENFORCEMENT PROJECT

"NO FAULT"
A Costly And Failed Experiment
In Social Engineering

Testimony Of
Harvey Rosenfield and Jamie Court
on S. 1860
Before the
Commerce Committee
United States Senate
Washington, D.C.
September 24, 1996

Mr. Chairman and Members of the Committee:

Thank you for inviting the Proposition 103 Enforcement Project to present its views on S. 1860 to the Committee. The Project's principal function is monitoring implementation of Proposition 103, the property-casualty insurance reform Proposition approved by California voters in 1988; it also conducts research and education activities on insurance matters in general.[1] Harvey Rosenfield, the founder of the organization, is a California consumer advocate and the author of Proposition 103. Jamie Court is the Director of Advocacy for the Project; a consumer advocate who also spearheads a related project to protect the public interest in high quality health care.

We are pleased to provide the Committee with our analysis of the impact upon consumers of S. 1860 and of no fault statutes as they generally operate in the United States, along with a brief discussion of the no fault proposals, twice rejected by overwhelming margins by the California electorate, most recently in March.

Based upon an extensive analysis of no fault laws and proposals such as S. 1860, it is our conclusion that no fault is an extremely costly and failed experiment in social engineering. No state has adopted a no fault system since 1976. Since 1989, four states have repealed their mandatory no fault laws.[2] The United States

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[1] The Enforcement Project is an arm of the Network Project, a California-based, non-profit, non-partisan consumer research, education and advocacy organization founded in 1985 and supported by foundation grants and donations from members of the public. Approximately 15% of the organization's 1994 donations came from individuals who could be identified as lawyers.

[2] As of 1994, ten states had mandatory no fault laws. Another eleven states and the District of Columbia had non-mandatory, or "optional," no fault systems. In these states, tort suits and

Congress should not consider preempting the laws of the fifty states to impose this flawed system upon American motorists. We reach this conclusion for the following reasons:

I. No Fault Raises Insurance Premiums.

A. Impact of No Fault in Other States

The following tables summarize data drawn from the California Department of Insurance and from annual reports published by the National Association of Insurance Commissioners, most recently, *State Average Expenditures & Premiums for Personal Automobile Insurance in 1994* (January 1996). This is the most recent data available.[3]

No fault states have the highest average auto premiums. Of the ten states where auto insurance was most expensive in 1989, eight were no fault states. Since then, three of those states -- Pennsylvania, New Jersey and Connecticut -- have repealed their mandatory no fault systems (no fault remains optional in Pennsylvania and New Jersey). In 1994, six of the top ten most expensive states (including D.C.) had no fault systems. Hawaii, as in 1993, remained the most expensive in the nation. Note that in 1993, New York -- model for the "verbal threshold" no fault proposals promoted by no fault advocates -- surpassed California. It is now the 6th most expensive state in the nation. As a result of stringent regulation instituted by the voters in 1988, California dropped off the top ten chart altogether in 1994. It now ranks 12th. See Table 1.

Table 1. States With Highest Average Liability/No Fault Premiums

	1989			1994	
1.	New Jersey****	$650	1.	Hawaii*	$741
2.	California	$519	2.	Massachusetts*	$721
3.	Connecticut*	$473	3.	New Jersey****	$640
4.	Hawaii*	$468	4.	Rhode Island	$612
5.	Dist. of Columbia**	$466	5.	Connecticut*****	$601
6.	Pennsylvania***	$439	6.	New York*	$578
7.	Maryland**	$429	7.	Delaware**	$556
8.	Massachusetts*	$427	8.	Dist. of Columbia**	$546
9.	Florida*	$421	9.	Louisiana	$536
10.	Rhode Island	$408	10.	Nevada	$515

* Denotes Mandatory No Fault State/** Denotes Optional No Fault State/***No fault made optional 1990/****No Fault made optional 1989/*****No fault repealed 1993, effective 1994.

No fault premiums rising nearly one-third faster than non-no fault states. Table 2 below shows that states with mandatory no fault systems saw their rates increase an average of 45.6% between 1989-94, nearly one-third higher than the average rate of growth of the average premium in non-no fault states, which saw an average 33.7% increase over the same period.

compensation are not restricted, and motorists may choose to "add-on" no fault coverages, or motorists may choose whether to be covered by no fault or by tort.

[3] Data for "average liability insurance premiums," which includes no fault premiums in no fault states, was selected from the NAIC report because the so-called 'insurance crisis' of the 1980's involved skyrocketing increases principally in the liability portion of premiums for homeowner, businesses and auto insurance.

Table 2. Comparison of Growth in Average Liability Premiums, 1989-1994

	% Change 1989-94
Average of All Mandatory No Fault States *	45.6
Average of All Non- No Fault States *	33.7
California	-4.5

* Average of State Averages; excludes states which changed their type of tort system

Of the fifteen states with the greatest increases in the nation in auto liability premiums between 1989 and 1994, ten states have some form of no fault -- either mandatory or optional. The top three are all no-fault states: Texas (69.0% increase), Massachusetts (68.9%) and South Dakota (64.2%). See Table 3.

Table 3. States With Highest Growth in Average Liability Premiums

	1989-1994	Growth
1.	Texas**	69.0%
2.	Massachusetts*	68.9%
3.	South Dakota**	64.2%
4.	Nebraska	63.7%
5.	Utah*	59.2%
6.	Hawaii*	58.4%
7.	West Virginia	57.6%
8.	Kentucky**	57.2%
9.	New Mexico	52.2%
10.	Rhode Island	50.0%
11.	Colorado*	49.8%
12.	New York*	49.2%
13.	Arkansas**	47.1%
14.	Delaware**	46.9%
15.	Wyoming	46.0%

* Denotes Mandatory No Fault State/** Optional No fault

Repealing no fault and regulating insurers lowers auto insurance premiums. The NAIC data demonstrate that repealing no fault and instituting rollbacks and effective regulation of the insurance industry results in substantial rate reductions.

Between 1989 and 1994, the four states whose average liability insurance premiums either dropped or grew the most slowly were: Georgia (-4.8%), California (-4.5%), New Jersey (-1.6%), and Pennsylvania (+1.9%).

- Georgia eliminated its no fault system effective in October, 1991, and established stringent regulation of rates and mandated a 15% rollback.

- Pennsylvania repealed its mandatory no fault law effective in July, 1990, made no fault coverage optional, provided a 10% rollback for those customers choosing tort coverage, and provided protections against arbitrary cancellations or surcharges. Pennsylvania, which had the 6th highest average auto liability insurance premium in 1989, dropped off the top ten chart and now ranks 18th!

- New Jersey dropped its mandatory no fault law in 1990 in favor of a system in which motorists may choose tort or no fault coverage, and forced insurers to pay

off $1.4 billion in losses that the state's auto insurance joint underwriting authority had incurred because of the insurance industry's mismanagement. New Jersey, which had the most expensive average liability insurance premium in the nation in 1989 (see Table 2), dropped to 3rd place by 1994.

Georgia, New Jersey and Pennsylvania's reforms were inspired by California voters, who in November, 1988, enacted the most stringent rollback and regulatory regime in the nation.

Connecticut also repealed its no fault system effective January 1, 1994; rates in Connecticut dropped 9.7% during the year after no fault was repealed.

California's Proposition 103 has lowered auto insurance premiums. Proposition 103 was approved by California voters in November, 1988, to address massive increases in the price of business, homeowner and auto liability insurance between 1985 and 1987 -- the so-called "insurance crisis," which rocked the state as well as the nation in the mid-1980s. 103 called for a 20% rate rollback, stringent "prior approval" of rate increase requests, application of the antitrust laws to the industry, establishment of auto premiums based on driving safety record rather than zip code; a 20% good driver discount; and an elected insurance commissioner.

Auto premiums fell 4.5% in California between 1989 and 1994, while premiums throughout the rest of the nation increased 29.6%. In 1988, California had the seventh fastest rate of annual growth in auto insurance liability premiums in the nation. By 1994, California was 47th. Between 1988 and 1994, California experienced the slowest rate of auto premium growth of any state.

In 1989, California had the 2nd highest average premium in the nation. In 1994, it was 12th. California is the only state in the nation to achieve a decrease in auto insurance premiums three years in a row. Because of its impact on premiums, Proposition 103 has saved California motorists an estimated $12.2 billion. That does not include over $1 billion in Proposition 103 refunds paid to California motorists.

Interestingly, NAIC data on profits suggests that rates in California could be further reduced. Despite a lengthy freeze on rate increases and over $1 billion in refunds, the average profit of California insurers is twice the national average. Proposition 103's pressure to eliminate waste, inefficiency and fraud has worked. However, the excessive profits insurance companies are earning in California prove that further reductions in existing rates are justified.

B. Why No Fault Is More Expensive

The NAIC data show that No Fault raises premiums. No fault is an inherently more expensive system for delivering auto accident protection for the following reasons.

• **Twice the people covered.** Under no fault, both the innocent victim and the person who caused the accident are paid -- regardless of who is at fault. Paying both parties is vastly more expensive than under "tort" systems, in which the

liability policy of the at-fault driver covers the innocent driver only. Restrictions on the right to sue -- even draconian restrictions such as those contained in S. 1860 -- do not necessarily offset the higher cost of paying both parties.

• **More claims.** Because insurance companies are required to provide the no fault benefits to whomever requests them, without the independent judicial review of the legal system, consumers have an incentive to increase treatment. In other words, the availability of medical care up to the limits of the no fault policy encourages greater utilization.

• **More fraudulent claims.** Fraud is rampant under no fault systems. The easy availability of medical benefits and wage loss encourages unnecessary claims. Additionally, individuals who are not covered by other forms of health care, or who are hurt at work but want greater benefits than workers' compensation provides, file claims under the no fault system for injuries or illnesses not caused by the operation of a motor vehicle.

• **Encourages reckless driving.** Studies show that drivers operate vehicles more recklessly when they are relieved of personal responsibility under no fault laws. (See, for example, "Effects of Tort Liability and Insurance on Heavy Drinking and Drinking and Driving," Sloan, et. al., Journal of Law and Economics (April, 1995)).

• **Additional Insurance Required.** Under no fault, motorists must still purchase property damage liability protection; uninsured/unregistered motorist coverage; and under-insured coverage.

C. S.1860 Does Not Mandate Lower Premiums

While the insurance industry and other sponsors of S. 1860 claim the legislation would reduce auto insurance premiums, nothing in the bill requires a reduction of auto insurance rates or premiums.

Section 6 (b) of the legislation requires the appropriate insurance regulator in each state to issue a general finding, based on evidence adduced at a public hearing, that the measure will reduce the "average" premium by 30%, as a precondition of the statute's applicability in that state. While insurance companies and pro-industry state regulators will have no trouble providing the actuarial "studies" needed to support such a general finding, this provision offers only the illusory promise of a reduction.

• Nothing in S. 1860 requires any insurance company to actually reduce its premiums by one penny. A general finding by a state regulator has no application to specific insurance companies or specific consumers.

• Many state regulators do not have the authority to regulate premiums. While S. 1860 overrides state tort laws governing the protection of consumers, it provides no authority for state regulators to order refunds, or to lower rates, even if such reductions could be justified.

• Across the board rate reductions are always subject to legal challenges by insurance companies, and no insurance company can be forced to reduce its rates if such action would deprive it of a fair return. Because S. 1860 provides no

empirical basis for the 30% figure, the reduction would be extremely vulnerable to constitutional attack by the insurers as "arbitrary" and "irrational" even if a state regulator chose to order such a reduction and had the authority to do so. The reduction could be thrown out by the courts on this ground alone. Another fatal defect may be the process by which insurers can seek relief from the reduction. If the state statutes which the legislation says are to govern the rollback process do not contain the constitutionally-required due process protections, the courts will strike down the rollback. A federal court struck down a Nevada rate rollback on just such grounds.

• The record suggests that insurers will do everything in their power to avoid reducing rates. California insurers spent six years and an estimated $200 million in legal fees fighting the 20% premium rollback mandated by the 1988 voter-approved insurance reform initiative, Proposition 103. It was not until February of 1995 that the U.S. Supreme Court, refusing to hear the insurers appeal of a unanimous California Supreme Court ruling upholding the rollbacks, put an end to the litigation. And each insurer still has the right in California to litigate the application of the law to itself.

• Nothing in S. 1860 would prevent insurance companies from arbitrarily or unjustifiably increasing rates 30% prior to the effective date of S. 1860, thus enabling insurance companies to reduce their premiums by 30% while in effect making no net rate reduction. Nor does S. 1860 prohibit insurers from raising premiums by 30% one day after reducing them by 30%.

D. Insurance Companies Will Not Lower Premiums Voluntarily

Insurers favor no fault precisely because it costs more to pay for both the wrongdoer and the innocent victim of a car accident. Since insurers make most of their profit from the investment of premiums, high-revenue programs like no fault are preferred by insurance companies, particularly in regulated markets, because they can justify passing through to consumers the higher costs, along with their higher markup for profit and other excessive expenses. Higher costs equal higher premiums. Higher premiums provide more capital to invest. More investment capital means higher profits.

Since the Proposition 103 campaign in California in 1988, insurance companies have readily promised rate reductions as a political tactic when sponsoring no fault laws. However, these reductions do not materialize. In the California battle in 1988, insurance companies told voters their no fault proposition (104) would lower premiums by 20%. However, consumer advocates obtained transcripts of confidential briefings by insurance industry executives which revealed that rates would go up -- by as much as 35% in urban areas -- rather than go down, if no fault was approved by the voters.[4] Hawaii's motorists were promised a 15% rate rollback, "guaranteed" as part of amendments to the state's no fault law enacted in 1992. However, virtually all insurers reneged on their agreement to pay the reduction. In 1995, Hawaii's Governor vetoed a bill very similar to S. 1860, sponsored by State Farm, on the ground that its rate rollbacks were illusory.

[4]"No Fault Insurance Rate Hikes Revealed," Costa Mesa Daily Pilot, June 24, 1988, P.1. "No Fault Insurance Could Boost Some Rates, Agents Told," Los Angeles Times, June 24, 1988, p. 3.

Governor Cayetano was unwilling to allow the insurance industry to perpetrate a fraud on Hawaii's motorists a second time.

Some insurance industry officials have themselves admitted that traditional no fault systems will not lower premiums and have avoided promising rate decreases. According to a statement on no fault made by the president of the Association of California Insurance Companies, "The new no-fault will not lower rates. No-fault will control rates. We have never said it will lower rates."[5] The deputy insurance Commissioner of Michigan has argued --after the fact-- that Michigan's no-fault law ". . . was never designed primarily as a savings measure. All of the arguments focused on paying people better and faster and enhancing rehabilitation by giving people money immediately."[6] A director of Independent Mutual Agents in New York went out of his way to diminish the importance that consumers should place on getting lowered, or even stabilized, premiums under no-fault. Unfortunately, he said, "the no-fault concept was erroneously sold to the public by the legislature, and by a certain segment of the insurance industry, on the basis of cost savings alone."[7] And, testifying in California, an official from New York State's Department of Insurance illustrated how promises of lower premiums are nothing more than bait-and-switch tactics to try and sucker voters: "... we do not believe that the major impetus for enacting a no-fault law should be the expectation of premium reductions (though they may occur). . ."[8]

E. What Is a Worthless Policy Worth?

Whether or not a rate reduction would be justified under S. 1860 is, of course, a separate matter from whether insurers may be compelled to provide it. It should be noted that in eliminating the liability of wrongdoers for the pain and suffering (non-economic damage) they cause, and in making virtually all other sources of compensation primary, S. 1860 effectively eliminates the need for employed individuals, seniors on Medicare or those with other compensation sources to purchase auto insurance at all. For these individuals, an S. 1860 auto insurance policy would be a worthless investment, even at a 30% off present rates. Does that mean insurers will voluntarily provide the 30% rate reductions after all? On the contrary. Lowered premiums means lowered investment returns; insurers will not likely accede voluntarily to rate reductions that will reduce their own profits.

F. The RAND Report

The California-based Rand Corporation has issued a series of widely distributed reports on no fault auto insurance. Press releases accompanying the reports invariably suggest that no fault proposals, including those similar to S. 1860, would dramatically lower insurance "costs" in many states.

[5] Underwriter's Report, October 3, 1991, p. 5.

[6] Paulson, Morton C., "The Compelling Case For No-Fault Insurance," Changing Times, July 1989 (quoting Jean Carlson, Michigan Deputy Insurance Commissioner).

[7] The National Underwriter, "Agents Blame Inflation For High Rates; Seek Amendments To N.Y. No-Fault Law."

[8] From testimony of Richard C. Hala, Deputy Superintendent of Insurance, New York State Dept. of Insurance, before California Legislature Assembly Committee on Finance, Insurance and Public Investment, May 24-25, 1993.

The Rand reports have been widely touted by no fault supporters to bolster their argument that no fault will dramatically lower premiums. However, the studies utilized highly questionable and sometimes severely flawed assumptions; the resulting conclusions are inaccurate and often misrepresented. In any event, the "savings" described by Rand are in the form of lower costs to insurers, not lower premiums for policyholders -- a point omitted from the publicity generated by Rand and the insurance industry. Scrutinized critically, the Rand studies show that no fault will not lower rates significantly -- if at all. Moreover, the Rand reports confirm other fundamental problems associated with no fault systems. [9]

The flaws in the Rand reports raise several important points about the typical debate around no fault's impact on premiums. Insurers inevitably attempt to dominate the debate by employing actuaries to "scientifically" estimate premiums under proposed no fault laws. However, experience in state after state proves that there is little science to such efforts and even less reason to rely on the results.

First, there is very little accurate data upon which to draw meaningful comparisons between states; the Rand studies demonstrate this, since Rand was forced to construct an elaborate computer simulation and make numerous assumptions about human behavior in order to conduct its investigation. Second, that data which is available comes entirely from the insurance industry and cannot be verified; it is subject to both manipulation and error. Third, insurer actuaries simply extrapolate existing data or, too often, hypothesize outcomes. Not surprisingly, actuarial analyses of various no fault proposals tend to support the insurers claims even after significant defects in their methodology are pointed out.

While it is clear that no fault in practice leads to premium increases rather than decreases, this is not to say that a no fault law could not be drafted which would lower premiums. Manifestly, severe limits on claims and compensation would so reduce payouts that insurers could reduce rates and still maintain their present level of profits. But this raises the related question, considered below, of whether such a policy would be of value either to the policyholder or to society. Again, such rate reductions can only be achieved through a series of massive subsidies between drivers.

II. No Fault Contradicts Basic American Principles Of Individual Responsibility And Accountability

All no fault systems contradict the fundamental principle of American justice that wrongdoers be held responsible for the harm they cause. Under no fault, good drivers and bad drivers receive compensation, regardless of who was at fault in an accident. However, S. 1860 represents an extension of the "no fault" concept far beyond the original no fault theory, which emphasized unlimited medical and wage loss benefits in exchange for restrictions on non-serious injuries. S. 1860 reflects the insurance industry's use of no fault to limit its own responsibility to policyholders by proposing an unprecedented diminution of individual responsibility and accountability. The legislation violates a central tenet of American democracy: that any individual may have access to the judicial system -- the one branch of government in which a citizen is accorded authority equal to

[9] See Appendix A for a critical analysis of the Rand report.

that of any corporation, no matter how powerful -- to hold wrongdoers fully accountable for all the harm they cause.

• By eliminating "fault," no fault treats good drivers and bad drivers the same. No fault thus rewards the bad driver, who, in a tort system, would be ineligible for compensation unless he or she purchased additional first party coverage. Reckless drivers are excused from paying for the harm they cause. Careful drivers end up subsidizing negligent drivers. This is not to say, however, that insurers will not be able to assign blame as part of their own rating systems. S. 1860 contains no statutory or regulatory constraints on insurers' rating practices. Carriers will be free to assert that every policyholder is at fault in an accident, and increase premiums accordingly. Such arbitrary actions fail to apply the appropriate emphasis upon careful driving.

• Evidence suggests no fault can lead to more accidents. In their 1987 book *The Economic Structure of Tort Law*, conservative theorists William M. Landes and Richard A. Posner found that tort law leads to lower accident rates because, they argue, if the incentive to take care is reduced, people will be less careful, and the cumulatively significant result will be more fatal accidents.

• No fault encourages drunk driving, according to a recent study. ("Effects of Tort Liability and Insurance on Heavy Drinking and Drinking and Driving," Sloan, et. al., Journal of Law and Economics (April, 1995)).

Between criminal justice and no justice lies a significant amount of reprehensible behavior that leads to many deaths and injuries. It is here that society has intervened to establish the civil justice system. It is this system, more than anything else, that distinguishes civilized society from lawless rule or anarchy. Restriction of civil justice rights may well return society to the era of "frontier justice," in which individual disputes, perceived or real, are settled by brute force.

III. No Fault Eliminates The Right To Full Compensation

As originally envisioned, no fault systems would provide consumers with full and unlimited compensation of medical expenses and wage losses arising from a motor vehicle accident. In exchange, motorists would sacrifice their common-law right to sue to obtain compensation for human pain and suffering for their minor injuries. However, victims of serious and/or permanent injuries could sue for pain and suffering compensation.

S. 1860 contains a total ban on all compensation for pain and suffering, regardless of the seriousness of the injury, the irresponsibility of the person who caused the crash, the inadequacy of the victim's own insurance coverage, or the abusiveness of the insurance company. By taking away the right to sue for pain and suffering, S. 1860 depersonalizes the injured human being to the status of damaged property.

IV. No Fault Shifts Costs From Private Insurance Companies To Taxpayers

Under S. 1860, accident victims are compensated by their insurance companies according to the limits in the policy they purchased, but victims must also first turn to other programs for payment.

Victims of catastrophic accidents would be forced to rely on taxpayer-funded welfare and health care programs to foot the bill for medical and rehabilitation expenses and wage loss before auto insurance coverage applies.

S. 1860 requires a victim's auto insurance benefits to be reduced by the amount of benefits recovered by such persons from workers' compensation insurance, state-mandated disability insurance, social security disability insurance, or under any similar federal or state law providing disability benefits. Instead of meeting the commitment and obligation consumers pay them for, insurers profit by allowing taxpayer funded programs to pay all or part of their obligation.

V. No Fault Stacks The Deck In The Insurance Companies' Favor

All insurance industry no fault proposals attempt to further undermine the power consumers have when demanding an insurance company pay claims fully and promptly. S. 1860 would leave the injured person alone, without representation, to face clever insurance adjusters, deprived of the leverage of adequate legal remedies.

First, the elimination of compensation for accident victims' pain and suffering removes the incentive for scrupulous lawyers to accept auto accident cases, since their fees would then have to be paid out of the victim's recovery of medical costs and lost wages. One of the unstated but obvious purposes of no fault proposals such as S. 1860 is to discourage lawyers from representing accident victims, no matter how serious their cases. Without the ready availability of such representation, insurers will have little reason to eschew abusive settlement practices.

Indeed, S. 1860 not only discourages lawyers from taking accident cases; it strips policyholders of traditional state consumer protection laws that permit insurers to be sued and face heavy penalties should they fail to settle claims in good faith. Section 5(a)(3) of S. 1860 abolishes the right to punish an insurance company with a punitive damage award. Since insurers have a financial incentive to deny claims -- they earn most of their profits from the investment of premiums -- the threat of a financial penalty is often the only leverage a policyholder can wield to force an insurance company to comply with its legal obligations.

S. 1860's requirement that the insurance company pay claims within thirty days or pay 50% interest is designed to disguise the impact that freeing insurers from punitive damage awards would have in encouraging more misbehavior by insurers. But it is an illusory protection. S. 1860 allows an insurance company to fail to pay benefits that are in "reasonable dispute." But S. 1860 allows the insurance company to determine what a "reasonable dispute" is. This deliberate and gaping loophole places the policyholder in a position of great weakness vis-a-vis the insurance company.

VI. S. 1860 May Enhance Disputes

In traditional no fault states like Michigan, suits by motorists against their own insurance companies for failure to pay no fault benefits have skyrocketed. Testifying before the Maine legislature, which was considering a no-fault proposal nearly identical to Michigan's, Representative Nelson W. Saunders told the legislators to beware of claims that no-fault would reduce the number of lawsuits:

> "What we did not count on when we enacted our no-fault legislation was a drastic increase in first-party litigation. You are seeking to enact no-fault legislation to contain costs, to provide prompt and adequate coverage and to reduce the need for litigation. Auto no-fault does not result in a reduction of litigation. The number of first party auto no-fault lawsuits filed in Michigan is nearly three times as great as the number of third party suits. Most of our insureds who file suits find themselves not suing a liable negligent driver, [the third party] but, rather, suing their own insurer for their own first party benefits. This has resulted in driving up administrative costs and has considerably lengthened the time it takes for insureds to receive benefits. Auto no-fault does not reduce the number of suits filed or the cost of litigation."

This is reflected in the record. During the period 1977-89, of the 1,119 appellate opinions in Michigan dealing with no-fault, a whopping 73% (826) were first party cases in which insureds wound up having to sue their own insurance company to receive benefits.[10]

Traditional no fault systems also spawn enormous litigation over whether a particular individual has met the threshold over which claims for pain and suffering may be requested. Another 22% of the reported cases (241) in Michigan concerned the bodily injury threshold requirement, where the question was whether a suit could appropriately be filed against a third party because the injuries were serious enough.[11]

Noting these trends, an article in the Insurance Counsel Journal, a publication for insurance defense attorneys, concluded: "Whatever the advantages of no fault, a reduction in court cases and court costs would not appear to be one of them."[12]

Of course, S. 1860's arbitrary elimination of compensation for non-economic losses will eliminate "threshold" issues. And its ban on punitive damage claims in lawsuits against insurers who act in bad faith will likely discourage claims by all but the wealthiest accident victims. Nevertheless, by altering the cost-benefit analysis undertaken by insurance carriers in determining whether and for how much to settle a claim, S. 1860 will likely lead to more disputes, some of which will find their way to courts. Moreover, litigation over property damage -- the vast majority of car accidents involve property damage -- will continue under S. 1860, because like all no fault systems, it retains the liability system for property claims.

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10 Sinas, George T., "No-Fault: A Perspective From Michigan," June 30, 1990, p. 15.

11 Id.

12 *Insurance Counsel Journal*, July, 1986, p. 389.

VI. No Fault vs. Auto Insurance Reform in California

California is a "tort" state; its law requires drivers to purchase "liability" insurance for the bodily injuries and property damage that occurs when a motorist causes an accident. People who cause accidents are held accountable for their actions and injured victims have the right to full compensation for their losses and injuries suffered. Accident victims seek compensation for their property and bodily injury losses from the person and the insurance company of the person "at fault." Only the innocent victim is paid compensation. People who cause accidents are not entitled to any benefits if they were hurt, unless they have purchased "med-pay" coverage or have their own health insurance policies. There are no arbitrary limits on the victim's right to compensation for the injuries sustained; compensation is decided by arbitrators, courts or the parties themselves.

With the largest concentration of motorists in the United States, California has proven a fertile ground for insurance reform efforts. California voters have twice been presented with insurance industry no fault proposals. In each instance they have been decisively rejected by the voters, despite deceptive multi-million PR and political campaigns, the first time in favor of landmark legislation regulating the rates and practices of the insurance industry itself.

The insurance industry and its representatives often mischaracterize events in California. The following is a brief history of efforts to enact no fault in California.

A. No Fault vs. Rate Regulation: The 1988 Initiative Battle

Prior to 1988, California was the only major state in the nation which did not regulate the insurance industry's rates. State law shielded the industry from both competition and regulation; neither the free market nor government supervision were permitted to moderate the severe impact of the insurance cycle.

During 1987, a coalition of hundreds of organizations representing millions of Californians sponsored a statewide legislative campaign to push for modest regulation of the insurance industry and repeal of the industry's exemption from the antitrust laws. The insurance industry's powerful Sacramento lobby refused to acknowledge the need for any reform and successfully blocked the consumer proposals, setting the stage for Proposition 103. The announcement of the initiative in November 1987 led to the domino-like filing of six other insurance-related initiatives. Five initiatives ultimately gained enough signatures to be placed on the November 1988 ballot.

Insurers backed three of the propositions, which would have enacted various tort restrictions and no fault auto insurance, spending a total of between $60 and $80 million in support of their measures and against Proposition 103.[13] Proposition 104, the insurance industry's no fault measure, was overwhelmingly rejected: 75% of the state's voters opposed it. The state's trial bar backed a fourth initiative with $14 million; it was a more detailed but less dramatic version of Proposition 103. Only 103 received voter approval in 1988, largely due to an unprecedented

13 Seager, Susan, "Insurance initiative war hits record $63.5 million," L.A. Herald-Examiner, Nov. 1988.

grassroots campaign and the support of consumer advocate Ralph Nader.[14] As noted above, Proposition 103 has delivered over $1 billion in premium refunds and saved consumers over $12 billion, resulting in a net decline of premiums in the first five years since its passage.

B. Proposition 200 on the March 1996 California Ballot

On December 20, 1994, a group calling itself the Alliance to Revitalize California proposed a so-called "pure" no fault initiative for the March 1996 ballot as part of a package of three initiatives to broadly limit access to the courts and the application of the state's tort laws. The provisions of Proposition 200 were nearly identical to S.1860. Like S. 1860, Proposition 200 would have:

- abolished pain and suffering compensation for even the most seriously injured consumers;
- established a first party auto insurance liability system;
- required that taxpayer-funded public assistance programs and other forms of private insurance coverage bear the costs of auto accident victims before auto insurers are responsible to pay claims;
- offered drastically lowered benefits;
- promised substantially lower auto insurance premiums, without any guarantee that reductions would be made;
- eliminated bad faith lawsuits against insurers.

The chief difference between the two proposals is that Proposition 200 abolished tort liability even for economic damages.

Like S. 1860, Proposition 200 was based on a proposal drafted by Jeffrey O'Connell and Michael Horowitz, two recognized leaders of the national corporate campaign to restrict state tort laws, and publicized by the Manhattan Institute.

O'Connell is considered the "father of no fault," a proposal for unlimited auto insurance benefits which he first discussed in a legal publication with Robert Keeton in 1965. Californians first met O'Connell in 1988, when he became one of the insurance industry's leading spokespeople against insurance reform Proposition 103 and advocate of Proposition 104, the insurance industry-

14 Operating under the rubric of "Voter Revolt," the campaign organization established by Harvey Rosenfield to campaign for Proposition 103, the pro-reform sponsors spent $2.9 million raised from modest contributions from the public. Immediately after the election, Clinton Reilly, the insurance industry's political consultant for the initiative battle, wrote a confidential memorandum urging the industry to find ways to co-opt grass-roots consumer and minority organizations in order to affect some "consumer credibility," a quality the industry clearly lacked. This would be necessary, he argued, because, "Without consumer credibility, reform concepts are easily discredited as special interest pocket-lining by the industry. . . . The insurance industry desperately needs the credibility of third parties to endorse and advance efforts to control insurance costs in California." As will be seen, this strategy proved unsuccessful in 1996.

sponsored "no fault" initiative defeated by voters by a three to one margin. Campaign disclosure reports later revealed that O'Connell had received at least $67,000 from the insurance industry for his California moonlighting against Prop 103.[15]

Michael Horowitz is a long-time advocate of restricting the right of citizens (as opposed to big corporations) to go to court. He served as General Counsel at the Office of Management and Budget and was chief consultant for the Reagan Administration's Tort Policy Working Group, a favorite of Vice President Quayle's. He joined the Manhattan Institute in the late 1980s where the O'Connell-Horowitz plan was drafted.

The Manhattan Institute is a think tank[16] which purports to be concerned about the protection of consumers against avaricious lawyers,[17] but it is funded by a roll call of some of the largest corporations in the world, led by insurance companies: State Farm Insurance, Aetna, Chase Manhattan Bank, CitiCorp, Bristol-Myers Squibb, Exxon, Pfizer, Phillip Morris, Procter & Gamble, Prudential, RJR Nabisco, Cigna, Dow Chemical, General Electric, Union Carbide, Metropolitan Life, Safeco, and Traveler's. Among the four corporate donors listed at the $50,000 and above level by the Manhattan Institute two are insurers, State Farm Insurance Company and Aetna.[18]

The Institute has worked hard to adopt a patina of academic respectability, but its purpose is laid out in a blunt November 1992 fundraising letter to the Institute's corporate and insurance industry sponsors.[19] The fundraising letter previewed the pure no fault proposal which became Proposition 200 and is now S.1860.[20]

The Manhattan Institute publicly unveiled its no-fault proposal in a March 21, 1993, New York Times op-ed by Michael Horowitz criticizing a "pay at the pump no fault system" that corporate consultant and financial writer Andrew Tobias had promoted in a self-published book and in the California Legislature.[21] "Bravo,

[15]The campaign disclosure reports are attached in the Appendix.

[16]One of the Institute's most influential founders was William J. Casey, Ronald Reagan's Director of the Central Intelligence Agency. The Institute views itself as-being on the "forefront" of the current "realignment" of business and economic interests over civil rights, boasting that it has published the work of writers such as Charles Murray, author of *The Bell Curve*. In addition to Murray, the Institute has been a principle patron of civil rights critic Dinesh D'Souza (*Illiberal Education*) and tort reform guru, Peter Huber (*Liability: The Legal Revolution and Its Consequences*).

[17]"Rethinking Contingency Fees," (1994, Horowitz, O'Connell, Brinkman) which sets forth the proposal upon which the Alliance attorneys fees initiative is modeled, suggests that limitations on contingency fees will provide plaintiffs with higher net recoveries and speedier payments. Peter Passell, "Contingency Fees in Injury Cases Under Attack by Legal Scholars," *New York Times*, February 11, 1994, p. A1.

[18]A copy of the donor list is attached in the Appendix.

[19] Attached in Appendix.

[20]Lest there be any doubt about the interests of corporations in funding the Manhattan Institute's agenda, the fundraising solicitation specifies precisely the pay-off: "We feel that any funds made available to the Judicial Studies Program will yield a tremendous return at this point -- perhaps the highest 'return on investment' available in the philanthropic field today." William H. Hammett, President of Manhattan Institute, Corporate Solicitation Letter accompanying "Judicial Studies Program Mission Statement and Overview," New York, N.Y., November, 1992

[21] Andrew Tobias, "Auto Insurance Alert!" January, 1993. Tobias widely advertised that the booklet's proceeds were to go to a consumer group, whose leader, Bob Hunter, subsequently announced his opposition to Prop. 200.

Andy!" Horowitz exclaimed, for the portion of Tobias' proposal that would "abol[ish] all pain-and-suffering claims...." But Horowitz expressed his funders' disinterest in a pay-at-the-pump insurance delivery system that would have taken insurance out of the hands of the insurance industry: "Having seen the dreary effects of a judicialized system, Mr. Tobias would substitute a politicized and bureaucratized one."[22] Horowitz then recommended his own 1992 "plan, co-drafted with O'Connell."

Tobias' 1993 proposal to establish a "pay at the pump no fault" system, in which motorists would purchase insurance through a gas tax, ran into considerable opposition in the California Legislature, largely because the insurance industry strongly opposed the "pay at the pump" aspect of the plan, which would have virtually eliminated insurance agents, marketing and other expenses of the insurance system. To win support from insurers, Tobias approved amendments which eliminated the "pay at the pump" part of the plan -- the core of his proposal -- leaving only a typical "no fault" law, which insurers had always sought from the Legislature. This rapid capitulation was the first indication that Tobias' s professed interest in consumers was vulnerable to political expediency.[23] Tobias's "no fault" proposal was nevertheless defeated in a subsequent committee hearing. He then proposed a similar initiative for the November, 1994 ballot, under the banner of "Common Sense Legal Reform," but later withdrew it after its debut elicited widespread criticism.

With the universal collapse across the nation of no fault, the insurance industry and its allies, O'Connell, Horowitz and Tobias, were prepared to go to greater lengths to resuscitate no fault, suggesting even more cumbersome and complex alternatives.[24] The "pure" no fault proposal in which the right to sue was eliminated completely, along with pain and suffering, was unthinkable even by O'Connell's standards when he first proposed no fault. It was the antithesis of the humane program of "socialized auto insurance" he had originally articulated. But pure no fault became acceptable when it grew clear that traditional no fault was an experiment that would soon be relegated to the dust bins of history as state after state repealed their no fault laws (as noted above, since 1979, five states have repealed their no fault laws, and no state has adopted a no fault system since 1976). The Insurers-O'Connell-Horowitz-Tobias plan is the core of S.1860 and Proposition 200.

Their proposal focused not on unlimited benefits but, in the aftermath of California Proposition 103, on lower premiums. Their no-fault plan promised the insurance industry could "save" consumers more than $30 billion nationally by "replac[ing] 'third party' with 'first party' insurance," and letting consumers "opt out of ... pain-

[22] Michael Horowitz, "Let Drivers Tailor Auto Insurance," New York Times, March 21, 1993.

[23] University of San Diego Law School Professor Bob Fellmeth, also director of the Children's Advocacy Institute and Center of Public Interest Law, has written of Tobias's decision to work with insurers: "We backed this model [the pay at the pump legislation] when it was introduced in California. But it ran into heavy special interest opposition. Rather than courageously taking on the wrong-headed, Mr. Tobias has chosen to join one of several profit-stake interests in the mix -- the insurance industry. That industry unsurprisingly tends to favor high premiums and low claim pay-outs." Bob Fellmeth, Children's Advocacy Institute, Letter to Editor, University of San Diego Vista , February 9, 1996.

[24]"No-Fault's O'Connell Keeps Trying, Offers A Variation On Choice Plan," Auto Insurance Report, Risk Communications, Laguna, Niguel California, March 13, 1995. Also Peter Passell, "Contingency Fees in Injury Cases Under Attack by Legal Scholars," *New York Times*, February 11, 1994, p. A1.

and-suffering" compensation.[25] This was the genesis of Proposition 200 and S.1860, which eliminate pain and suffering compensation and which the Proposition 200 proponents trumpeted across California as a consumerist idea of their own making -- Tobias's pay-at-the pump without the pump.[26]

Sponsorship is a critical issue when it comes to insurance and civil justice matters, as insurance companies and other corporate proponents have long recognized. Indeed, the establishment of the Manhattan Institute and similar enterprises reflected an effort to cloak self-interested proposals in a non-partisan, non-profit and academic disguise.

To give the California effort a veneer of legitimacy and independence from the insurance industry, Tobias and his colleagues recruited Silicon Valley executives, entrepreneurs and high-tech corporations by offering to place on the ballot two separate propositions of particular interest to them: Proposition 201, which would have required swindled investors to post a bond paying for swindlers' legal expenses before recovering their losses; and Proposition 202, which would have cut the fees of consumer's contingency fee attorneys (but not, of course, those of corporate defense attorneys). The strategy was to use the massive financial resources of these business groups to obviate the need to rely on insurance industry money, which would have instantly condemned the measure to defeat by California voters. (Campaign disclosure reports revealed that many of the major donors who ultimately gave a total of $15 million to the Alliance to Revitalize California campaign had engaged in allegedly illegal conduct in the past, for which Propositions 201 and 202 could buy them legal immunity). Conversely, Proposition 200, promising lower premiums, was designed to be the "populist" measure, a Trojan horse which would overshadow, and thus grease voter approval of, the other two propositions.

But business support alone was insufficient to convince voters that the three initiatives were pro-consumer. This Michael Horowitz recognized in his 1993 New York Times oped when he noted, "Still, the Tobias proposal is exciting because for the first time it opens up the possibility of a broad alliance between market-oriented and consumer groups."

Thus, a second tactic was to portray the three propositions as "pro-consumer" by portraying their sponsors as consumer advocates. This was accomplished by hiring consultants, fund-raisers and other campaign operatives who once worked with "Voter Revolt," the organization established by Harvey Rosenfield to sponsor Proposition 103.[27] In a confidential November 15, 1995 campaign memo, the Chairman of Proposition 200 's campaign noted the need for legitimacy in the eyes

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[25] Michael Horowitz, "Let Drivers Tailor Auto Insurance," New York Times, March 21, 1993.

[26] While helping to fund Proposition 200, Tobias worked hand in hand with the nation's largest insurer, State Farm, to pass a nearly identical pure no fault proposal in Hawaii, where beleaguered motorists pay the highest premiums in the nation under its current no fault system. In the failed 1995 legislative campaign by State Farm for a "pure" no fault auto insurance system, Tobias teamed with the company in a full page June 1995 advertisement in the Honolulu Advertiser, paid for by State Farm, in favor of the pure no fault legislation. (Advertisement Attached in Appendix) Tobias also reluctantly admitted under questioning from a Honolulu talk radio show host that State Farm's public relations agency had arranged his island tour. (Transcript Attached in Appendix).

[27] Rosenfield left the organization in 1993.

of the public: "When voters perceive the battle to be between insurance companies on the one hand and a coalition of consumer groups and lawyers on the other, they are overwhelming inclined to side with the lawyers...However when consumers are added to both sides of the equation the lawyers realize no benefit...This observation underscores the critical importance of Voter Revolt being put forward as an equal partner in the fight for no fault." (Memo Attached.)

Once the state's toughest critic of insurance companies and big business, the "Voter Revolt" name was put at the forefront of efforts for pure no-fault legislation. The "Voter Revolt" name has also been invoked in Congress on behalf of pure no fault legislation. Testifying before the House Subcommittee on Courts and Intellectual Property of the House Judiciary Committee on February 10, 1995, Michael Horowitz invoked support by "Voter Revolt" for H.R.10, claiming it was "the Nader-affiliated consumer group which sponsored California Proposition 103 mandating sharp auto-mobile insurance rate reduction." (his emphasis) Nader subsequently wrote Representative Carlos Moorhead, Chairman of the Committee, commenting, "Voter Revolt has been taken over by turncoats who now provide their services for anti-consumer initiatives. They are NOT affiliated with me or any of our organizations."

Campaign disclosure reports filed with the Secretary of State show how the merchandising of the Voter Revolt name enriched a number of individuals:

- While the proponents of the measures claim be acting in the name of Voter Revolt, these individuals were never actually employed nor paid by Voter Revolt for their work on that campaign.

  For example, Michael Johnson, an employee of Andrew Tobias and a spokesperson for the no fault initiative, claimed to be the "Policy Director" of Voter Revolt. In fact, Johnson was never paid by Voter Revolt, but rather by the Alliance to Revitalize California. Johnson, who continues to represent himself as a staff person of Voter Revolt, apparently still works for Silicon Valley sponsors of the measures. The group currently opposes Proposition 211, the Retirement Savings and Consumer Protection Act - an initiative on the November '96 ballot, sponsored by a coalition of citizen groups and plaintiff securities lawyers, which would make the courts more accessible to victims of securities fraud.

  Bill Zimmerman, a Santa Monica based public relations executive, earned $535,707.96 in the twelve weeks prior to the election through commissions on television, radio and newspaper ads purchased by the Alliance. Zimmerman's firm received an additional $230,607 for management, travel and other fees. During the initiative campaign, Zimmerman claimed to be the "Political Director" of Voter Revolt.

- People hired to collect signatures and campaign door to door for the three propositions identified themselves as "Voter Revolt" workers. But campaign reports show that during the election period when the Alliance spent in excess of $13 million on the initiatives in the name of Voter Revolt, Voter Revolt itself had virtually no staff or resources. During the entire time period from January 1, 1996 to March 31, 1996, Voter Revolt reported receiving $84,583 and

spending $116,747. From April 1 to June 30, 1996 Voter Revolt reported receiving $7,166 and spending $12,536.

In fact, these individuals were hired by "Progressive Campaigns" a private, for-profit organization that specializes in campaign signature gathering and political canvassing. Progressive Campaigns received $5,344,495.30 in fees from the Alliance to conduct its operations in the name of Voter Revolt. The Voter Revolt name was used by Progressive Campaigns to both sway voters and solicit contributions from unsuspecting members of the public.

This pioneering effort to establish "grassroots legitimacy" -- sometimes referred to as an "Astroturf" strategy -- failed. Proposition 200 was met with unanimous and strong opposition by consumer groups. More than 75 public interest groups opposed the initiative, along with the powerful Consumer Attorneys of California, and no citizen group supported it. Even some-time supporters of traditional no fault weighed in to oppose the draconian abolition of pain and suffering compensation for even the most seriously injured accident victims (which is identical to S.1860). Robert Hunter, a nationally-recognized consumer advocate on insurance matters and former Texas Insurance Commissioner, opposed Proposition 200. Hunter stated," Proposition 200, with its puny benefits and total abolition of legal rights, would harm California consumers seriously. Proposition 200 is bad no-fault that strips away important rights to motorists and passengers."

In California, a vigilant press helped expose the deception. The San Francisco Bay Guardian, for instance, editorialized, "Proposition 200, 201 and 202 would eliminate consumer protections in a wide range of areas. Every legitimate consumer group in the state is opposing them. How did Voter Revolt get so badly co-opted? Why is the organization that was once the insurance industry's worse nightmare turn into its wildest electoral dream?...It's annoying that Voter Revolt has been compromised; it would be tragic if the industry scam really worked."

On March 26, 1996, the California voters issued a stinging rebuke of no-fault for the second time in eight years. A conservative Californians electorate defeated a ballot measure to establish a pure no-fault auto-insurance, a prototype for S.1860, by nearly a 2 to 1 margin: No 65%, Yes 35%.[28]

Conclusion

No fault auto insurance systems have been a national disaster. They have failed to deliver on promises of lower insurance premiums. According to the latest data from the National Association of Insurance Commissioners, the quickest way to reduce auto insurance rates is to reject no fault systems. No fault systems have a historical experience of driving up rates because good drivers are required to pay for bad drivers, all drivers are covered regardless of fault so that double the claims are paid, fraudulent claims perpetuate, drivers must litigate property damage claims, and insurance companies have reneged on promises to voluntarily lower premiums.

[28] The mostly conservative Republican electorate that sponsors had counted on to be receptive to the proposals rejected the other measures as well. Prop. 201was defeated by nearly a margin of 3 to 2: No 60% Yes 41%. Prop. 202 lost narrowly:No 51% Yes 49%. News articles and campaign disclosure reports from the campaign are attached in the appendix.

S.1860 is an attempt by insurance companies who promised no fault would work two decades ago to elevate their failed experiment to a draconian level: the abolition of pain and suffering compensation for even the most seriously injured auto accident victims. Yet S.1860 guarantees no premium reduction, precludes bad faith claims against insurers by eliminating punitive damages, abolishes pain and suffering compensation for even those opting for the tort system, and creates an administrative insurance system of red tape that is dramatically tilted against the consumer.

S.1860's counterpart proposal in California, a ballot initiative establishing a pure no fault auto insurance system, was resoundingly defeated by a 2 to 1 margin. California consumers refused to abandon the system of personal responsibility and access to justice that, coupled with proper regulation of the insurance industry, has made California the only state in the nation to achieve a decrease in auto insurance premiums for three years in a row. The Senate should similarly reject S.1860 and not preempt the consumer protection laws of fifty states to impose a flawed proposal that extends a failed experiment.

APPENDIX A

The Rand Report on No Fault

In December, 1991, the California-based Rand Corporation issued a widely distributed report on no fault auto insurance.[29] The Rand press release accompanying the report suggested that no fault would dramatically lower insurance "costs" in many states.[30] For example, the report was quoted as stating that no fault "offers great potential for cost savings" of as much as 24% in California.[31]

Close examination of the Rand report demonstrates that the assumptions used by the authors of the study were severely flawed, and that the resulting conclusions were inaccurate and misunderstood, if not misrepresented.

Data and Methodology.

In undertaking their inquiry, Rand's researchers had two serious problems:

First, Rand had no access to independent data. All of its data was obtained from insurance industry sources. The integrity and credibility of the data are questionable. Second, the data obtained from the insurance industry was incomplete. Rand was forced to make numerous assumptions and extrapolations, some of which are erroneous or unjustified.

Faulty data and questionable methodology render the Rand report's conclusions suspect. Here are the chief defects in the report's protocols:

Data Source. Rand used insurance industry data for its study. This data was not verified either by Rand or by an independent regulatory body such as the National Association of Insurance Commissioners.

Use of Industry "Closed-Claim" Data. Rand based much of its report on extrapolations from an insurance industry trade group's own study of claims closed by thirty-four insurance companies over a two week period in 1987. Insurance industry experts themselves warn against using closed claim studies to estimate insurance costs because smaller claims are over-represented and larger, more expensive claims are under-represented in such studies, especially during periods when the average size of a claim is growing. This is a particularly serious defect in the Rand report, since no fault's benefit system increases the amount paid out for higher claims. Since Rand's data already inflates the proportion of small claims, the net result is major under-estimates of no fault's likely cost.

Moreover, the industry data contains estimates of medical and other bills which may be submitted by the claimant in the future. These estimates, however, are made by insurance adjusters, not the claimants. Thus, the data is inherently unreliable and depends on estimates by individuals who may have little knowledge of or expertise in guessing what a particular policyholder may claim in the future.

Use of Industry "Consumer Panel" survey. Since the closed-claim database did not include data on people who filed no claims, Rand used industry polling data from households where a person was injured but did not file a claim. But the industry itself has noted that such data may not be demographically representative or reliable.[32]

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[29] Unless otherwise noted, all references are to Carroll, et. al., "No Fault Approaches to Compensating People Injured in Automobile Accidents, A Policy Perspective" Rand Institute for Civil Justice, R-4019/1-ICJ, December 1991. [Hereafter, "Rand Report"]. This is a twenty-three page summary of the full report, which is titled "No Fault Approaches to Compensating People Injured in Automobile Accidents," and is coded R-4019/ICJ.

[30] Rand Institute for Civil Justice, Press Release (California), p.1 [hereafter "News Release"].

[31] Id., p. 2.

[32] See Attorney Involvement in Auto Injury Claims, All-Industry Research Advisory Council (AIRAC), December, 1988, p. 35.

Use of "Special Tabulations" Made by the Industry for Rand. The Insurance Services Office, an industry association that disseminates pricing and other data to most insurers pursuant to the industry's federal antitrust exemption, provided Rand with a special computer run. The reliability of this data is unknown.

Extrapolation of Consumer Behavior. Rand assumed that in any given state, people's behavior will remain the same regardless of whether the system is changed to no fault. This is untrue: the availability of first party payments may encourage injured people to file claims who do not presently do so -- perhaps from fear of insurance rate increases. Moreover, the fact that thresholds of all kinds gradually fall to limit litigation suggests that behavior within no fault systems itself changes over time.

Indeed, referring to the amendment of no fault in Massachusetts in 1988, an industry expert noted that the "actual additi-on costs [of] raising the PIP limit were roughly double what the commissioner assumed....What law makers failed to foresee were the behavioral changes of participants in the system which the auto reform precipitated."[33]

Another potentially erroneous assumption by Rand is that no fault does not reduce the accident deterrent effect of the tort system. There is literature suggesting it does, though Rand dismisses it summarily.[34]

By under-estimating the impact of higher first party benefits upon claims behavior, the Rand report under-estimated the cost of no fault.

Results.

Savings. Rand's report was widely quoted for the proposition that policyholders would reap large savings on their auto insurance premiums under no fault plan. However, the details of the report provide a different picture:

- The Rand report referred to savings in "total injury coverage costs." These are costs incurred by insurance companies. For example, Rand's definition of "total injury coverage costs" included the insurers' own legal fees and claim processing costs.[35] The "savings" reported by Rand would go to insurance companies, not policyholders.

- The Rand report did not include property damage costs in its study. Property damage costs constitute about half of the typical auto insurance premium, as the Rand study acknowledges.[36] Therefore, the "savings" for insurers suggested by the news reports are, at the least, inflated by 50%.

Compensation. The report confirms that victims receive less compensation under no fault:

- According to the report, on the average victims receive more net compensation (compensation left after legal fees and related expenses) under the tort system ($3,645) than under no fault ($3,182).[37] Under traditional tort systems, 62% of victims receive additional compensation above their medical bills and partial wage loss; under no fault, only 26% receive the additional compensation.[38]

- Most of no fault's "savings" come from simply restricting the amount of compensation paid to victims. Referring to so-called "no frills" no fault plans such as those proposed in California, Rand's authors admit:

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[33] National Underwriter, December 23, 1991, p.4.

[34] Carroll, et. al., "No Fault Approaches to Compensating People Injured in Automobile Accidents," Rand Institute for Civil Justice, R-4019/ICJ, December 1991, p.15.

[35] Rand Report, p. 9.

[36] Id., p.2.

[37] Id., p. 10.

[38] Id., p.11.

"No fault plans that slash costs tend to reduce the compensation less seriously injured people receive for non-economic loss, such as pain and suffering. And they don't substantially improve the traditional system's treatment of the more seriously injured, who rarely recover even their economic losses in wages, medical payments and out-of-pocket expenses."[39]

"All no fault plans reduce transaction costs. However, with the exception of plans that ban claims for non economic loss, the net reduction in total costs provided by reduced transaction costs is only about 10 percent; the rest of the savings must come from reduced compensation."[40] [Emphasis supplied]

Benefits for bad drivers. The Rand study also illustrates how wrongdoers benefit compared to victims in the majority of accident cases:

Referring to drivers involved in accidents who are "... at fault or if the other driver was at fault but uninsured," the study says: "they will tend to benefit from no fault because they can expect to collect a larger fraction of their economic loss." [Emphasis supplied].[41]

But "if the other driver was both insured and at fault, the claimant's compensation will be lower under no fault than under the traditional system, because no fault limits compensation to economic loss." [Emphasis supplied].[42]

In summary, the Rand report confirms that "injured people with more modest economic losses -- who constitute the vast majority of those injured in auto accidents -- lose because they receive no compensation for non-economic loss."[43]

Waste and delay in payments. The Rand study suggests that no fault will speed payment of claims by "an average of two months." But the Rand data shows that insurers still force claimants to wait inordinately long periods of time to be paid, and that there is no difference between no fault and tort systems in the number of claimants paid immediately after the accident:

- Roughly the same percentage of people (45%) are paid within three months of the claim under either the tort or no fault systems.[44]
- Under no fault, about 20% of claimants still wait an average of three to six months; under tort, about 40% wait three to six months.[45]
- The average claimant under no fault will still have to wait more than three months (116 days) to receive less compensation; under the tort system claimants wait twice as long (181 days) on the average, but receive more funds.[46]
- The insurers' transaction costs are about the same percentage of the total "injury coverage costs" under either system -- 12% for no fault vs. 14% for tort systems.[47] No fault will do nothing to reduce the profligate nature of insurance industry overhead and bureaucracy.

Insurance industry funding of the Rand study. The report acknowledges that over 50% of the Rand Institute for Civil Justice's funding is derived from the insurance industry. In addition, the insurance industry is heavily represented on the ICJ Board of Overseers: board members include representatives from State Farm (two), Kemper, Aetna, GEICO, Travelers, Allstate, SAFECO, USAA, CNA, the Alliance of American Insurers (two), John Hancock, and the Property-Casualty Insurance

39 Rand Institute for Civil Justice, Press Release (National), p.2 [hereafter "National News Release"].
40 Rand Report, p. 17.
41 Id.
42 Id.
43 Id.
44 Id., p.13.
45 Id.
46 Id., p.12.
47 Id., p.10.

Council. Of the numerous law firms and associations represented on the board, only one is identified as a plaintiff law firm. The study states that "consumer groups" were asked to provide input; however, neither Voter Revolt nor other acknowledged consumer groups which have pressed for regulation of insurance rates (including those that also support no fault!) were contacted by Rand. Industry sponsorship, funding and control of the institution raises concerns that may explain Rand's choice of presentation of the data to suggest that no fault will lower insurance rates or otherwise benefit consumers.

What Rand didn't study. Insurer funding may also explain why Rand has never studied the need for insurance rate regulation, the discriminatory redlining and territorial rating practices of insurers, the waste and inefficiency in the industry, the compensation of its executives, the need for private suits to force insurers to settle claims and the investment practices of the industry.

Testimony of Governor Christine Todd Whitman
before a hearing of the
Joint Economic Committee of the United States Congress
Washington, D.C.
Wednesday, March 19, 1997

Mr. Chairman, Members of the Committee, thank you for inviting me here today.

I applaud you for holding this important hearing. Asking the states about our experience in addressing the high cost of auto insurance illustrates the partnership that the Congress is building with us. As a governor, I welcome that spirit of partnership and cooperation.

Mr. Chairman, let me begin by stating two basic facts about automobile insurance in New Jersey.

First, it is mandatory. Every driver in New Jersey is now required to carry a minimum $250,000 medical insurance component, as well as coverage for some lost wages and other out-of-pocket expenses. Each driver's own policy pays, regardless of fault. It doesn't matter who caused the accident; in New Jersey, payment for medical bills through auto insurance is guaranteed.

Second, automobile insurance rates in New Jersey are the highest in the nation.

There are many reasons we hold this distinction. New Jersey is the most densely populated state in the nation. We also have 782 cars per square mile.

New Jersey has a high cost of living, which means higher costs for medical treatment and car repairs after a car accident.

More than 90 percent of New Jersey drivers choose higher liability limits than the law requires. Consumers buy higher coverage to protect assets of higher value than in other areas of the country.

Those demographics are unique to New Jersey and are part of what makes the state the wonderful, diverse place it is. But those numbers make clear that New Jersey will never have the lowest car insurance rates in the country -- especially given the frequency of lawsuits in our state.

New Jersey is the most litigious state in the Union. In 1995, we filed 819 lawsuits per 100,000 residents. The next state behind us -- Nevada -- had 512 lawsuits per 100,000 residents.

In fact, litigation costs account for more than $300 of every $1,000 in insurance premiums, while only $190 of that same $1,000 goes to paying medical bills for the injured.

I have proposed a major reform to New Jersey's auto insurance system which, in part, resembles the Auto Choice plan now before Congress.

My proposal recognizes that the single most important thing car insurance can do for a family in the event of an accident is to pay medical bills, lost wages, and other out-of-pocket expenses promptly and without regard to fault.

In New Jersey, as I mentioned, insurance is mandatory. But that should not mean it can't be affordable and allow consumers to choose the amount of insurance that best meets their needs.

I have proposed a four-choice system that will allow drivers to keep the insurance they have today at a savings, or select from other new, less expensive policy options.

These innovative options will allow those who do not wish to pay the high cost associated with "pain and suffering" lawsuits to have full access to the courts for any economic losses they suffer as victims in an accident, and at the same time enjoy reduced rates for agreeing to sue only for economic losses, and not for non-economic claims.

The first option -- the Economic Choice policy -- will provide coverage for medical bills up to $250,000, lost wages, and other costs. Policyholders can sue and be sued for economic losses, but agree not to sue or be sued for pain and suffering. Consumers choosing this option could save up to $250 on today's most commonly purchased New Jersey policy.

Our second proposed option -- the Scheduled Benefit policy -- provides the same basic coverage as option one. It adds benefits for pain and suffering compensation based on a predetermined schedule to be paid by one's own policy, without the need for litigation. Consumers choosing this option could save up to 10 percent off today's typical policy.

The third option -- the Serious Injury policy -- is most similar to our state's current "verbal threshold" policy, which limits the ability to sue for pain and suffering to a list of serious injuries. This verbal threshold is now chosen by 88 percent of our drivers. My proposal differs from the current policy in that we will impose tighter limits on lawsuits, allowing suits only for the most serious injuries.

The fourth option -- the Lawsuit Recovery policy -- is similar to our "zero threshold" policy. Drivers who choose this option could sue for pain and suffering whatever the severity of their injury.

I should note here that each of these four policy options contains tough sanctions for drunk drivers and illegally uninsured drivers. No matter which policy you choose, if you are hit by a drunk or uninsured driver in New Jersey, you can sue that person for pain and suffering. And, even if the drunk or uninsured driver is not the at-fault driver, he or she cannot sue for pain and suffering.

I believe that offering new choices to drivers will reduce the cost of auto insurance in New Jersey. But we are doing other things to keep insurance costs down, particularly in the prevention of fraud and abuse.

We know, for instance, that when insurance companies pay for unnecessary and overused medical treatment, that drives up insurance costs for all drivers. So we have enacted a law that requires doctors to notify an insurance company within 21 days that they are treating injuries related to a car accident. And we have proposed establishing a peer review panel of physicians to examine instances of questionable treatment. In such cases, medical professionals would now be the ones to determine whether a course of treatment is truly necessary.

In addition, we will make sure insurance companies comply with our state laws against insurance fraud by reporting acts of fraud -- whether they are committed by auto body shops, medical professionals, lawyers, or the drivers themselves. If insurance companies allow fraud to go unreported, we are proposing to hit them with a $25,000 penalty for each and every violation.

Given our plan for reform in New Jersey, I am encouraged by the direction the Congress has taken in regard to auto insurance legislation.

Last year's S. 1860 was a model of federalism in that federal law would represent the first word, rather than the last word, on the subject. New Jersey and every other state would be free to modify or even repeal any element of the bill. In addition, under S. 1860, states would have been able to block the law from taking effect if they could demonstrate it would not lead to significant savings for their drivers.

Just as my proposal allows drivers choice, federal legislation should allow states the flexibility to address their own unique demographic, economic, and public safety concerns. What makes sense for addressing New Jersey's crowded roads, busy courts, and high cost of living might look very different from the right solution for many other states.

Mr. Chairman, I urge that this year's version of the Auto Choice bill preserve these elements of federalism and allow the states maximum latitude to design insurance reforms that will work best for their citizens.

Thank you very much.

T E S T I M O N Y

RAND

Effects of an Auto-Choice Automobile Insurance Plan on Costs and Premiums

Stephen Carroll

CT-141

March 1997

Institute for Civil Justice

The RAND testimony series contains statements of RAND staff members exactly as delivered.

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Preface

This publication contains the written statement of Stephen Carroll delivered on March 19, 1997 to the Joint Economic Committee of the United States Congress. The statement is based on several RAND Institute for Civil Justice studies of alternative approaches to compensating automobile accident victims for their personal injuries, but it does not necessarily reflect the views of RAND, of the Institute for Civil Justice, or of the Institute's Board or research sponsors.

The author summarizes previous RAND estimates of the effects of an automobile insurance plan that offers drivers a choice between their state's current automobile insurance plan and an absolute no-fault plan.

Effects of a Choice Automobile Insurance Plan

Statement submitted to the Joint Economic Committee of the United States Congress

by
Stephen Carroll
Institute for Civil Justice, RAND[1]

Mister Chairman and Members of the Committee, thank you for inviting me to participate in your hearings on Auto-Choice insurance. My name is Stephen Carroll; I am a Senior Economist in the Institute for Civil Justice at RAND. The views and conclusions presented here are my own and should not be interpreted as representing the views of RAND, of the Institute for Civil Justice, or of the Institute's Board or research sponsors.

Introduction

The rising costs of auto insurance covering personal injuries and dissatisfaction with a liability-based system for compensating auto accident victims have stimulated policy debates in numerous states and at the federal level for three decades. Numerous public and private individuals and organizations have proposed no-fault automobile insurance plans that offer cost savings and speedier, more certain compensation to auto accident victims. But, to obtain those benefits, accident victims have to be denied traditional tort rights unless the costs or nature of their injuries exceed a specified threshold. Many states confronted with this tradeoff have been unwilling to impose no-fault.

Choice auto insurance was proposed as a response to this policy concern. Under a choice auto insurance system, drivers elect to be insured under either the traditional system or a no-fault plan. Those who opt for tort retain traditional tort rights and liabilities. Those who choose no-fault neither recover, nor are liable to others, for noneconomic losses for less serious injuries incurred in auto accidents. The plan does not affect existing insurance coverage for property damage resulting from auto accidents.

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[1]Stephen Carroll is a senior economist at RAND. RAND is a nonprofit institution that helps improve public policy through research and analysis.

Giving motorists a choice of coverage has strong logical appeal. In principle, cost-sensitive drivers could realize the savings that would result from electing the no-fault option without infringing on the rights of drivers who valued their tort rights over cost reductions. But, in practice, how much would a choice plan reduce the premiums that motorists who chose no-fault pay? Would motorists who opted for tort encounter lower or higher premiums?[2]

As an initial step toward understanding the effects of choice auto insurance on premiums, we estimated how a plan that offers a choice between tort and absolute no-fault (ANF) would affect the costs of auto insurance in each of the states in 1987.[3] The plan we analyzed, proposed by Jeffrey O'Connell and Michael Horowitz (O'Connell, et al., 1993), is the most extreme version of choice--motorists who elect ANF may never sue, nor be sued, for noneconomic loss. As such, the results of this analysis suggest the upper bound on the savings that can be accomplished in each tort state via the choice approach.

We also estimated the effects of a corresponding choice plan on auto insurance costs in each of the states that had some form of no-fault auto insurance in 1987. In each of these states, we considered a plan offering a choice between the current no-fault plan and ANF.[4] The results of these analyses suggest the upper bound on the savings that can be accomplished in each no-fault state if the no-fault approach is extended to its limit.

Approach

We focus on how the choice plan affects auto insurers' compensation costs, including both the amounts insurers pay out in compensation and the transaction costs they incur in providing that compensation.[5] Because the choice plan has no effect on property damage coverages, we do not consider property damage in

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[2]Kentucky has offered drivers a choice between the tort system and a $1,000 threshold, no-fault plan since the 1970s. However, nearly all Kentucky drivers have opted for the no-fault alternative; for all practical purposes, Kentucky is a dollar threshold state. New Jersey, in 1989, and Pennsylvania, in 1990, have recently adopted plans than offer drivers a choice between the tort system and verbal threshold, no-fault. It is too soon to tell how either plan will affect premiums over the long term. In any case, at best these states' experiences only indicate how the particular plan each adopted worked in that particular context.

[3]Our data describe the outcomes of claims closed in 1987, the most recent year for which data were available when we conducted this study. Date for 1992 have recently become available, and we will use them to update the study later this year. The data used in this study reflect the insurance system in place in each state in 1987. For purposes of this analysis, *tort states* are those that relied on the traditional tort system in 1987. The analysis is described in detail in Abrahamse and Carroll, 1993.

[4]For purposes of this analysis, *no-fault states* are those that had a no-fault plan in 1987 and the *current plan* is the no-fault plan in place that year.

[5]Under the choice plan, claimants may recover reasonable attorney's fees for a claim for economic loss in excess of the mandated Personal Injury Protection insurance policy limits. The attorney's fees paid by insurers as a result of such claims are included in our estimates.

any of our estimates. We also do not consider the many other factors (e.g., insurers' overhead and profit margins and investment income) that play a role in determining insurance premiums.[6]

In each state, we estimate the average costs auto insurers incur in compensating a representative sample of accident victims under the state's current system and the corresponding "break-even premium"--the premium an insurance company must charge to cover exactly what it pays in claims and associated transaction costs. We then estimate the average cost of compensating accident victims on behalf of drivers who elect either the current system or ANF under the choice system and the "break-even premiums" for each class of driver. Finally, we calculate relative savings under choice as the percentage difference between the break-even premium under choice for drivers who elect either option and the break-even premium under the current system.

Because we focus on the relative costs of ANF and the current system in each state, any factors that proportionately affect costs under both the current system and the choice plan net out in the comparison. Our results are insensitive to changes in such factors over time.

Key Findings

Our analysis strongly suggests that the choice plan we examined can dramatically reduce the costs of personal injury coverages to drivers who opt for ANF, relative to the costs of providing personal injury coverages to the same drivers under their state's current auto insurance system. Figure 1 shows our estimates for each state of the reductions in auto insurance premiums, relative to the current system, that would be available to drivers who elect the ANF option.

[6]We estimate the effects of the choice plan on the total costs of auto insurance. We do not attempt to estimate the plan's effects on the costs of any particular coverage. Specifically, we compare the average amount insurers pay per insured driver under all coverages in the current system to the average amount paid under all coverages on behalf of drivers who choose either the current system or ANF, respectively, under the choice plan.

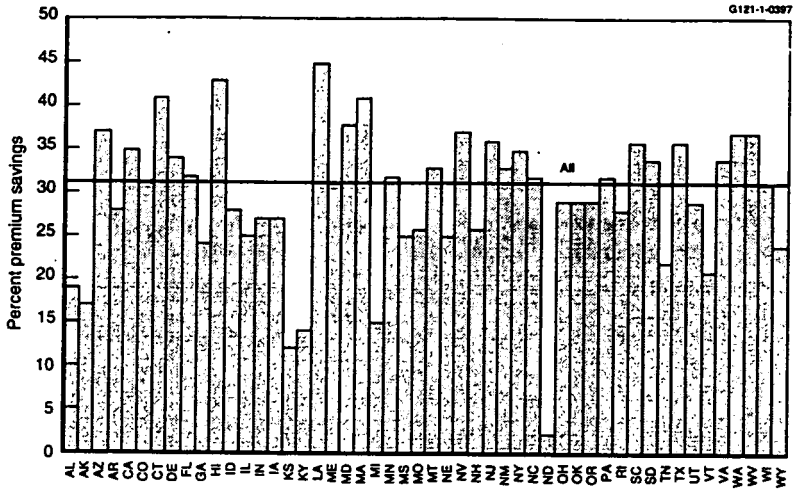

Figure 1--Under Choice, Motorists Who Switch Could Save 30 Percent on Premiums

In most states, we estimate that the costs of compensating accident victims on behalf of drivers who elect ANF would generally be about 60 percent less than what they would be under the current insurance system in each state.[7] If auto insurance premiums are proportional to the costs insurers incur on behalf of those they insure, the adoption of a choice plan would allow drivers who are willing to waive their tort rights to save about 30 percent on their automobile insurance premiums.[8] (Because coverages for personal injury and property damage each account for roughly half of total auto insurance compensation costs, a 60 percent reduction in the costs of personal injury coverage should translate into a roughly 30 percent reduction in a driver's total auto insurance premium.)

Figure 1 shows the average effects of the choice option on all drivers who elect ANF. The affordability of auto insurance is a particular concern to low-income drivers. Our data do not allow us to directly estimate the effects of the plan on

[7]Results vary from state to state. Some of this variation reflects differences among the states; some reflects variation in the sample drawn for each state. Results for smaller states are particularly sensitive to the latter. However, we feel that the consistency of results across the states provides firm support for our basic conclusions.

[8]In four no-fault states, these savings are considerably lower. Drivers in these states who choose ANF will pay about 30 percent less than what they pay for personal injury coverage under the current no-fault system, which translates into a 15 percent reduction in a driver's total auto insurance premium.

low-income drivers. However, we can estimate its relative effects on drivers who purchase only the coverages required by law in their state's current system, as low income drivers are most likely to do. Figure 2 translates our estimates of savings on compensation costs into reductions in premiums for drivers who purchase only mandated coverages, assuming that insurers' returns on investment income and profit margins are held constant. Motorists who purchased only the coverage required by law could save 50 percent on their insurance premiums under a choice plan.

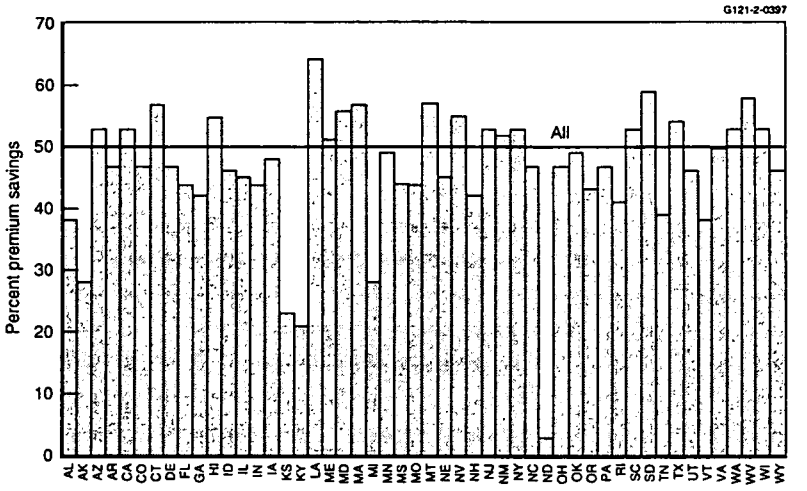

Figure 2--Motorists Who Had Only Mandatory Coverages Could Save 50 Percent Under Choice

Thus, the choice plan offers drivers the opportunity to waive compensation for noneconomic loss if they are injured in exchange for much lower insurance premiums.

Our analysis also suggests that the choice plan we examined will have little effect on drivers who opt to remain under their state's current auto insurance system. They will recover as much for their injuries and losses as they would under their state's current system, and our results suggest that there will not be any significant change in their insurance premiums. Figure 3 shows our estimates for each state of the reductions in auto insurance premiums, relative to the current system, that would be available to drivers who elect to remain in their state's current system.

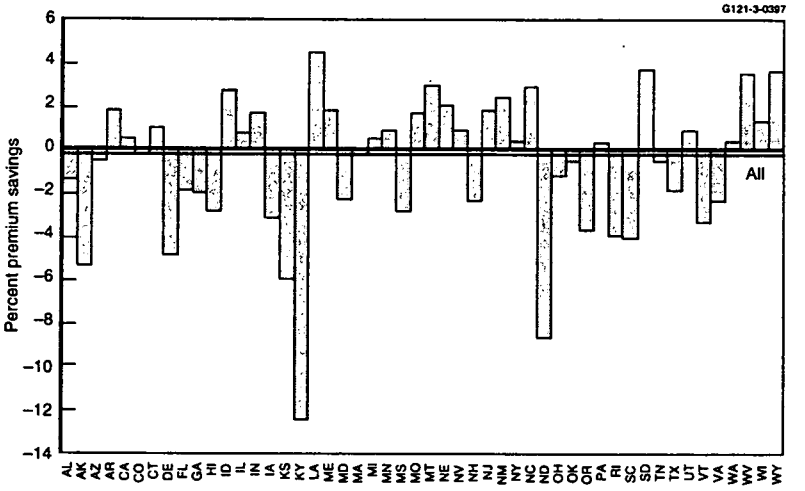

Figure 3--Motorists Who Choose the Current System Are Generally Not Affected

In most states, the costs of compensating victims on behalf of drivers who choose to remain in the current system under choice might increase, but probably by no more than 10 percent, and it is likely that the costs would decrease.[9]

[9]In four no-fault states, drivers who preferred to retain their current no-fault plan would pay 15 percent more for personal injury coverage than under the current system. That would imply a 5-10 percent increase in a driver's total auto insurance premium.

Effects of the Choice Plan on Compensation Outcomes

Our analysis found that the effects of the choice plan on an individual insured driver depend on that driver's choice of insurance type and are insensitive to the choices made by other drivers. Thus, the savings that will accrue to a driver who opts for ANF are largely independent of the number of other drivers in the state who selected that option. Of course, aggregate statewide savings depend on the fraction of drivers who elect the ANF option. For purposes of the illustrations below, we assume the fractions of insured and uninsured drivers who select the ANF option and show the effects of the choice plan on compensation outcomes.

Figure 4 draws on the results for California to illustrate the effects of the choice plan on compensation outcomes. The dark bars illustrate how $1,000 in compensation costs would be distributed in California under the current (tort) system. The lighter bars illustrate how these compensation costs would be affected by the choice plan, assuming that 50 percent of insured drivers switch to no-fault and 50 percent of uninsured drivers purchase no-fault. The dollar figure attached to each of the bars indicates how much of the $1,000 would be spent in each cost category.

For purposes of this comparison, we count all dollars paid accident victims as compensation for economic loss until they have been fully compensated for their economic loss; we include as compensation for noneconomic loss only the amounts paid victims in excess of their economic losses. The compensation figures are gross in that they show the amount paid to accident victims in compensation without regard for any legal fees or costs they must pay out of this amount.

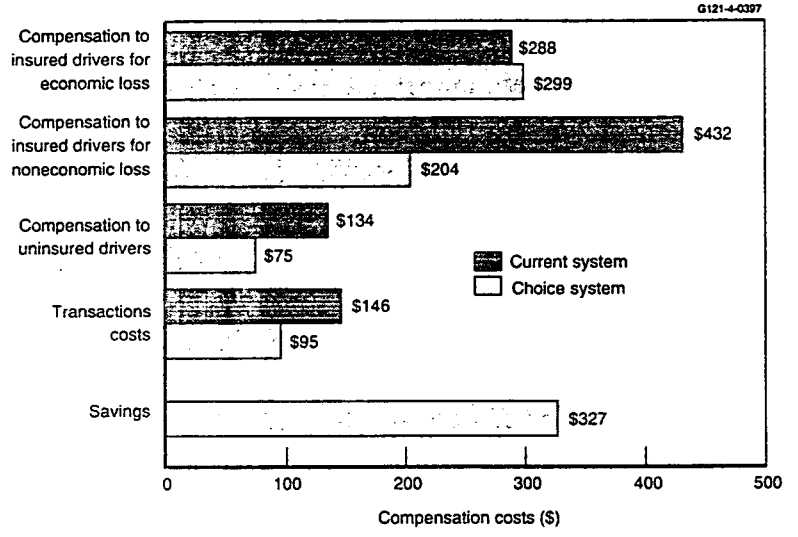

Figure 4--How $1,000 in Compensation Costs Would Be Distributed in California: Tort vs. Choice
(Assumes 50 percent of all drivers select no-fault option)

Out of each $1,000 spent in the current system, slightly less than $300 would be paid in compensation for economic loss to victims who have purchased insurance. Under choice, the total amount of compensation paid these victims for economic loss would be very similar. However, some victims would receive less compensation for economic loss under the choice plan compared with the compensation they would have received under the current system, while other victims would receive more.

About $430 of each $1,000 spent in the current system would be paid to insured victims in compensation for noneconomic loss. Under choice, the amount of compensation paid these victims for noneconomic loss would be cut to the extent that drivers switch to no-fault. Drivers who stay in the current system under choice would receive essentially the same compensation for noneconomic loss as under the current system. Those who switch to no-fault would receive no compensation for noneconomic loss. In the example, we assume that half of the insured drivers under the current system stay in the current system and half switch to no-fault. Consequently,

the amount paid these victims in compensation for noneconomic loss is roughly halved under choice.

The costs of compensating uninsured motorists under the current system account for about $130 of each $1,000 spent. The choice plan would cut these costs by about 45 percent. Uninsured drivers under the current system who switch to no-fault under choice waive compensation for noneconomic loss in return for being assured compensation of economic loss. Uninsured drivers under choice who are "lucky" enough to be injured in an accident with someone who opted for the current system under choice receive the same compensation they would have received under the current system. But uninsured drivers under choice who are injured in an accident with someone who opted for ANF under choice are compensated only for their economic loss in excess of the mandated personal injury insurance limit.

Insurers' transaction costs--defense fees and allocated loss adjustment expenses--account for about $146 out of each $1,000 under the current system. These costs would be cut by about one-third under the choice plan for these assumed parameters because there would be no need to debate either negligence of economic losses. Note that the O'Connell/Horowitz plan provides legal fees to ANF drivers who seek compensation for economic losses in excess of their personal injury insurance policy limits. Because this provision allows victims representation at no cost to themselves, we assume victims will generally secure representation, even on small claims.

As the last bar in Figure 4 suggests, the no-fault option under a choice plan would save nearly $330 out of every $1,000 of compensation costs for automobile accident victims in California. These savings would result from reductions in the amount of compensation paid accident victims for noneconomic loss and the associated transactions costs.

Figure 5 provides another perspective on the same picture. It shows the distribution of compensation costs under the assumption that all insured drivers and half of the uninsured drivers in the state select the no-fault option. Not surprisingly, the savings under this assumption are considerably larger.

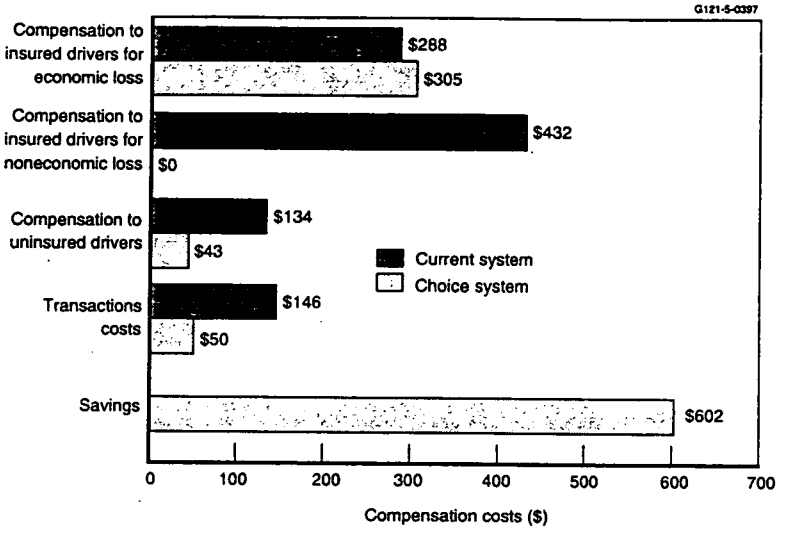

Figure 5--How $1,000 in Compensation Costs Would Be Distributed in California: Tort vs. Choice
(Assumes all insured drivers and 50 percent of uninsured drivers select no-fault option))

Sensitivity Analysis

The estimates presented above are based on the assumed values of four parameters: (1) the uninsured motorist rate under the current system, (2) the fraction of victims injured in single-car accidents, (3) the rate at which drivers who would have been insured under the current system opt for ANF coverage, and (4) the rate at which drivers who would have gone uninsured under the current system opt for ANF coverage. To test the robustness of our results, we estimate the effects of the choice plan for a number of different sets of parameter values in each state. We made 81 different estimates for each state, varying the fraction of drivers uninsured under the current system (10, 20, or 30 percent), the fraction of victims injured in single-car accidents (0, 10, or 20 percent), the fractions of insured drivers under the current system who switch to ANF under the proposed plan (20, 50, or 80 percent), and the fractions of uninsured drivers under the current system who switch to ANF under the proposed plan (20, 50, or 80 percent).

Table 1 illustrates these analyses for cases in which the fractions of insured drivers under the current system who switch to ANF under the proposed plan and the fractions of uninsured drivers under the current system who switch to ANF under the proposed plan are the same. It presents some of the sensitivity calculations for California.

Table 1

Relative Savings Under Different Assumptions About Insurance: California

			Relative Savings (%)	
Uninsured Prior to Choice (%)	Switch Under Choice (%)	Single-Car Accidents (%)	Drivers Who Retain Current Insurance	Drivers Who Select ANF Under Choice
10	20	0	-0.57	69.0
		10	-0.56	66.1
		20	-0.55	62.6
	50	0	-1.42	66.9
		10	-1.40	64.0
		20	-1.39	60.5
	80	0	-2.26	64.7
		10	-2.24	61.8
		20	-2.22	58.4
20	20	0	0.45	69.9
		10	0.45	67.2
		20	0.44	63.8
	50	0	1.12	68.1
		10	1.11	65.4
		20	1.10	62.0
	80	0	1.80	66.3
		10	1.78	63.6
		20	1.76	60.2
30	20	0	1.37	70.8
		10	1.36	68.1
		20	1.34	64.9
	50	0	3.42	69.2
		10	3.39	66.6
		20	3.36	63.4
	80	0	5.48	67.7
		10	5.43	65.1
		20	5.38	61.9

Nothing in these estimates poses a serious threat to our main finding that the cost of insuring drivers who elect ANF under choice will fall dramatically and that the cost of insuring drivers who choose to stay in the current system will be essentially unchanged.

Conclusions

Our results suggest that the choice plan can deliver on its promise to offer dramatically less expensive insurance to drivers willing to give up access to compensation for noneconomic loss without affecting those who want to retain access to compensation for all their losses, both economic and noneconomic. If insurers pass their cost savings on to drivers, the adoption of a choice plan would allow

- *Drivers* who are willing to waive their tort rights to save approximately 30 percent on their automobile insurance premiums;
- *Drivers* who prefer to retain their full tort rights to do so, at essentially the same costs as under their state's current system.

RAND ICJ Studies of Choice Insurance

Abrahamse, A., and S. J. Carroll, *The Effects of a Choice Auto Insurance Plan on Insurance Costs*, MR-540-ICJ, RAND: Santa Monica, CA, 1995.

O'Connell, J., S. J. Carroll, M. Horowitz, and A. Abrahamse, *Consumer Choice in the Auto Insurance Market*, RP-254, RAND: Santa Monica, CA, 1994. (Reprinted from the Maryland Law Review, Vol. 52, 1993.)

O'Connell, J., S. J. Carroll, M. Horowitz, A. F. Abrahamse, and P. Jamieson, *The Comparative Costs of Allowing Consumer Choice for Auto Insurance in All Fifty States*, RP-518, RAND: Santa Monica, CA, 1995. (Reprinted from Maryland Law Review, Vol. 55, No. 1, 1996.)

O'Connell, J., S. J. Carroll, M. Horowitz, A. Abrahamse, and D. Kaiser, *The Costs of Consumer Choice for Auto Insurance in States Without No-Fault Insurance*, RP-442, RAND: Santa Monica, CA, 1995. (Reprinted from Maryland Law Review, Vol. 54, No. 2, 1995.)

Congress of the United States
JOINT ECONOMIC COMMITTEE
(CREATED PURSUANT TO SEC. 5(a) OF PUBLIC LAW 304, 79TH CONGRESS)
Washington, DC 20510-6602

April 29, 1997

RAND Finds Substantial Savings from Auto-Choice

Dear Colleague,

The high cost of auto insurance is an issue that Americans must deal with year after year. Thanks to factors such as excessive litigation and claiming fraud and abuse, premiums are growing one-and-a-half times faster than inflation. One solution that would address many of the problems affecting auto insurance is Auto-Choice. Auto-Choice would allow drivers to opt out of recovery for pain and suffering losses in return for significant premium savings as well as quicker and more complete payment for economic losses.

A recent study by the RAND Institute for Civil Justice, prepared at the request of the Joint Economic Committee, examines the effects of a proposed Auto-Choice reform. This study, by RAND economists Stephen Carroll and Allan Abrahamse, examines a large set of insurance claims data to see what effect Auto-Choice would have on compensation costs. The authors find that Auto-Choice could reduce the personal injury portion of auto insurance premiums by over 60 percent on average (results vary by state). For overall insurance premiums, Auto-Choice could save drivers who choose the new system approximately 30 percent on average.

A copy of the RAND study is attached for your review. As you will see, the analysis offers a systematic and empirical examination of the issue, and it uses actual premium data to produce credible estimates. The study goes a long way towards filling a key information void. Congress would be well advised to take advantage of research provided by a highly regarded institution such as RAND.

If you would like additional copies of the RAND study, or a copy of the new JEC Auto-Choice study, please contact the JEC at 224-5171.

Sincerely,

Jim Saxton
Chairman

Attachment

RAND

The Effects of a Choice Automobile Insurance Plan Under Consideration by the Joint Economic Committee of the United States Congress

Allan F. Abrahamse and Stephen J. Carroll

DRU-1609-ICJ

April 1997

Prepared for the Joint Economic Committee of the United States Congress

Institute for Civil Justice

The Institute for Civil Justice

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Preface

At the request of the Joint Economic Committee of the United States Congress, this Project Memorandum draws on previously published Institute for Civil Justice studies of choice automobile personal injury insurance systems as well as on a special analysis to estimate the effects of a specific choice automobile person injury insurance plan. The work was funded by the Institute for Civil Justice. The discussion here does not necessarily reflect the views of RAND, of the Institute for Civil Justice, or of the Institute's Board or research sponsors.

Introduction

An earlier RAND Institute for Civil Justice study (Abrahamse and Carroll, 1995) estimated the effects of a choice automobile insurance plan on the costs of compensating auto accident victims. The Joint Economic Committee of the United States Congress asked us to extend that analysis to estimate the effects of a slightly modified version of the plan. This document presents the results of the extended analysis.

In the discussion below, we summarize our key findings, then briefly review the methodology we used to estimate the effects of the modified version of the plan and present our results. We refer the reader to our earlier study for detailed discussions of the methodology, the assumptions that underlie the analysis, and the tests we performed to assess the sensitivity of our results to the underlying assumptions.

Summary of Key Findings

We examine an automobile insurance plan that would give drivers in each state a choice between their state's current automobile insurance system and an absolute no-fault (ANF) plan that bans recovery for noneconomic losses. Our results suggest that the choice plan can dramatically reduce the costs insurers incur in compensating people injured in automobile accidents. If these insurer savings are passed on to consumers, drivers in most states who opt for ANF could buy personal injury coverages for about 60 to 65 percent less on average than what they pay for those coverages under the tort system. Because coverages for personal injury and property damage each account for roughly half of total auto insurance compensation costs, this reduction translates into a roughly 30 percent reduction in the average driver's total auto insurance premium. Individual drivers would realize greater, or smaller savings, depending on risk factors such as their driving record and where their car is garaged and on the personal injury coverages and policy limits they would purchase if ANF were not an option.

In sum, if insurers pass cost savings on to drivers roughly in proportion to current costs, the adoption of a choice plan would:

- allow drivers in most states who are willing to waive their tort rights to buy ANF personal injury coverage for roughly 60 to 65 percent less than what they have to pay for personal injury coverage under their state's current system,
- cut the total automobile insurance premium for these drivers by about 30 percent, on average.

The Choice Plan

The choice plan we examine is patterned on one proposed by O'Connell and Horowitz (O'Connell et al., 1993) for the states in which the traditional tort system governs compensation for auto accident victims. Under the plan, drivers are given a choice between the tort system and an absolute no-fault (ANF) plan that bans recovery for noneconomic losses. Drivers who opt for the current system are required to purchase bodily injury (BI) coverage to at least the state's financial responsibility level. They are also required to purchase a new form of insurance, tort maintenance (TM), to at least that level.[1] They may purchase the same optional coverages—medical payments (MP), uninsured motorist (UM), and underinsured motorist (UIM)—available in the current system. Drivers who opt for ANF are required to purchase personal injury protection (PIP) coverage to at least the state's financial responsibility level. They are also required to purchase supplementary bodily injury coverage to at least the state's financial responsibility level.[2]

We defined a choice plan for the current no-fault states that is analogous to the O'Connell/Horowitz plan. Drivers are given a choice between their state's current no-fault plan and ANF. Drivers who opt for the current system are required to purchase the coverages now required under the current system. They are also required to purchase tort maintenance to at least the state's financial responsibility level. They may purchase the same optional coverages available in the current system. Drivers who opt for ANF are required to purchase personal injury protection to at least the state's financial responsibility level as well as supplementary bodily injury coverage, also to at least the state's financial responsibility level.

The rules of a state's current system govern recovery by drivers who elected the current system: Drivers proceed as under their state's current system if injured by another driver who also elected the current system, by an uninsured motorist, or in a single car accident. The current system's rules also govern drivers' recovery if injured by a driver who elected ANF, except they would be compensated by their own insurer under their TM policy for any amount the ANF-insured driver would have owed them under the current system. That is, in a tort state, drivers could be compensated by their own TM coverage for all losses (to the policy limit) to the extent that the ANF-insured driver was negligent. In a no-fault state, drivers would be compensated for their economic loss by their own PIP coverage up to the policy limit and, if their injury surmounted the tort threshold, from their TM coverage for their noneconomic losses (to the policy limit) to the extent that the ANF-insured driver was negligent.

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[1] Tort maintenance coverage compensates the policyholder if he or she is injured by a driver who opted for ANF.

[2] This provision departs from the original O'Connell/Horowitz proposal, which did not require drivers who opted for ANF to purchase supplementary bodily injury coverage. The addition of this provision to the O'Connell/Horowitz plan is the principal difference between the plan examined here and our earlier study.

Drivers who elect ANF are compensated by their PIP insurance for any economic losses resulting from an auto accident, including accidents involving drivers who elected their state's current system, to the policy limit, without regard for fault. Drivers electing ANF can never seek compensation for noneconomic losses.[3]

All drivers, whether they elected the current system or ANF, are liable in tort to someone they injure, and may seek compensation from someone who injured them, for economic losses in excess of the mandated TM (current system electees) or PIP (ANF electees) coverage, regardless of that person's insurance status. When claims for excess economic loss are pursued, a reasonable attorney's fee is recoverable, in addition to the excess economic loss.

Compensation for injured nondrivers--passengers, pedestrians, bicyclists, and so on--who have purchased auto insurance is governed by the rules relevant to their insurance, even though they were not driving when injured.[4] Compensation for injured nondrivers who have not purchased auto insurance is governed by the rules relevant to the insurance purchased by the driver who injured them.

Data

Our analysis uses data from closed claim surveys conducted by the Insurance Research Council, formerly named the All-Industry Research Advisory Council.[5] These surveys obtained detailed information on a national random sample of auto-accident injury claims closed with payment during 1987 under the principal auto-injury coverages--BI, MP, UM, UIM, and PIP.[6] The data detail each victim's accident and resulting injuries and losses, as well as the compensation each claimant obtained from auto insurance. The data were collected by 34 insurance companies that, together, accounted for about 60 percent of private-passenger automobile insurance by premium volume at the time the data were collected. In each state, the survey represents a simple random sample of all claims closed in that state by the companies.[7]

We combine data from several sources to estimate insurers' transaction costs,[8] including both allocated loss-adjustment costs--legal fees and related expenses incurred on behalf of and

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[3]Both the original O'Connell/Horowitz proposal and the variant under consideration by the Joint Economic Committee would allow an accident victim to recover under tort when the injury was caused by a tortfeasor's alcohol or drug abuse. And ANF electees injured while under the influence of alcohol or illegal drugs would forfeit their PIP benefits. Because of data and resource limitations, we do not consider these provisions in this analysis.

[4]Motorists who choose either tort or no-fault bind their resident relatives to that choice.

[5]All-Industry Research Advisory Council (1989) provides a detailed description of the data.

[6]These are the most recent available data that describe the outcomes of a national sample of individual claims.

[7]The sampling fraction differs from state to state, but because we only make estimates for individual states, the differential sampling does not affect our results.

[8]Carroll et al. (1991), Appendix D, describes the data and methods used to estimate insurers' transaction costs.

directly attributed to a specific claim--and unallocated, or general claim-processing, costs, for each line of private-passenger auto insurance.[9] We estimate insurers' allocated loss-adjustment expenses as 1 percent of MP compensation paid, 1 percent of PIP compensation paid, 10 percent of BI compensation paid, and 8 percent of UM or UIM compensation paid. We estimate insurers' unallocated loss-adjustment expenses as 8 percent of paid compensation for each type of coverage. The plan provides that anyone who seeks compensation for economic loss in excess of the mandated PIP limit can recover attorneys' fees; we assume claimants' attorneys' fees of 31 percent.

Scope and Limitations

We assume that the distributions of accidents, injuries, and losses observed in the 1987 data for each state are representative of the corresponding future distributions in that state. We estimate the future costs of compensating the sample of auto accident victims in each state under either its current insurance system or the choice plan. The ratio of these estimates indicates the relative costs of compensating the same victims, for the same injuries and losses, under the two plans.[10] Because any factors that proportionately affect costs under both the current system and the choice plan net out in the comparison, the results are insensitive to changes in such factors over time.[11] However, because our results address relative costs, they do not address whether auto insurance costs will rise or fall if a state adopts the choice plan. Rather, they show the difference between what would happen in that state if the current system is retained and what would occur instead if the choice plan were adopted.

We assume that drivers' insurance decisions under choice are statistically independent of the distributions of accidents and losses. Drivers covered by ANF who cause accidents impose costs on their insurers for their own economic losses, so insurers have the same incentives to experience rate drivers who elect ANF under choice as they do to experience rate drivers under the current system. Similarly, "accident-prone" drivers have to consider the loss of access to compensation for noneconomic loss if they elect ANF under choice. For both reasons, we expect that adverse selection would not likely be sufficient to dramatically affect the results of this analysis.

In other analyses, we have found evidence of extensive excess claiming for medical costs in auto personal injury cases across the United States (Carroll, Abrahamse, and Vaiana, 1995). The current system in most states encourages excess claiming as a means for leveraging larger settlements from auto insurers; the ANF option would eliminate the incentive for excess claims.

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[9] We do not include claimants' legal costs, the value of claimants' time, or the costs the courts incur in handling litigated claims. Those costs do not affect insurers' costs and hence do not affect auto insurance premiums.

[10] We include all accident victims--insured and uninsured drivers, passengers, pedestrians, bicyclists, people injured in single-car accidents, etc.--in these calculations.

[11] For example, inflation in medical costs will drive up insurance costs under both the current system and the choice plan but will have little effect on the relative costs of the two systems.

To the extent that the distributions of claimed economic losses reflect excess claiming in response to the current system, drivers who elect ANF under choice would submit fewer, smaller claims than we assume. Thus the choice plan might result in greater savings than those reported here.

We focus on how the choice plan affects auto insurers' compensation costs, including both the amounts insurers pay out in compensation and the transaction costs they incur in providing that compensation.[12] Because the choice plan has no effect on property damage coverages, we do not consider property damage in any of our estimates. We also do not consider the many other factors (e.g., insurers' overhead and profit margins and investment income) that play a role in determining insurance premiums.

We estimate the effects of the choice plan on the total costs of auto insurance. We do not attempt to estimate the plan's effects on the costs of any particular coverage. Specifically, we compare the average amount insurers pay per insured driver under all coverages in the current system to the average amount paid under all coverages on behalf of drivers who choose either the current system or ANF, respectively, under the choice plan.

Estimating Future Compensation Costs

We estimate the relative cost effects of the choice plan in each state in three steps: (1) We estimate the average cost of compensating accident victims under the current system and the corresponding "break-even premium"--the premium an insurance company must charge to cover exactly what it pays in claims and the associated transaction costs. (2) We estimate the average cost of compensating accident victims on behalf of drivers who elect either the current system or ANF under the choice system and the "break-even premiums" for each class of driver. (3) We calculate relative savings under choice as the percentage difference between the break-even premium under choice for drivers who elect either option and the break-even premium under the current system.

We describe each of these steps below. Because California turns out to be the 25th state in the distribution of savings that would accrue to drivers who opt for ANF, we use that state to illustrate our methodology.

Estimating Future Compensation Costs Under the Current System

To estimate what compensation costs would be under the current system, we estimate the average amount of compensation that would be paid to an accident victim and the associated transaction costs, depending on the type of insurance that the victim and any other driver involved in the accident had purchased. We then assume a distribution of insurance

[12]Under the choice plan, claimants may recover reasonable attorney's fees for a claim for excess economic loss. The attorney's fees paid by insurers as a result of such claims are included in our estimates.

purchase decisions and compute the expected compensation paid the average accident victim under the current system, given that distribution.

Table 1 indicates the sources of compensation available to an accident victim under the current system, depending on the victim's insurance status, whether another driver was involved the accident, and, if so, the other driver's insurance status.

Table 1

Compensation Under the Current System

	Insurance Status	*Other Driver*		Single Car Accident
		Uninsured	Insured	
Accident Victim	Uninsured	0	BI	0
	Insured	UM or MP; PIP + UM	MP + BI; PIP + BI	MP; PIP

To estimate compensation costs for each state, we use our data on the compensation provided a representative sample of accident victims and the associated transaction costs, as follows:

We assume that an uninsured accident victim injured in a single-car accident or in an accident involving another car whose driver is also uninsured receives no compensation from auto insurance.

We estimate the costs of compensating as uninsured accident victim injured in an accident with an insured driver as the average compensation paid on BI claims ($7,253 in California) times the probability that an accident victim exceeds the tort threshold.[13] We assume average transaction costs are 18 percent of BI compensation in all states.

In tort states,[14] we estimate the costs of compensating an insured accident victim injured in an accident involving another car whose driver is uninsured as the average compensation paid on UM claims ($5,808 in California) times the fraction of insured drivers in the state who purchased UM coverage (.9),[15] plus the average compensation paid on MP claims ($2,016 in California)

[13]By definition, all accident victims "exceed the tort threshold" in tort states. In a no-fault state, we take the fraction of accident victims who obtained third-party compensation as an estimate of the probability that a victim will exceed the tort threshold in that state.

[14]Because our data describe the outcomes of claims closed in 1987, they reflect the insurance system in place in each state that year. For purposes of this analysis, tort states are those states that relied on the traditional tort system in 1987.

[15]Based on conversations with several insurance companies, we assume 90 percent of insured drivers have UM coverage.

times the fraction of insured drivers in the state who did not purchase UM coverage and did purchase MP coverage (.05).[16]

In no-fault states,[17] we assume compensation costs as the average compensation paid on PIP claims, plus the average compensation paid on UM claims times the fraction of insured drivers in the state who purchased UM coverage times the probability that an accident victim exceeds the tort threshold. We assume average transaction costs are 9 percent of MP or PIP compensation paid and 18 percent of UM compensation paid.

We estimate the costs of compensating an insured accident victim injured in an accident with another insured driver in a tort (no-fault) state as the sum of the average compensation paid on MP (PIP) claims times the fraction of insured drivers in the state who purchased MP (PIP) coverage,[18] plus the average compensation paid on BI claims. We assume transaction costs are 9 percent of MP or PIP compensation paid and 18 percent of BI compensation paid.

We estimate the costs of compensating an insured accident victim injured in a single car accident in tort (no-fault) states as the average compensation paid on MP (PIP) claims times the fraction of insured drivers in the state who purchased MP (PIP) coverage. We assume transaction costs are 9 percent of MP or PIP compensation paid.

Because insurance purchase decisions are made before accidents occur, an accident victim's decisions are independent of whether or not that victim is subsequently involved in an accident, whether any other driver is involved in the accident, and, if so, what the other driver's insurance coverage and the victim's injuries and losses are. Formally, we assume that a driver's decision to purchase insurance is statistically independent of whether or not that driver will cause, or be injured in, an auto accident and the severity and resulting losses of any caused or incurred injuries. Given these assumptions, the probability that an accident victim will fall into any one of the cells in Table 1 depends on the probability that an accident victim is injured in a single-car accident and on the probability that a driver is uninsured under the state's current system.

We assume values for these probabilities, compute the resulting fraction of accident victims that would be found in each cell of Table 1, multiply that fraction by the corresponding compensation costs, and sum over the cells. The result is an estimate of the average cost of compensating an accident victim in each state under that state's current system. The product of this estimate and the ratio of accident victims to insured drivers in that state is the amount that the state's insured drivers would have to be charged, on average, to recover the costs of compensating all victims.

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[16]The National Association of Independent Insurers (1991) reports that the ratio of MP-earned exposures to BI-earned exposures in California in 1987 was 53 percent. We assume that half of the insured drivers who do not purchase UM purchase MP.

[17]For purposes of this analysis, no-fault states are those states that had a no-fault plan in 1987, and the current plan is the no-fault plan in place that year.

[18]We assume that all insured drivers in the no-fault states purchase PIP.

In California, for example, if 20 percent of drivers are uninsured and 10 percent of all accident victims are injured in single car accidents, the average cost of compensating auto accident victims under the current system will be $7,787. Given an assumed 20 percent uninsured driver rate, the average insured driver would have to be charged $9,734 * V, where V = the average number of accident victims per driver. We lack data on V for each state. However, we show later that this number cancels out when we compute the ratio of costs under the current system to costs under the choice system.

Note that under the assumption that insurance purchase decisions are statistically independent of subsequent accidents and the resulting injuries and losses, the estimates we obtain for each state are identical to those we would have obtained by estimating expected compensation outcomes for each individual victim and averaging over the victims in the sample for each state. In other words, the method outlined above essentially takes account of the variations in relevant accident characteristics (e.g., the victim's negligence) and injuries/losses among individual accident victims.

Estimating Future Compensation Costs Under the Choice System

Table 2 shows the compensation available to accident victims under the choice plan, depending on what their insurance status would have been under the current system and their choice of insurance status under the choice system.

Table 2

Compensation Under the Choice System

		Other Driver			
	Insurance Status	**Uninsured**	**ANF**	**Current**	**Single Car Accident**
Accident Victim	Uninsured	0	XEL	BI	0
	ANF	PIP	PIP + XEL	PIP + XEL	PIP
	Current	UM or MP; PIP + UM	TM + XEL	MP + BI; PIP + BI	MP; PIP

In each state, we estimate compensation costs under the choice plan as follows:

The current system's compensation rules govern in accidents that do not involve a driver who elected ANF under choice. We use the methods described above to estimate compensation in these cases.

An uninsured victim injured in an accident involving another car whose driver switched to ANF is compensated by the other driver's supplemental BI insurance for any economic loss

in excess of the mandated PIP policy limit. We estimate the expected value of compensation for excess economic loss, denoted XEL in Table 2, in three steps: First, we compute the difference, if positive, between the victim's economic loss and the mandated PIP limit up to each possible value of the BI policy limit, weighted by the distribution of BI policy limits in the state. We then multiply by 5, assuming that the victim will, on average, be 50 percent negligent. Finally, we average over all victims in the state. In California, for example, we estimate that compensation for excess economic loss will average $504. We assume transaction costs are 49 percent of compensation paid for excess economic loss—18 percent in insurer's costs and 31 percent in plaintiff's attorney fees.[19]

We estimate compensation costs for accident victims who switched to ANF under choice as their own PIP coverage plus recovery of excess economic loss. We estimate PIP as the average value of victims' economic losses up to the PIP policy limit. We estimate XEL as described above. We assume that transaction costs are 9 percent of PIP compensation and 49 percent of XEL compensation.

Drivers who chose the current system and are injured in an accident involving another driver who switched to ANF are compensated by their own TM coverage. Because recovery under TM is governed by the same rules that govern recovery from an insured driver under the state's current system, we estimate average TM recovery using the methods described above to estimate BI recovery under the current system (e.g., $7,253 in California). Drivers who chose the current system are compensated by the other driver's supplemental BI insurance for any economic loss in excess of the TM policy limit. We estimate XEL as described above. We assume that transaction costs are 18 percent of TM compensation paid and 49 percent of XEL compensation.

We assume that drivers' insurance purchase decisions are statistically independent of whether or not they will cause, or be injured in, an auto accident. We also assumed that the decision to elect ANF under choice is independent of a driver's insurance status under the current system. Given these assumptions, we group drivers into three types according to their insurance purchase decisions and estimate the compensation costs insurers incur on behalf of each type of driver. Specifically, we estimate the costs incurred by insurers under policies purchased by:

1. ***stayers***: drivers who would be insured under the current system who select the current system under choice,
2. ***insured switchers***: drivers who would be insured under the current system who select ANF under choice, and
3. ***uninsured switchers***: drivers who would go uninsured under the current system who select ANF under choice.

[19]Because the O'Connell-Horowitz plan provides that victims who seek recovery of excess economic losses may recover their legal costs, we assume that all such victims will seek representation.

We use these cost estimates to calculate break-even premiums up to the unknown value of the average number of accident victims per driver of each type. Assuming that there is no adverse selection--i.e., that the number of injuries per driver is independent of insurance purchase decisions--the average number of accident victims per driver is the same for each type of driver and factors out when we compute relative savings as the ratio of the break-even premium for each type of driver to the break-even premium under the current system.

Our estimates for any state are based on the assumed values of four parameters: (1) the uninsured motorist rate under the current system, (2) the fraction of victims injured in single-car accidents, (3) the rate at which drivers who would have been insured under the current system opt for ANF coverage, and (4) the rate at which drivers who would have gone uninsured under the current system opt for ANF coverage. Table 3 presents our compensation cost estimates, the corresponding break-even premiums, and the relative savings for California drivers for the case in which 20 percent of drivers are uninsured, 10 percent of all accident victims are injured in single car accidents, half of the drivers who would go uninsured under the current system opt for ANF under choice, and all drivers who would purchase insurance under the current system opt for ANF under choice.[20]

Table 3

Costs and Relative Savings Under the Choice System
California

Insurance System	Driver Type	Compensation Costs per Victim ($)	Percent of Drivers (%)	Break-even Premium ($)	Relative Savings (%)
Current	Insured	7,787	80	9,734	
Choice	Stayers	0	0	0	0
	Insured Switchers	2,869	80	3,586	63
	Uninsured Switchers	284	10	2,844	71

Assuming that 100 percent of insured drivers opt for ANF under the choice plan, there are no stayers.

Under the choice plan, the average cost of compensating auto accident victims under policies purchased by insured switchers will be $2,869. Because 80 percent of drivers are insured, the average driver who elected to stay in the current system when given the choice would have to be charged $3,586 * V, where V = the average number of accident victims per driver. The

[20]We do not have any estimates of the fractions of uninsured or insured drivers under the current system who would opt for ANF if given the choice. The Joint Economic Committee asked us to consider the case in which 50 percent of uninsured and 100 percent of insured drivers elect ANF under choice.

ratio of the break-even premium for each of these drivers under choice to what would be the break-even premium for each of them under the current system, $9,734 * V, implies that average drivers of this type would save 63 percent on their insurance premiums for personal injury coverages under the choice plan.

Drivers who would have gone uninsured under the current system also benefit in the sense that the costs of compensating accident victims on behalf of drivers who would have gone uninsured under the current system and who opt for ANF under choice would be about 71 percent lower than what it would have cost to compensate victims on their behalf if they had purchased insurance under the current system. They should be able to purchase ANF under the choice plan for about 30 percent of what they would have had to pay for personal injury coverage, on average, under the current system.

Sensitivity Analyses

The estimates presented above are based on the assumed values of four parameters: (1) the UM rate under the current system, (2) the fraction of victims injured in single-car accidents, (3) the rate at which drivers who would have been insured under the current system opt for ANF coverage, and (4) the rate at which drivers who would have gone uninsured under the current system opt for ANF coverage. In our earlier study (Abrahamse and Carroll, 1995) we tested the robustness of our results by estimating the effects of the choice plan for a number of different sets of parameter values. Specifically, we made 81 different estimates in each state, varying the fraction of drivers uninsured under the current system (10, 20, or 30 percent), the fraction of victims injured in single-car accidents (0, 10, or 20 percent), the fractions of insured drivers under the current system who switch to ANF under the proposed plan (20, 50, or 80 percent), and the fractions of uninsured drivers under the current system who switch to ANF under the proposed plan (20, 50, or 80 percent).

The estimates were generally quite stable. None of the variations in the assumed parameter values affected the estimates of the savings individual drivers would realize if they opted for ANF under choice. We have not had an opportunity to replicate those sensitivity analyses for the variant of the plan examined here. However, we believe that the differences between the original plan and the variant examined here would not have any effect on the relative estimates associated with different assumptions regarding the values of the parameters. Nothing in these estimates poses a serious threat to our main finding that the cost of insuring drivers who elect ANF under choice will fall dramatically.

Effects on Premiums

We calculated the effects of the choice plan on the average insurance premium for insured switchers, assuming that insurers' expense ratios, profit margins, and returns on investment are independent of compensation costs. Specifically, in each state, we estimated the total

premiums insured switchers pay for all property damage coverages (collusion, comprehensive, and property damage liability) and for all personal injury coverages under the current system. We then estimate what their total premiums for personal injury coverages would be if reduced in proportion to the savings insurers would realize on the costs of compensating accident victims on their behalf. We then add this estimate to our estimate of total property damage premiums and compare the result to our estimate of what these drivers pay under the current system.[21]

For example, in 1994, the most recent year for which data are available, California drivers paid $11.067 billion in auto insurance premiums. We estimate that personal injury coverages accounted for $5.695 billion that year; the various property damage coverages cost $5.373 billion. If all insured drivers switch to ANF when given the choice, insured switchers' compensation costs decline 63 percent, on average, and if expense ratios, profit margins, and returns on investment are held constant, insurers could reduce their premiums for personal injury coverages by $3.596 billion. This estimate translates into a 32.5 percent reduction in these drivers' automobile insurance premiums. Note that all these calculations are on a statewide basis. Individual drivers would save more, or less, on their insurance premiums depending on their risk factors and the coverages and policy limits they purchase.

The Effects of the Choice Plan on Costs and Premiums

We repeated the analyses described above for every state. Table 4 presents our estimates of the relative savings of the choice plan on the compensation costs insurers would incur on behalf of insured switchers--drivers who would purchase insurance under the current system and switch to ANF when given the choice--and the consequent effect on their automobile insurance premiums.

[21]O'Connell et al., 1996, provides a detailed discussion of our procedure for translating compensation cost savings into expected premium reductions.

Table 4

Relative Savings Under Choice by State

Insurance System	State	Relative Savings on Compensation Costs for Drivers Who Select ANF Under Choice (%)	Premium Reductions to Drivers Who Select ANF Under Choice (%)
Tort/Add-on	Alabama	53	20
	Alaska	54	24
	Arizona	62	35
	Arkansas	69	27
	California	63	32
	Delaware	58	33
	Idaho	61	27
	Illinois	61	25
	Indiana	69	28
	Iowa	73	30
	Louisiana	76	44
	Maine	71	31
	Maryland	65	34
	Mississippi	61	25
	Missouri	68	27
	Montana	80	34
	Nebraska	67	26
	Nevada	67	38
	New Hampshire	70	31
	New Mexico	66	33
	North Carolina	69	33
	Ohio	60	27
	Oklahoma	62	27
	Oregon	63	33
	Pennsylvania	59	33
	Rhode Island	65	30
	South Carolina	61	30
	South Dakota	81	35
	Tennessee	60	23
	Texas	62	32
	Vermont	58	23
	Virginia	58	29
	Washington	69	38
	West Virginia	76	38
	Wisconsin	72	32
	Wyoming	65	25
No-Fault	Colorado	55	29
	Connecticut	79	42
	Florida	63	34
	Georgia	59	23
	Hawaii	69	44
	Kansas	45	16
	Kentucky	38	17

Table 4—continued

Insurance System	State	Relative Savings on Compensation Costs for Drivers Who Select ANF Under Choice (%)	Premium Reductions to Drivers Who Select ANF Under Choice (%)
No-Fault	Massachusetts	75	44
	Michigan	27	13
	Minnesota	77	41
	New Jersey	54	29
	New York	72	36
	North Dakota	52	18
	Utah	67	31

NOTE: 20% are uninsured; 100% of insured and 50% of uninsured switch under choice; and 10% are injured in single-car accidents.

We estimate that, in most tort states, the costs of compensating victims on behalf of drivers who elect ANF under the choice plan would be about 65 percent less, on average, than what they would have been had those drivers been insured under the traditional tort system. Our estimates for the states that have adopted some form of no-fault auto insurance system vary widely, depending on the kind of plan currently in place. However, the costs of compensating victims on behalf of drivers who elect ANF would be reduced by about 60 percent, on average, in those states, compared with what the costs would have been had those drivers been insured under their state's current system.

At the request of the Joint Economic Committee, this analysis considers the effects of a choice plan that assumes all drivers who would purchase insurance under their state's current system switch to ANF when offered a choice. Hence, in this analysis, we assume that there are no stayers--drivers who elect to remain in their state's current system when offered a choice. In our earlier study (Abrahamse and Carroll, 1995), we examine cases in which some drivers elected to stay in their state's current system and found that the availability of the ANF option would have no effect on them. The compensation costs insurers incur on their behalf and, hence, their automobile insurance premiums, would not be affected.

Drivers who opt for ANF under choice are not liable for the noneconomic losses of others. In the tort states, the compensation costs incurred on their behalf are substantially lower than they would have been under the tort system. However, the amounts paid them under their PIP coverages generally exceed what would be paid them under MP insurance. In general, the savings obtained by eliminating compensation payments on their behalf for noneconomic loss under choice greatly outweigh the additional costs incurred in providing them more generous first-party no-fault compensation—PIP versus MP. Hence, tort-state drivers who elect ANF realize substantial savings relative to the costs incurred on their behalf under the traditional tort system.

Current no-fault plans already limit accident victims' access to compensation for noneconomic loss. Hence, the savings obtained by totally eliminating compensation payments for noneconomic loss on behalf of drivers who elect ANF are smaller than in the tort states. But current no-fault plans already include PIP compensation, so no new costs are incurred on behalf of drivers who elect ANF under choice in the no-fault states. Hence, ANF electees in the no-fault states would also generally realize substantial savings relative to the costs incurred on their behalf under their state's current system.

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Research Brief

RAND ⁘ *Institute for Civil Justice*

JULY 1995

15TH Anniversary Year

Choosing an Alternative to Tort

Escalating auto insurance premiums have been a major public policy issue at the state level for the last three decades. *No-fault* auto insurance, spawned in the 1970s, was one response, offering cost savings to motorists and speedier compensation to auto accident victims. But because it required claimants to give up rights to seek compensation through the courts unless their losses exceeded a specified threshold, many states found it an unappealing alternative.

Choice auto insurance was proposed to address this concern. Under a choice auto insurance system, drivers may choose either a traditional auto insurance plan (tort) or a no-fault plan. Those who choose tort retain traditional tort rights and liabilities. Those who choose no-fault neither recover, nor are liable to others for, noneconomic losses (typically, pain and suffering) for less-serious injuries incurred in auto accidents.

Giving motorists a choice of coverage has strong appeal. But how does the choice alternative affect the premiums motorists pay? In a series of analyses, Stephen Carroll and Allan Abrahamse estimated how a choice auto insurance plan would affect insurance premiums in each state. Their basic finding: Overall, choice auto insurance could reduce the price tag for auto insurance by about 30 percent.

APPROACH

To understand the cost effects of choice auto insurance, the researchers estimated how a plan that offers a choice between tort and no-fault would affect the costs of auto insurance in each state that now relies on the traditional tort system. The plan they analyzed is *absolute no-fault*, the most extreme version of choice: Motorists may never sue, or be sued, for noneconomic loss. Thus, these estimates suggest the upper bound on the savings that can be accomplished in each tort state via the choice approach.

The researchers also estimated the cost effects of a choice plan in each state that already has some form of no-fault auto insurance. These estimates suggest the upper bound on the savings that can be accomplished in current no-fault states by extending the no-fault concept to its limit.

RAND research briefs summarize research that has been more fully documented elsewhere. This research brief describes work done in the Institute for Civil Justice and published as follows: S. J. Carroll, S. Kakalik, N. M. Pace, and J. L. Adams, No-Fault Approaches to Compensating People Injured in Automobile Accidents, *R-4019-ICJ, 1991, 239 pp., $20.00, ISBN: 0-8330-1182-0; S. J. Carroll and J. S. Kakalik, "No-Fault Approaches to Compensating Auto Accident Victims,"* The Journal of Risk and Insurance, *Vol. 60, No. 2, 1993, reprinted as RP-229, 1993 (no charge); J. O'Connell, S. J. Carroll, M. Horowitz, and A. Abrahamse, "Consumer Choice in the Auto Insurance Market,"* Maryland Law Review, *Vol. 52, 1993, reprinted as RP-254, 1994 (no charge); A. Abrahamse and S. J. Carroll,* The Effects of a Choice Auto Insurance Plan on Insurance Costs, *MR-540-ICJ, 1995, 74 pp., $13.00, ISBN: 0-8330-1641-5; J. O'Connell, S. J. Carroll, M. Horowitz, A. Abrahamse, and D. Kaiser, "The Costs of Consumer Choice for Auto Insurance in States Without No-Fault Insurance,"* Maryland Law Review, *Vol. 54, No. 2, 1995; J. O'Connell, S. Carroll, M. Horowitz, A. Abrahamse, and P. Jamieson, "The Comparative Costs of Consumer Choice for Auto Insurance in All Fifty States,"* Maryland Law Review, *forthcoming.*

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RESULTS FOR EACH STATE

In the tort states, the costs of compensating accident victims on behalf of drivers who elect no-fault would be at least 60 percent less than they would have been if those drivers had been insured under the traditional tort system. These savings include both the compensation paid to accident victims and the transactions costs incurred in providing that compensation.

If these savings are passed on to consumers, drivers in tort states who select choice could buy personal injury coverages for about 60 percent less than they pay for those coverages under the tort system. Because coverages for personal injury and property damage each account for roughly half of total auto insurance compensation costs, this 60 percent reduction translates roughly into a 30 percent reduction in a driver's total auto insurance premium. Premiums are unchanged for motorists who choose to remain in the traditional tort system.

In most no-fault states, a choice plan would have a similar effect on the costs of compensating accident victims and, again assuming that insurer savings are passed on to consumers, would result in similarly lower insurance premiums. And in most no-fault states, drivers who preferred to retain their current no-fault plan would pay no more for personal injury coverage than under the current system.

The savings an individual driver will realize from a choice system do not depend on the proportion of uninsured drivers in a state's current system, the proportion of previously insured who switch to absolute no-fault, or the proportion of the previously uninsured who switch to absolute no-fault. The effects of the plan on the total costs of auto insurance do depend on how many drivers choose to switch to the absolute no-fault option.

Nationwide, the reductions in personal injury premiums resulting from choice could be enormous. For example, if every currently insured driver in the country were to choose absolute no-fault, total auto insurance premiums in 1993—the last year for which data are available—would have been $26 billion lower. The table shows the relative savings for motorists in each state.

In addition to the savings in premiums, choice has another important cost effect. Because the no-fault premium is much lower than the premium for mandatory coverage under a tort system, some motorists who chose to drive without insurance under tort will choose no-fault. These uninsured drivers who switch to no-fault could contribute $1 billion to $4 billion to the compensation system nationwide.

Automobile Insurance Savings in Each State Under Choice[1]

State	% Premium Savings for All Motorists (assumes 50% of insured motorists choose absolute no-fault)	% Premium Savings for Low-Income Motorists (assumes 50% of insured motorists choose absolute no-fault)	Total savings, $ millions (assumes all insured motorists choose absolute no-fault)
Alabama	19	38	176
Alaska	17	28	24
Arizona	37	53	533
Arkansas	28	47	195
California	35	53	3622
Colorado	31	47	462
Connecticut	41	57	678
Delaware	34	47	93
Florida	32	44	1395
Georgia*	24	42	484
Hawaii	43	55	229
Idaho	28	46	75
Illinois	25	45	772
Indiana	27	44	450
Iowa	27	48	187
Kansas	12	23	53
Kentucky	14	21	40
Louisiana	45	64	592
Maine	31	51	114
Maryland	38	56	661
Massachusetts*	41	57	1154
Michigan	15	28	647
Minnesota	32	49	483
Mississippi	25	44	137
Missouri	26	44	405
Montana	33	57	79
Nebraska	25	45	113
Nevada	37	55	196
New Hampshire	26	42	92
New Jersey*	36	53	1496
New Mexico	33	52	173
New York	35	53	2334
North Carolina	32	47	658
North Dakota	2	3	−8
Ohio	29	47	840
Oklahoma	29	49	278
Oregon	29	43	272
Pennsylvania*	32	47	1300
Rhode Island	28	41	103
South Carolina	36	53	398
South Dakota	34	59	61
Tennessee	22	39	261
Texas	36	54	1688
Utah	29	46	145
Vermont	21	38	31
Virginia	34	50	612
Washington	37	53	621
West Virginia	37	58	222
Wisconsin	31	53	443
Wyoming	24	46	31
All states	31	49	26100

[1]The choice plan examined here is described in J. O'Connell, S. J. Carroll, M. Horowitz, and A. Abrahamse, "Consumer Choice in the Auto Insurance Market," *Maryland Law Review*, Vol. 52, 1993. Reprinted as RAND RP-254, 1994.
*Insurance system changed since January 1, 1988.

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EXCERPTS FROM
CONSUMER CHOICE IN THE AUTO INSURANCE MARKET

JEFFREY O'CONNELL,* STEPHEN CARROLL,** MICHAEL HOROWITZ*** & ALLAN ABRAHAMSE****

John Garamendi, California's powerful insurance commissioner, surprised his staff one day by declaring that henceforth, "no-fault" insurance would be called "personal-protection" insurance in his office. "What's the difference?" asked an aide at a staff meeting. "About a million votes," replied Walter Zelman, a Garamendi deputy.[1]

THE PRESENT SITUATION

It was the often-acknowledged—and even arguably horrendous—inadequacy of traditional tort liability as applied to personal injury suffered in automobile accidents[2] that led to the enactment of no-fault insurance laws in many states.[3] Why has no-fault liability also—at least in the eyes of many—earned a bad name? And, more importantly, what kind of new reform can we effect to free us from the inadequacies of both tort law and no-fault laws?

In 1991, the RAND Corporation published an appraisal of no-fault laws, being careful to make clear that RAND itself neither supported nor opposed no-fault reforms.[4] As the summary of the RAND study noted, disputes about auto insurance continue to excite debate.[5] Critics of the tort system insist that its costs are too high and that its payments are "inefficient, inequitable, and slow" in

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1. Stephen K. Yoder, *Insurance Regulator in California Woos Voters, Bashes Firms*, WALL ST. J., Aug. 10, 1992, at 1.

2. *See, e.g.*, *infra* notes 34-38 and accompanying text.

3. STEPHEN J. CARROLL ET AL., NO-FAULT APPROACHES TO COMPENSATING PEOPLE INJURED IN AUTOMOBILE ACCIDENTS 7-9 (RAND Institute for Civil Justice 1991). "Fifteen states," stated RAND in 1991, "now have a no-fault plan that includes some form of tort threshold that limits access to the liability system." *Id.* *But see infra* note 22.

4. *See* STEPHEN J. CARROLL & JAMES S. KAKALIK, NO-FAULT AUTOMOBILE INSURANCE: A POLICY PERSPECTIVE (RAND Institute for Civil Justice 1991).

5. *Id.* at vii.

compensating injured people.[6] But critics of no-fault laws rebut that the systems that replaced fault-based payments with PIP payments[7] infringed upon fundamental legal rights of victims to recover both economic and non-economic—principally pain and suffering—losses from those injuring them, and in any event failed to hold down the costs of automobile insurance.[8] In trying to help resolve these opposing views, the RAND report asked the following questions about the effects of adopting a PIP system:

(1) What would be the effect of a PIP system on (a) the costs of compensation, (b) transaction costs, principally for lawyers' fees and other costs of claim processing, (c) "the adequacy and equity" of compensation, and (d) promptness of compensation?[9]

(2) How would variations in the design of PIP programs affect the answers to the above questions?[10]

(3) What would be the resultant variations between states?[11]

The RAND study concluded:

* A PIP system either can produce substantial savings over the fault-based system or it can increase costs, depending both on the plan's design and on differences among states that affect auto insurance costs.[12] For example, the level of PIP benefits, the nature and size of barriers to pursuit of tort claims for pain and suffering, and the litigious nature of a state's population will all factor into the cost equation.
* PIP plans reduce transaction costs.[13]
* Compensation under PIP plans more closely matches compensation with economic losses—principally medical costs and wage losses.[14]
* Present PIP laws eliminate compensation for non-economic losses—principally pain and suffering—but only for less serious injuries.[15]
* Compensation is more prompt under PIP coverage.[16]

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6. *Id.*
7. Insurance payments that do not take account of fault are usually termed personal injury protection or personal protection insurance payments, in either case commonly nicknamed "PIP."
8. CARROLL & KAKALIK, *supra* note 4, at vii.
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.*
13. *Id.*
14. *Id.*
15. *Id.*
16. *Id.*

The RAND study closed its summary by indicating to policymakers that, in choosing between the traditional tort system and PIP alternatives, they must face difficult trade-offs as to "whether to cut costs or to preserve or increase compensation for injured people, and what balance to seek between compensation for economic and for noneconomic losses."[17]

In the main body of its report, RAND examined the effects of four PIP plans broadly representative of current laws.[18] Two of the plans studied have what are termed "strong verbal thresholds" similar to those found in Florida, Michigan, and New York.[19] Under a strong verbal threshold, traffic victims can seek payment for noneconomic losses only if they suffer statutorily defined serious injuries. For example, strong verbal thresholds always include "death,"[20] but may also include such injury thresholds as "significant and permanent loss of an important bodily function," "permanent serious disfigurement," or "permanent consequential limitation of use of a function or system."[21] The other two plans RAND examined have a $5,000 threshold that blocks traffic victims from seeking compensation for non-economic losses unless their medical losses exceed the statutory threshold.[22] Thereafter, RAND matched a $5,000 threshold with a PIP benefit level of (a) $15,000, and (b) $50,000. All four plans assumed no deductible against PIP benefits nor any deduction for collateral sources.[23] The results were presented in a table, reprinted below.

Table 1 shows the estimated cost reductions caused by verbal and monetary thresholds and different PIP benefit levels. The above reductions are not in total premiums, but rather only in some of the costs going to make up total premiums. For example, we estimate that costs of paying losses constitute approximately three-quarters of automobile insurance premiums,[24] and costs of paying

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17. *Id.*

18. CARROLL ET AL., *supra* note 3, at 29-39.

19. *Id.* at 29.

20. *Id.* at 6 n.14.

21. *Id.*

22. *Id.* at 29. Monetary thresholds around the country varied as of 1991 from a low of $400 in Connecticut's plan to a high of $7,600 in Hawaii's plan. *Id.* at 6 n.15, 29 n.1. In July 1993, Connecticut repealed its no-fault law. *See* Mark Mazniokas & Larry Williams, *Weiker Signs Repeal of No-fault Insurance Law*, HARTFORD COURANT, July 2, 1992, at d1.

23. *Id.* at 29 & n.3. *But see infra* text accompanying note 64.

24. INSURANCE INFORMATION INSTITUTE, *The Executive Letter: Special Report—Where the Auto Insurance Dollar Goes*, Sept. 9, 1991, at 2 [hereinafter INSURANCE INSTITUTE]. In effect, such costs of paying losses are the equivalent of "pure premium." *See infra* note 28.

TABLE 1
EFFECTS OF THRESHOLD AND PIP BENEFIT LEVEL ON COSTS AND COMPENSATION

	Threshold/PIP Benefit:			
	Strong Verbal		$5,000	
	$15,000	$50,000	$15,000	$50,000
Percent change in:				
Total injury coverage costs	−22	−12	−14	− 6
Transaction costs	−39	−38	−30	−29
Net Compensation	−13	+ 1	− 7	+ 6

for personal injury in turn constitute approximately one-half of total payment costs, including all payment for collision insurance and property damage liability costs.[25]

Again, all the plans RAND examined in Table 1 preserve full-scale tort claims for unreimbursed economic as well as for non-economic losses above the pertinent threshold. At the urging of Professor O'Connell, RAND also examined the effect of eliminating tort claims for non-economic losses *above* the threshold—which no current state no-fault insurance law does.[26] The need for this estimate was prompted by the results of a study produced by the Alliance of American Insurers, a trade association of mostly mutual insurers. The study indicated the relatively low cost of high PIP benefits, compared to total personal injury costs, even in states with strong verbal thresholds.[27] New York's $50,000 of PIP benefits, for example, contributed only 36 percent of the total pure premium for personal injury in 1987.[28] In other words, the relatively few tort claims preserved over New York's strong verbal threshold—about fifteen percent—contribute disproportionately to total costs.[29] Furthermore, RAND estimated that on a nationwide basis almost half of the personal injury pure premium would go for non-economic losses,

25. INSURANCE INSTITUTE, *supra* note 24, at 2. *See also infra* note 53 and accompanying text.

26. *See infra* Appendix I.

27. *See* Jeffrey O'Connell, *No-Fault Auto Insurance: Back by Popular (Market) Demand?*, 26 SAN DIEGO L. REV. 993, 998 tbl. 15 (1989). *See infra* Appendix 1 for results in other states from the same source.

28. *Id.* at 997. Pure premium is that portion of premium used only to pay losses. It thus excludes an insurer's marketing, administrative, and legal defense costs.

29. *Id.*

even in states with high PIP benefits and a high threshold.[30]

To test the effects of thus eliminating claims for non-economic loss above a variety of thresholds, RAND included in its study the cost effects of such proposals in Table 2,[31] which is presented below.

TABLE 2
EFFECTS OF THRESHOLD AND PIP BENEFIT LEVEL ON COSTS AND COMPENSATION

Threshold:	$1,000	$1,000	Strong Verbal	Strong Verbal	Absolute Ban	Absolute Ban
PIP Benefit	$15,000	$250,000	$15,000	$250,000	$50,000	Unlimited
Percent change in:						
Total injury coverage costs	−12	+13	−22	+ 5	−52	−29
Transaction costs	−27	−22	−39	−34	−83	−80
Net Compensation	− 5	+31	−13	+24	−36	− 4

The first four columns demonstrate the effects of plans combining PIP benefits with the right to claim in tort for unreimbursed economic losses and for non-economic losses above the specified monetary or verbal threshold. The first column shows the effects of a $1,000 threshold and a fairly low PIP benefit of $15,000, while the second column shows the effects of combining the same threshold with a very high PIP benefit level of $250,000. (According to RAND, "less than 1% of the people injured in auto accidents had medical costs in excess of $250,000."[32]) The third and fourth columns follow the same PIP benefit pattern, but with barriers to any suits unless strong verbal thresholds are breached.

The fifth and sixth columns, however, show the cost effects of plans that allow for *no* payment at all for non-economic loss—the fifth column with a $50,000 PIP benefit, and the sixth column with unlimited PIP benefits. RAND assumed that persons incurring eco-

30. Nationally, payment for non-economic loss would contribute 76% to the total cost of paying for both economic and non-economic losses above a strong verbal threshold like New York's with, as in New York, PIP benefits of $50,000. Thus, just about half of the pure premium would go for non-economic losses (100 − 36 = .64 × .76 = .486). CARROLL ET AL., *supra* note 3, at 75 tbl. G. 3.1, 1.2 ($4239 × .37 = $1568; $1568 ÷ $2052 = .76).

31. *Id.* at 32, tbl. 4.

32. *Id.* at 32.

nomic losses in excess of the $50,000 PIP benefit level in column five could seek compensation for their unreimbursed *economic* losses exceeding $50,000—that is, through a traditional tort claim.[33] By definition, there would be no unreimbursed economic losses in column six due to its assumption of "unlimited" coverage of economic losses. What is striking in columns five and six is that very high PIP benefits can be combined with substantial reductions in total costs.

In addition to the large potential savings from eliminating the high costs of preserving tort claims for non-economic losses above a threshold, the substantial savings and relative stabilization of rates from eliminating smaller claims for non-economic loss—which some existing no-fault laws already realize—must be taken into account. In this connection, Liberty Mutual Insurance Company has reviewed its automobile insurance costs in two states—California and New York.

> These two states are similar in many respects. They have large urban populations which have easy access to sophisticated (and expensive) medical and legal services. In terms of Property Damage frequency, New York is slightly higher than California owing, perhaps, to the fact that New York is somewhat more densely populated. The major difference between these two states is that New York has a verbal threshold no-fault law while California has the traditional tort-liability system. The graph below compares the bodily injury [BI] liability claims to property damage [PD] [liability] ratios for New York and California. *In 1989, there were 56 bodily injury claims in California versus 11 for New York for every 100 property damage claims.*

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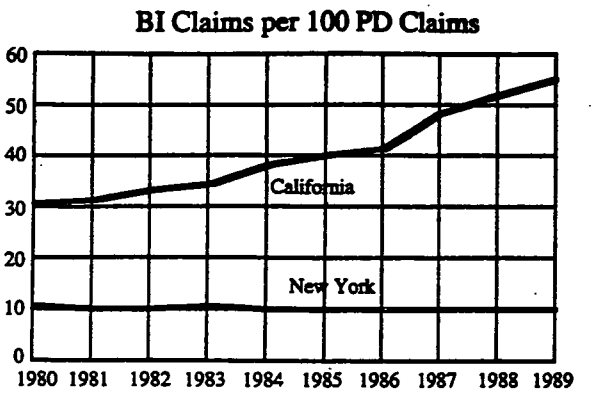
33. *Id.*



> In California (where lawsuits are allowed for all injuries) the bodily injury claim pattern is climbing and no end is in sight. The lower claim patterns in New York (where lawsuits are allowed only for "serious" injuries) are clearly evident and reflected in the liability rates charged by Liberty Mutual and the rest of the industry. In spite of the fact that the true accident frequency is higher in New York and that New York includes a minimum of $50,000 in no-fault benefits, the Liberty Mutual's average liability rate for the first half of 1989 was $405 in New York [including no-fault benefits] compared to $550 for California, a difference of $145 per car. Similar differentials are found in the rates of other carriers.[34]

These recent pronounced increases in frequency of claims for personal injury are all the more dramatic for having occurred while the rate of personal injury from auto accidents has been drastically declining. Recent years have seen (1) safer cars, containing collapsible steering wheels, padded dashboards, energy-absorbing fronts, and air bags, (2) massive education and law-enforcement campaigns against drunk driving, and (3) state laws mandating—and achieving much higher rates of—use of seat belts and child-restraint devices. Since the late 1960s, with the onset of more sophisticated and energetic programs of traffic safety, traffic fatalities have dropped re-

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34. John B. Conners, No-Fault 10-11 (Liberty Mutual Insurance Co., Boston, Mass., 1991) (emphasis added).

markably.[35] During the 1980s, fatality frequency dropped by thirty-eight percent, from 3.35 per 100 million miles in 1980 to 2.07 in 1990,[36] thus making the dramatic contemporaneous increase in claim frequency all the more anomalous and troublesome.

Further indication of the swelling phenomenon of personal injury claims from auto accidents when unrestrained by the elimination of tort suits is reflected in data from a single state—Pennsylvania.

> [The table below] shows the BI and PD claim experience for selected territories in Pennsylvania for the years 1985-1987 combined. In Philadelphia, the BI claim frequency was 2.98 claims per 100 insured cars for the central city and [2.59] for the semi-suburban area. In contrast, the BI claim frequency was just 0.73 in Pittsburgh and 0.46 to 0.56 in Harrisburg. The PD claim frequencies for these territories varied moderately, from 3.50 in Harrisburg to 3.98 and 4.3 in [Philadelphia to 4.62 in Pittsburgh. Because of these widely different BI claim frequencies, the number of BI claims for every 100 PD claims also differed. *In Philadelphia, there were 75 BI claims for every 100 PD claims.*] *Yet, in Pittsburgh there were 15.7 BI claims for every 100 PD claims and in Harrisburg only about 13 BI claims per 100 PD claims.* BI claims were four to five times more frequent relative to PD claims in Philadelphia than in Pittsburgh or Harrisburg.[37]

Similar, if somewhat less sensational, results exist in other states as well.[38]

What this indicates is how a state like New York has greatly alleviated the problem of high costs for smaller tort claims while not dealing with the problem of larger tort claims,[39] and that the key to the latter would be the elimination of claims for non-economic dam-

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35. *See, e.g.*, BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE U.S. 609 (112th ed. 1992) [hereinafter 1992 Statistical Abstract]; Daniel Popeo, *The Fraud Tax: The Cost of Hidden Corruption in American's Tort Law*, LEGAL BACKGROUNDER (Wash. Legal. Found., Wash., D.C.) Mar. 27, 1992, at 1.

36. *See* 1992 STATISTICAL ABSTRACT at 610; TRENDS IN AUTO BODILY INJURY CLAIMS (Insurance Research Council, Oak Brook, Ill.), Nov. 1990, at 11 [hereinafter TRENDS].

37. TRENDS, *supra* note 36, at 17-18 (emphasis added). The second bracketed material was inadvertently omitted from the published text. Communication to Jeffrey O'Connell from The Insurance Research Council (Jan. 22, 1993) (on file with author).

38. *See* TRENDS, *supra* note 36, *passim*.

39. *See supra* text accompanying note 29.

BI AND PD CLAIM FREQUENCIES FOR PHILADELPHIA, PITTSBURGH AND HARRISBURG

Territory	BI Claim Frequency	PH Claim Frequency	Number of BI Claims Per 100 PD Claims
Philadelphia			
(01)	2.98	3.98	75.0
(14)	2.59	4.30	60.1
Pittsburgh			
(03)	0.73	4.62	15.7
Harrisburg			
(07)	0.50	3.94	12.7
(23)	0.46	3.50	13.1
(25)	0.56	4.14	13.5
State Average	0.83	3.95	20.9

Definition of Territories:

01	Philadelphia
03	Pittsburgh
07	Harrisburg
14	Philadelphia Semi-Suburban
23	Adams, Franklin, Snyder and Union Counties, remainder of Lancaster, Lebanon and York County, etc.
25	Southern Daupain County

Notes: (1) Claim frequency is the number of claims per 100 insured cars.
(2) Data are for 1985-1987 combined.

Source: NAII* Automobile Compilation (1988).

* National Association of Independent Insurers.

ages in both more serious as well as less serious cases.[40]

In this connection, however, there are practical political difficulties when a statute completely cuts off individual tort rights—particularly when very serious injuries have occurred—while correspondingly capping the amount of PIP benefits available to claimants. New York, with its relatively high though limited PIP benefits of $50,000, bowed to this consideration by preserving tort claims above its threshold—but with the costly results mentioned

40. Although RAND itself takes no stand as to the merits of such a proposal, proponents of reform could arguably point to RAND data in support of it. *See supra* text accompanying note 31.

above. Robert E. Keeton, co-author of the original no-fault insurance draft bill, explained the problem this way:

> To whatever extent provisions for compensation [payable without regard to fault] fall short of assuring every victim *full* compensation at least for out-of-pocket loss, the [reform] system fails to assure distribution of loss—that is, it fails to spread it among a large group and instead leaves it to be borne by an individual. To this extent, the system must still confront the argument that as between just two individuals—an innocent victim and a blameworthy driver—it seems unfair to make the victim bear the loss. To escape this argument and its basic appeal to one's sense of what is fair, a pure non-fault system [eliminating all tort claims] must come at least very close to compensating fully for all out-of-pocket loss. But no non-fault system has yet offered that much to victims. The reason, it would seem, is cost. Thus, a pure non-fault system that pays full compensation costs too much, and one that falls far short of full compensation at least for out-of-pocket losses is too inequitable.[41]

In answer to this, the RAND figures in column 6 of Table 2 indicate the feasibility of providing unlimited PIP benefits for economic loss coupled with a ban on non-economic losses.[42] The data make it clear that, despite such *very* high benefits, the savings in bodily injury compensation costs would be about twenty-nine percent, which would arguably translate into about fifteen percent savings in total auto premiums, including the premium components for both bodily injury and all car damage.[43] It can perhaps be argued, though, that such savings may not be substantial enough to mandate by statute that everyone completely give up tort claims for non-economic loss.

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41. ROBERT E. KEETON, VENTURING TO DO JUSTICE: REFORMING PRIVATE LAW 136 (1969). *See also* Jeffrey O'Connell & Robert H. Joost, *Giving Motorists A Choice Between Fault and No-Fault Insurance*, 72 VA. L. REV. 61, 64 (1986) (noting that a strong no-fault law should balance the amount of no-fault benefits paid and the degree of restrictions on tort damages).

42. *See supra* text accompanying note 31.

43. *See supra* text accompanying note 25. *See also* CARROLL ET AL., *supra* note 3, at 41 (noting that the savings in total premiums is an estimate because of the fluctuation of various factors, including the underlying distributions of injuries and the amounts of losses and compensation, that affect the total injury coverage costs).

EXCERPTS FROM

THE COMPARATIVE COSTS OF ALLOWING CONSUMER CHOICE FOR AUTO INSURANCE IN ALL FIFTY STATES

JEFFREY O'CONNELL,* STEPHEN CARROLL,** MICHAEL HOROWITZ,*** ALLAN ABRAHAMSE,**** & PAUL JAMIESON*****

INTRODUCTION

This is the third in a series of articles by researchers at RAND's Institute for Civil Justice, the University of Virginia Law School, and the Hudson Institute dealing with reform of auto insurance. We designate the two prior articles, *Maryland One*[1] and *Maryland Two*.[2]

Since *Maryland Two*,[28] RAND has done a further study[29] exposing the flaws inherent in a no-fault system that allows tort claims for noneconomic damages (usually pain and suffering) for claims above a threshold. Because pain and suffering damages are generally calculated as a multiple of medical bills, there is an incentive on the part of an injured claimant to pad those bills.[30] Thus, for every dollar incurred in medical bills, an injured party can receive two, three, or more times as much compensation in pain and suffering damages. Insurance padding is not only lucrative for claimants, who receive several times their economic loss, but also for health care providers (including, and perhaps especially, chiropractors) who receive additional business, and for lawyers who receive their contingent fees out of the

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1. Jeffrey O'Connell et al., *Consumer Choice in the Auto Insurance Market*, 52 MD. L. REV. 1016 (1993) [hereinafter *Maryland One*].

2. Jeffrey O'Connell et al., *The Costs of Consumer Choice for Auto Insurance in States Without No-Fault Insurance*, 54 MD. L. REV. 281 (1995) [hereinafter *Maryland Two*]. Additional articles are a distinct possibility as further updated data become available. *See, e.g., infra* note 61.

28. *Maryland Two*, *supra* note 2 at 293-94.

29. STEPHEN CARROLL ET AL., RAND INSTITUTE FOR CIVIL JUSTICE, THE COSTS OF EXCESS MEDICAL CLAIMS FOR AUTOMOBILE PERSONAL INJURIES (1995).

30. *Id.* at 5-6.

pain and suffering component.[31] The new RAND study makes a distinction between "hard" injuries that are objectively verifiable—for example, the loss of a limb or a fracture detected by an x-ray—as opposed to "soft" injuries such as sprains and strains, which are not so objectively verifiable.[32] The latter thus present an opportunity to exaggerate an injury's existence or severity. No-fault auto insurance laws in effect in New York and Michigan, more than in other states, have largely taken the profit out of unnecessary medical bills by virtue of their relatively high verbal thresholds below which claims for pain and suffering are barred.[33] RAND found that in those states seven soft-injury claims are made for every ten hard-injury ones.[34] In Hawaii, where a no-fault law with a dollar threshold provides a greater incentive for exaggerating claims, there are nine soft-injury claims for every ten hard-injury claims.[35] In California, a state without any no-fault law and where the tort system is therefore unimpeded by any barrier to tort claims, twenty-five soft-injury claims are filed for every ten hard ones.[36]

On this score, after Massachusetts amended its automobile no-fault law in 1988 to require a higher threshold of economic damages before tort claims would be allowed, the next year the median number of treatment visits per claim for automobile injuries rose radically from 13 to 30 per claim, or a 131% increase.[37] Similarly, a study by the Insurance Research Council of 1990 auto tort claims in Hawaii revealed that the median number of treatment visits by claimants to chiropractors was a remarkable fifty-eight, with one-quarter of such claimants having more than eighty-four visits.[38] The graph below from the new 1995 RAND study shows the distributions of medical costs for soft-injury claims in Hawaii and New York.[39] The vertical line in the graph indicates Hawaii's dollar threshold. The average cost of soft-injury claims in both states is adjusted for interstate differences in medical costs and treatment patterns.

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31. CHARLES WOLFRAM, MODERN LEGAL ETHICS 528 n.1 (1986).

32. CARROLL ET AL., *supra* note 29, at 10.

33. *See supra* note 8.

34. CARROLL ET AL., *supra* note 29, at 15.

35. *Id.*

36. *Id.*

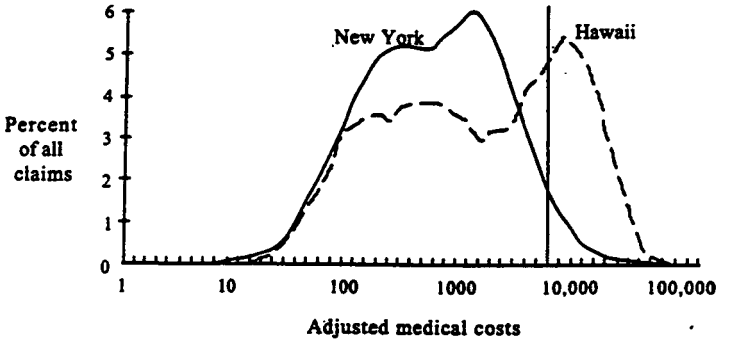
37. Sarah S. Marter & Herbert I. Weisberg, *Medical Expenses and the Massachusetts Automobile Tort Reform Law: A First Review of 1989 Bodily Injury Liability Claims*, 10 J. INS. REG. 462, 488, tbl. 12 (1992). Even for fracture treatments, health care visits increased in 1989 by 50% following the higher no-fault threshold law.

38. INSURANCE RESEARCH COUNCIL, AUTOMOBILE CLAIMS IN HAWAII 2, 16-27 (May 1991).

39. CARROLL ET AL., *supra* note 29, at 15.

As can be seen from the graph, the distribution of medical costs in New York rises quickly, peaks, and then declines sharply to the right. The large majority of soft-injury claims in New York entails relatively small medical costs, with very few such soft-injury claims exceeding Hawaii's threshold.[40]

DISTRIBUTION OF ADJUSTED MEDICAL COSTS FOR SOFT-INJURY CLAIMS IN HAWAII AND NEW YORK



Hawaii's distribution also rises sharply, flattens out, and then begins to drop off at a relatively low level of medical costs.[41] It then turns up again, rising sharply through the threshold, and then peaks above the threshold before finally falling off.

Thus, a substantial portion of Hawaii's soft-injury claims are for medical costs above its dollar threshold. Compared with New York, with its strong verbal threshold, the distribution of adjusted medical costs in Hawaii shifts substantially to the right, as one would expect given the incentives built into Hawaii's no-fault system.[42] Dollar thresholds, therefore, seem especially fragile compared to verbal ones.

But the key element—often overlooked by those who urge a New York-type strong verbal threshold as the cure for inadequate no-fault

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40. *Id.*

41. Note that the horizontal axis is a logarithmic scale: Equal intervals indicate equal percentage differences. *Id.*

42. *Id.* For a report on a Hawaii no-fault auto bill that would have abolished both large and small claims for noneconomic loss (with no choice of retaining tort coverage in place of PIP benefits) but was vetoed by the governor, see Alfred Haggerty, *Hawaii Legislature Lets Veto of Pure No-Fault Stand*, NAT'L UNDERWRITER (Property & Casualty/Risk & Benefit Management ed.), July 10, 1995, at 2.

laws—is that even in New York, claims for pain and suffering above its strong verbal threshold are hugely expensive, contributing disproportionately to auto insurance costs. As discussed in *Maryland One*,[43] a good measure of the propensity for personal injury claims to rise is the change in recent years in the ratio of personal injury (PI) to property-damage claims (PD) claims, that is, the PI-PD ratio. In California, without any no-fault law, that ratio rose steadily from 31.1 PI claims per 100 PD claims in 1980 to 67.2 per 100 in 1992.[44] In New York, on the other hand, with its relatively strong verbal threshold, the PI-PD ratio remained very constant at about 11 per 100 from 1980 to 1989.[45] But as an illustration of the ill effects of PI tort claims even in New York, in the late 1980s studies show that its $50,000 of benefits contributed only 24.6% of the total pure premiums for PI claims. In other words, the relatively few tort claims preserved over New York's strong verbal threshold contribute disproportionately (over 75%) to total PI costs.[46]

New York, then, has long dealt relatively effectively with higher costs for smaller tort claims, but it has also long dealt ineffectively with higher costs for larger tort claims. Arguably the only way to deal with both is to eliminate claims for noneconomic damages in cases both large and small.[47] Furthermore, even in New York, experienced plaintiffs' counsel are increasingly exploiting the possibility of suing in tort above the state's relatively high verbal threshold. This activity has led to a recent rise of almost 50% in New York's PI-PD ratio from 1989 to 1992 (from 11 per 100 to 15 per 100).[48] Thus, simply reducing the number of tort claims over a strong verbal threshold fails to net optimal savings.

II. A System Allowing Choice as Applied to All Fifty States

Returning to the thesis of this Article, under a choice system a state's existing no-fault law is retained both as to the level of PIP benefits and the tort threshold, except that (save for injuries caused intentionally or by drugs or alcohol) motorists can elect to end their rights to claim and be claimed against for noneconomic loss above the

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43. *Maryland One*, *supra* note 1, at 1019-20.

44. Insurance Research Council, Trends in Auto Bodily Injury Claims, app. A, tbl. A-6 (2d ed. 1995) [hereinafter IRC].

45. *Id.* at tbl. A-34.

46. *See Maryland One*, *supra* note 1, at 1019-20.

47. RAND estimates that nationally, in states like New York with high PIP benefits coupled with a high threshold, almost half of the personal injury premiums go for noneconomic losses. *Id.*

48. IRC, *supra* note 44, at tbl. A-24.

threshold. There is a corollary reliance on tort maintenance coverage for noneconomic losses above the threshold for those who prefer insurance coverage allowing such claims. Under the plan allowing choice no one is required to buy PI liability insurance, but those with assets to protect can be expected to do so.[49]

This third Article presents actuarial results for all fifty states, including those currently with no-fault laws. As in *Maryland One*[50] and *Two*,[51] we focus here on the effects of the plan allowing choice on the costs of personal, that is, private passenger, auto insurance.[52] Here as earlier, we first estimate what auto insurers would have to charge the average insured motorist to recover the costs incurred in compensating accident victims under all coverages and limits under the status quo. We also estimate separately the costs of those buying only mandatory coverages and limits.[53] We then develop corresponding estimates for motorists who elect to retain the status quo ("stayers") and for motorists who switch to the new plan allowing choice ("switchers").[54] We next compare these estimates to determine how the adoption of the plan allowing choice would affect the costs of auto insurance, depending on whether motorists stay or switch, and whether they buy more than mandatory coverages.

Under the status quo, motorists can purchase several different personal injury (PI) coverages at various limits—Bodily Injury (BI) Liability, Uninsured Motorist (UM), including Underinsured Motorist (UIM), Medical Payments (MedPay), as well as PIP in an add-on or no-fault state. Accordingly, insured motorists must bear the sum of the compensation costs of any of those coverages at the limits they buy. We estimate the compensation cost of the status quo to the average insured motorist by taking the sum of what insurers pay out plus

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49. *See infra* notes 56-57, 74-75 and accompanying text.

50. *Maryland One*, *supra* note 1.

51. *Maryland Two*, *supra* note 2.

52. Although this analysis examines only personal auto insurance, this plan would likely have an even more favorable impact on insurance costs for commercial vehicles. This is because the liability exposure of commercial vehicles (especially, but not limited to, large ones) is even greater than for private passenger vehicles. Even more important, traffic victims in commercial vehicles will already be covered by workers' compensation. *See generally* Jeffrey O'Connell, *A Model Bill Allowing Choice Between Auto Insurance Payable With and Without Regard to Fault*, 51 OHIO ST. L.J. 947, 968 n.74 (1990).

53. *See infra* notes 56-57, 75 and accompanying text (discussing option to buy PI liability insurance, an option particularly appealing to people with assets to protect).

54. In a traditional tort or add-on state, the switch from the status quo will be to PIP insurance with abolition of claims for noneconomic loss both by and against the switchers. In a no-fault state, the switch will be from the status quo to abolition of claims for noneconomic loss by and against switchers above the threshold; PIP benefits will continue to cover economic losses up to the limits purchased, just as they do today.

the associated transactions costs, under all the above applicable coverages and limits, divided by the total number of insured motorists. As indicated, we also compute the average costs for those buying only mandatory coverages and limits. Motorists who are uninsured, of course, bear none of the costs of auto insurance.

Under the plan allowing choice, motorists may remain in their state's current system (stayers), elect the new choice system (switchers), or be illegally uninsured.[55] Stayers will purchase tort maintenance coverage, in addition to BI, and possibly MedPay or UM, and PIP in an add-on or no-fault state. Following the pattern set forth in the foregoing paragraph, we estimate the average stayer's compensation costs under the plan allowing choice as the sum of what auto insurers pay injured people and the associated transactions costs under all coverages and limits on behalf of stayers, divided by the total number of stayers. Note that the average stayer's compensation costs include the costs insurers incur on an insured's behalf in providing compensation under PI tort liability type coverages—BI, UM, and tort maintenance—plus any applicable MedPay coverage, or, in an add-on or no-fault state, PIP. (All of which, per terminology adopted by the National Association of Insurance Commissioners, are subsumed under the term 'liability,' although technically speaking MedPay and PIP coverages are not liability-like coverages.[56])

Motorists who switch under the plan allowing choice purchase not only PIP but may also (although they are not required to) purchase PI to cover liability claims brought against them by others for losses in excess of either PIP or tort maintenance policy limits. Following the pattern set forth above, we estimate the average switcher's compensation costs as the sum of the costs auto insurers incur on behalf of such motorists for PIP and, if purchased, BI coverage, assuming switchers will not need UM or MedPay,[57] divided by the number of insureds. As was the case under the status quo, people who

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55. For a proposal allowing motorists to be legally uninsured at the price of losing any right to claim for noneconomic loss, see *infra* note 5 to app. B.

56. NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, AVERAGE EXPENDITURES & PREMIUMS IN 1995, at page entitled 'Technical Notes' (Nov. 1995). In this regard, see *infra* tables and charts and app. B.

57. PIP insureds are by definition covered for their medical (as well as wage) loss, and therefore will presumably have no need for MedPay. CARROLL ET AL., *supra* note 7, at vii-ix. As for UM, PIP insureds are guaranteed payments for economic loss whether or not the other driver is insured. *Id.* at vii.

go uninsured under the plan allowing choice bear none of the costs of compensating auto accident victims.[58]

III. The Results

As noted in our earlier articles,[62] the effects of the plan allowing choice on premiums charged particular drivers will vary with such factors as the coverages they buy, their policy limits, their insurer, mileage driven, location within the state, and of possibly greater significance under the reform compared to the present situation, the type of car driven.[63] So here, as before, our estimates are only meant to indicate the general nature of average cost effects, keeping such variables in mind.

To summarize Table 1 below, savings for switchers in no-fault states (those covered by PIP combined with abolition of both large

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58. For more on RAND's methodology, see *Maryland One*, *supra* note 1, at 1054-59. *See also* Allan Abrahamse & Stephen Carroll, RAND Institute for Civil Justice, The Effects of a Choice Auto Insurance Plan on Insurance Costs at xiii-xv (1995).

62. *Maryland One*, *supra* note 1, at 1029; *Maryland Two*, *supra* note 2, at 286.

63. *Maryland Two*, *supra* note 2, at 286. On this last point, we reiterate a statement made in *Maryland Two*, namely that the first-party character of the plan allowing choice will permit insurers to calibrate rates for motorists "switching," and under tort maintenance coverage for those "staying," on the basis of the crashworthy features of the vehicles of their own insureds, thereby creating a market mechanism to enhance auto safety. *Id.* at 286. The proposal will thus replace today's third-party system, under which the obligation of insurers to pay the claims of third parties who sue their insureds makes it infeasible to fix rates on the basis of the crashworthy features of their own insureds' autos. *See Maryland One*, *supra* note 1, at 1040-41.

TABLE 1: TOTAL PREMIUM SAVINGS UNDER CHOICE SYSTEM[a]

State	System	1 Total premium savings for all switchers* (%)	2 Total premium savings for switchers with low incomes and coverages** (%)	3 Total available savings ($ millions)**
AL	Tort	19.5%	37.5%	$176
AK	Tort	17.4	27.9	24
AZ	Tort	37.1	52.7	533
AR	Add-on	28.2	47.2	195
CA	Tort	34.5	53.0	3,622
CO	No-fault	30.6	46.6	462
CT[c]	No-fault	41.0	57.1	678
DE	Add-on	33.7	46.9	93
FL	No-fault	31.7	44.3	1,395
GA[d]	No-fault	25.8	41.8	484
HI	No-fault	43.2	55.4	229
ID	Tort	27.6	45.5	75
IL	Tort	25.1	45.2	772
IN	Tort	26.5	43.7	450
IA	Tort	25.1	47.6	187
KS	No-fault	12.4	22.7	53
KY	No-fault	14.0	21.4	40
LA	Tort	44.6	63.8	592
ME	Tort	31.0	50.7	114
MD	Add-on	38.3	56.0	661
MA[e]	No-fault	41.0	56.7	1,154
MI	No-fault	15.4	27.7	647
MN	No-fault	32.4	48.9	483
MS	Tort	24.9	43.5	157
MO	Tort	26.0	43.8	405
MT	Tort	33.3	57.4	79
NE	Tort	25.1	45.1	113
NV[f]	Tort	37.4	54.8	196
NH	Tort	26.0	42.2	92
NJ[g]	No-fault	35.9	53.0	1,496
NM	Tort	33.3	52.1	173
NY[h]	No-fault	34.9	53.3	2,334
NC	Tort	32.2	46.5	658
ND	No-fault	1.5	2.8	−8
OH	Tort	28.8	47.0	840
OK	Tort	29.3	49.1	278
OR	Add-on	29.3	45.0	272
PA[i]	Add-on	31.5	46.8	1,300
RI	Tort	28.4	40.8	103
SC	Add-on	36.3	52.8	398
SD	Add-on	33.5	59.2	61
TN	Tort	21.7	38.6	261
TX	Add-on	36.1	53.6	1,688
UT	No-fault	28.9	45.8	145
VT	Tort	21.0	38.0	31
VA	Add-on	33.6	49.7	612
WA	Add-on	36.8	52.9	621
WV	Tort	36.7	58.4	222
WI	Tort	31.4	52.5	445
WY	Tort	23.5	45.6	31
All States		31.4%	48.1%	$26,100

* Assumes 50% switch.
** Assumes 100% switch.

NOTES TO TABLE 1

a. Data are based on laws in effect January 1, 1988. For more complete data on insurance requirements in all 50 states, see *infra* app. C.

b. Low-income motorists will likely buy low (only mandatory) coverages, while higher income motorists will likely buy higher (more than mandatory) coverages. *See supra* text accompanying note 49 and *infra* notes 74-75 and accompanying text.

c. Connecticut repealed its no-fault law on July 29, 1993. The law had been in effect since 1973. *See* ROBERT H. JOOST, AUTOMOBILE INSURANCE AND NO-FAULT LAW 2D § 4:11A (Supp. 1994).

d. Georgia repealed its no-fault law on October 1, 1991. *See id.* § 4:12.

e. In 1988 Massachusetts amended its threshold no-fault law (effective January 1, 1989) to increase both the no-fault benefit level from $2,000 to $8,000 and the threshold dollar amount of medical expenses for bringing a tort suit from $500 to $2,000. *See id.* § 6:21.

f. Nevada repealed its no-fault law June 5, 1979. *See id.* § 4:23.

g. In 1988 New Jersey changed from a no-fault system to a modest plan allowing choice, in which drivers select either no-fault or tort liability. Motorists choosing no-fault insurance, however, retain the right to bring claims in tort for noneconomic loss in serious cases. *See id.* § 6:24.

h. In June 1995 New York increased the minimum liability requirements for BI from $10,000 to $25,000 for each person in an accident, from $20,000 to $50,000 BI coverage for all persons involved in the accident, and from $5,000 to $10,000 for property damage. *See* Kevin Sack, *Rise in Auto Insurance Minimums Is Voted*, N.Y. TIMES, June 30, 1995, at B6.

i. Pennsylvania enacted a modest choice system, in which drivers could select either no-fault or tort liability, in 1990. Motorists choosing no-fault insurance retain the right to bring claims in tort for noneconomic loss in serious cases. *See* JOOST, *supra* note c, § 6:28.

and small pain and suffering claims by and against them) turn out, like savings for switchers in tort and add-on states, to be very substantial. On the other hand, comparatively speaking, costs for stayers under the system allowing choice will be only marginally affected in no-fault states, as was the case in tort and add-on states.

Table 1 presents our findings regarding changes in the costs of personal auto insurance for every state—tort, add-on, and no-fault. Column 1 shows the percentage savings in total premiums, including property damage liability, for all switchers, cumulating those who buy only mandatory coverage and those who buy more than mandatory coverage. Column 2 shows percentage savings in total premiums for switchers who buy only mandatory coverage (almost always those with lower incomes). As indicated above, mandatory coverage would not include BI liability coverage nor UM, MedPay, collision or comprehensive coverages.[64] Both columns 1 and 2 assume that 50% of motorists switch although—as a comparison between Table 3 in Appendix A below, columns 1 and 2, and columns 5 and 6, indicates—savings estimates are not greatly altered, except for a few rural state outliers,[65] based on the percentage of switchers.[66] Column 3 of Table 1 shows the total available dollar savings if 100% of motorists switch. Tables 2 and 3, in Appendix A below, present our findings for many other categories, including, for example, PI premium percentage savings for switchers (Table 2, column 5) and stayers (Table 2, column 6), and total premium percentage savings for switchers buying more than mandatory coverage (Table 3, columns 1 and 2) and stayers doing the same (Table 3, columns 3 and 4).

As can be seen from Table 1, switchers would realize significant savings on personal auto insurance premiums. Cumulating the totals for both those who buy only the minimum coverage and those who

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64. *See supra* text between notes 56-57.

65. These states are as follows: Arkansas, Kansas, Kentucky, and North Dakota.

66. Under the system allowing choice proposed herein, insurers can confidently know that switchers will not be exposed to full liability in tort above the threshold liability, not only to switchers but to stayers as well. *See supra* text accompanying note 17. Thus, the insurer can charge lower premiums to switchers irrespective of how many switch. Under a scheme of inverse liability, or tort maintenance coverage, in a collision between a stayer and a switcher, no normal tort claims above the threshold between the motorists are allowed, but the stayer would be allowed to sue his own company for full tort damages as if his company covered the switcher. *Id.* Such a regime mirrors uninsured motorist coverage, extant today, that allows victims to claim damages against their own companies if the motorist with whom they collide is uninsured. Under the choice system, the costs of current uninsured motorist coverage, including tort maintenance coverage, would increase, but the increase would be neatly offset by fewer claims against the stayer's tort liability coverage because switchers would be precluded from full liability claims. *See Maryland Tax*, *supra* note 2, at 525-24 n.2 and *infra* note 5 to app. B.

purchase more than mandatory coverages,[67] switchers would save over 30% on total premiums nationally (Table 1, cell All States/column 1), with those purchasing only mandatory coverages saving approximately 50% (Table 1, cell All States/column 2). Savings on the order of 20 to 40% would be attained in almost every state (Table 1, column 1). If all motorists across the country switched, total annual dollars spent on auto insurance premiums would decline by $26.1 billion (Table 1, cell All States/column 3). Using New York as an example of an eastern no-fault state, and again cumulating the totals for both those who do and do not purchase more than mandatory coverages, we estimate savings in total premiums for all switchers of 34.9% (Table 1, cell NY/column 1), and savings of 53.3% (Table 1, cell NY/column 2) for those who buy only mandatory coverages.[68] If 100% of insureds switch, a total of $2.3 billion in premium savings would be available in New York (Table 1, cell NY/column 3). Similarly, in Ohio, as an example from a midwestern tort state, we estimate total premium savings for switchers of 28.8% (Table 1, cell OH/column 1), and savings of 47% for low-income switchers (Table 1, cell OH/column 2), with available annual savings of over $840 million if 100% switch (Table 1, cell OH/column 3). As a further example, in Texas, a large southwestern add-on[69] state, we estimate total savings for switchers of 36.1% (Table 1, cell TX/column 1), and savings of 53.6% for low-income switchers (Table 1, cell TX/column 2). A 100% switch in Texas would yield over $1.6 billion (Table 1, cell TX/column 3) in annual premium savings.[70]

Of course, such savings for total auto insurance premiums are remarkably high. The results are particularly noteworthy because they stem from savings in the 30 to 80% range for personal injury premiums for switchers (Table 2, column 5), with no allowance for any change in premiums for losses to property.[71] Furthermore, such estimates are arguably conservative.[72]

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67. *See supra* text accompanying notes 53, 56.

68. *See supra* text accompanying note 53.

69. *See supra* note 4.

70. These percentages assume that 50% of drivers will switch. Savings for switchers assuming 50%, 80%, or 100% of drivers switch remain remarkably constant, except for a few rural outlier states. *See supra* note 65 and accompanying text. Indeed, this is the purpose of a system of choice with an inverse liability scheme. *See Maryland Two*, *supra* note 2, at 323-24 n.2. Examining the sample state of New York, the RAND data is again illustrative: assuming 50% of drivers switch, New York switchers would save 34% on their total premiums; assuming 80% switch, New York switchers would save 34.5%; assuming 100% switch, New York switchers would save 34.5%.

71. *See supra* note 22 and accompanying text.

72. *Maryland Two*, *supra* note 2, at 289.

Effects on the Poor

As we argued in *Maryland Two*, high auto insurance rates have an especially harsh impact on the poor.[73] As Table 1 indicates, savings under the plan allowing choice mirror progressive taxation in that premium reductions will be proportionately higher for the poor. Nationally, switchers buying only the mandatory PIP limits will save an average of 48.1% on premiums (Table 1, cell All States/column 2). The savings, as we saw for such switchers in New York (Table 1, cell NY/column 2), Ohio (Table 1, cell OH/column 2), and Texas (Table 1, cell TX/column 2) are in this range in state after state. These dramatic savings occur because the plan frees switchers from any obligation to buy supplementary PI liability coverage[74]—a freedom that those having few or no assets to protect will embrace. In addition, the poor generally drive older cars and therefore rarely buy optional collision or comprehensive coverages.[75]

In sum, the choice plan will favorably impact the financial status of low-income motorists. As pointed out in *Maryland Two*,[76] when less

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For example, because of data limitations [*see Maryland One*, *supra* note 1, at 1054-62], we did not consider the effect of making PIP coverage excess to private health insurance benefits, publicly mandated sources such as Medicare, Medicaid, workers' compensation, and private sick leave or disability coverages for wage loss. Furthermore, premium reductions based on owning safer cars—brought about by the proposal's first party insurance character—should yield lower injury rates per accident [a factor not feasible to weigh precisely at this time]. In addition, because motorists will have less incentive to incur medical bills and wage loss to inflate claims for pain and suffering [Jeffrey O'Connell & Robert Joost, *Giving Motorists a Choice Between Fault and No-Fault Insurance*, 72 Va. L. Rev. 61, 70-72 (1986)], those who opt for PIP will have less incentive to pursue personal injury claims or to utilize medical treatment. However, RAND's estimates do not include this last factor in their primary findings, because its data lacks a means of precisely weighing reductions resulting from this drop in incentives. [*See* Carroll et al., *supra* note 7, at 16-17.]

Maryland Two, *supra* note 2, at 289; *see also infra* note 75.

73. *Maryland Two*, *supra* note 2, at 289-93. For an excerpt from an African-American Philadelphia newspaper condemning the effect of expensive mandatory coverage requirements on low-income individuals, see *id.* at 289-90.

74. *See supra* text accompanying notes 49, 56-57, 67 and *infra* note 75.

75. In this regard, RAND's estimates are again conservative, as they are based on the premise that anyone choosing PIP coverage would also buy supplementary PI coverage at the same PI limits they had bought under the traditional tort system. For former tort insureds who had bought liability coverage to protect their assets, that assumption would be correct. But many low-income motorists with few or no assets had previously bought PI only to comply with their state's financial responsibility laws and would be unlikely to purchase supplementary PI coverage under a choice system. *See Maryland Two*, *supra* note 2, at 290.

76. *Id.* at 290-91.

affluent motorists insure at all,[77] they currently can spend over 30%[78] of their annual household income on auto insurance, and many are forced to put off buying basic necessities in order to pay their premiums.[79]

Moreover, the poor not only pay a large percentage of household income for auto insurance, but also are likely to pay significantly more in absolute terms because many reside in urban areas where average personal auto insurance premiums are much higher than for suburban drivers.[80] PIP coverage also assists the poor by providing for more rapid benefit payments for economic loss than does today's adversarial tort system. Such drivers, lacking independent resources to cover the costs of their accidents, are often forced under tort law to accept low settlements because of their need for immediate cash awards of even modest amounts.[81] Prompt insurance payments based on simple proof of injury would be greatly to their advantage.

The choice plan also benefits the poor because it can correlate premium rates with the likely costs of payout. In rating insureds, insurers under today's third-party liability auto insurance only take account of the likelihood that their insureds will be involved in an accident, not what their insureds will be paid in that event. Liability insurers calculate premiums in this way because they do not pay their own insureds, but instead compensate the unknown persons whom their insureds might injure in a future accident. As a result, the poor, as well as the young, are charged very high premiums, even though their own losses in accidents are comparatively small; for example, they likely suffer minimal wage loss, if any. Under third-party liability, the less affluent, along with those with middle incomes, pay into the insurance pool the same as the more affluent for any given level of coverage, even though they stand to be paid much less from the pool.[82] With first-party insurance, the less affluent can at least get credit for the advantageous side of their risk—that their losses are likely to be smaller. Finally, the less affluent generally are least likely to pursue a tort remedy and generally derive the least benefit from the tort system.

* * *

77. *See, e.g.*, Gerald Stephens, *Please, No More Complaints*, 91 BEST'S REVIEW (Property/Casualty Ins. ed.) 61, 63 (Jan. 1991) (stating that 52% of the drivers in Los Angeles carry no auto insurance). *See also infra* note 5 to app. B.

78. ROBERT L. MARIL, THE IMPACT OF MANDATORY AUTO INSURANCE UPON LOW INCOME RESIDENTS OF MARICOPA COUNTY, ARIZONA 8-9, 11 (1993) (finding that 44% of low-income motorists were forced to postpone buying food to pay their auto insurance premiums); *see also Maryland Two*, *supra* note 2, at 290-91.

79. MARIL, *supra* note 78, at 8-9, 11.

80. *See Maryland Two*, *supra* note 2, at 291-92 (contrasting minimum liability premiums in central Los Angeles and Milwaukee, as opposed to surrounding suburbs).

81. *Id.* at 291-93.

82. *Id.*

EXCERPTS FROM

THE COSTS OF CONSUMER CHOICE FOR AUTO INSURANCE IN STATES WITHOUT NO-FAULT INSURANCE

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Effects on the Poor

The especially disastrous effects of high auto insurance rates on the poor can hardly be overemphasized. For example, a recent editorial in an African-American Philadelphia newspaper illustrates the problem in terms which apply to most urban areas in the United States:

> If you just listened to the candidates jocking [sic] for election in November, you would easily think that the only *issue* of importance is crime because all the candidates talk about is who will be the "toughest" on criminals.
>
> There is one issue that impacts more Philadelphians than all of the crimes committed in any given month and that is the (criminal) auto insurance rates Philadelphians are *forced* to pay simply because they live within the city.
>
> Because state law mandates that motor vehicle owners must have insurance to drive those vehicles and because many Philadelphians are required to pay auto insurance rates far in excess of the value of the vehicles they drive, many Philadelphians are committing a crime because they are driving without the legally required auto insurance.
>
> Curiously, none of these tough on crime candidates is addressing the issue of usurious auto insurance rates which has turned thousands of otherwise law abiding Philadelphians into criminals. Many city residents see a better option in becoming petty criminals than impoverishing themselves by paying the highest auto insurance rates in the nation.
>
> Candidates need to get real and use their clout to assist reforming auto insurance laws which force decent citizens to become criminals.[43]

As Table 1 indicates, savings under the choice plan mirror progressive taxation in that its premium reductions will be proportionately higher for the poor. This results from freeing PIP insureds from any obligation to buy supplementary BI liability insurance—a freedom that those having few or no assets to protect will embrace. In this regard, RAND's estimates are again conservative. They are based on the premise that anyone choosing PIP coverage would also purchase supplementary BI coverage at the same BI limits at which they had bought under the traditional tort system. For former tort insureds who had bought liability coverage to protect their assets, that assumption would be correct. But many low income motorists with no or few assets previously bought BI coverage only to comply with their state's financial responsibility laws. It is unlikely that these motorists would purchase supplementary BI coverage under a choice system that gives them the option not to do so.[44]

Thus, it is useful to note the significant positive impact of the choice plan on the fragile financial status of low income motorists. Because earners with no or low income can little afford discretionary spending, each dollar of savings on auto insurance can be spent directly on necessities like food and shelter that otherwise were sacrificed to pay for compulsory auto insurance. Currently, if less affluent

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43. PHILADELPHIA TRIBUNE, Oct. 21, 1994, at 6A.
44. See O'Connell, [illegible]

motorists insure at all, they may spend over thirty percent[45] of their annual household income on auto insurance.[46] Indeed, many less affluent motorists are in fact forced to delay buying basic necessities in order to pay their premiums.[47] For example, a recent study of low income insured motorists of Maricopa County, Arizona, found that forty-four percent were forced at some point to postpone buying food in order to pay their auto insurance premium,[48] forcing them to choose between putting food on the table or complying with the law.

In addition to consuming an exorbitant amount of a less affluent motorist's income, the relatively prohibitive cost of auto insurance potentially has other dire effects. All states have some form of a mandatory coverage or financial responsibility law. Financially strapped individuals who rely on their vehicles for transportation to work may be forced to give up their driving privileges because of their inability to afford auto insurance.[49] The loss of driving privileges may, in turn, result in the loss of employment and propel poorer motorists into further impoverishment and dependency on publicly funded support. Even small savings in premiums may provide the margin the less affluent need to keep bills paid. Thus, the large premium savings estimated by RAND under the PIP plan would increase the percentage of household income available to the less affluent for basic needs.

Moreover, the less affluent not only pay a huge percentage of their household income for auto insurance, but also may pay significantly more for insurance in absolute terms. Many poorer motorists reside in urban areas where average personal auto insurance premiums are often more than twice as high as premiums of suburban drivers.[50] For example, the average annual premium charged in 1994 by one insurer for minimum liability coverage in Los Angeles, California was $811, while the same coverage in Northridge, California was only

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45. ROBERT L. MARIL, THE IMPACT OF MANDATORY AUTO INSURANCE UPON LOW INCOME RESIDENTS OF MARICOPA COUNTY, ARIZONA 8-9, 11 (1993). Robert Maril is an associate professor in the sociology department at Oklahoma State University.

46. *See* Gerald D. Stephens, *Please, No More Complaints*, BEST'S REVIEW: PROP./CAS. ED., Jan. 1991, at 61, 83 (predicting that the number of uninsured motorists will exceed 75% if premiums continue to rise, and noting the built-in unfairness of the tort system when negligent defendants have no insurance or assets to satisfy judgments against them). *See also infra* note 18 to Appendix B.

47. MARIL, *supra* note 45, at 11.

48. *Id.*

49. *But see* U.S. DEP'T OF TRANSPORTATION, *supra* note 22, at 120 (rejecting this argument on the basis that insurance premiums are a small expense compared to the expense of an automobile. But in rebuttal to that, compare the often nominal cost of very old, but still operative, automobiles with still very high liability insurance costs for such autos.).

50. *Id.* at 67.

$578.[51] Similarly, in Milwaukee, Wisconsin, average annual minimum liability premiums in 1994 were $367, but only $213 in Waukesha.[52] Premium savings in the 50% range can have an especially substantial effect on the less affluent in both absolute dollars and percentage of household income saved. Those savings, in turn, can affect substantially the overall standard of living of the less affluent.

In addition, PIP coverage, which provides for more rapid benefit payments than does today's more adversarial tort system, is especially important to low income drivers. Less affluent drivers, who lack independent resources to cover the cost of their accidents, are often compelled under tort law to accept low settlements out of their need for immediate cash awards of even modest dimensions. An insurance system based on proof of injury, rather than the harder-to-prove negligence of the putative injurer, is thus highly progressive in character.

Finally, on the subject of the poor, this proposal also represents another corrective to the regressive nature of today's third-party auto insurance system. Under today's third-party auto insurance, your insurance company, in rating you, only takes account of the likelihood that you will be involved in an accident. It does not take account of your likely recovery once an accident occurs. This is so because your insurance company will pay not you but rather the unknown person you may injure in a future accident. As a result, the poor (along with the young) are charged very high rates, despite the fact that when they are in accidents, their losses are comparatively small. They suffer less wage loss compared to others, for example. Under present auto insurance, it is as though everyone was charged for fire insurance solely on the basis of how likely it was that a fire would start on one's property, with no consideration being given to the value of the house. Thus, under auto insurance, the poor, along with those with middle incomes, have to pay into the insurance pool the same as the rich for a given level of coverage, even though they stand to draw much less than the rich from the pool. But with first-party insurance, all of a sudden the less affluent would at least get credit for the advantageous aspect of their risks that their losses are likely to be smaller. Keep in mind, too, that it is the poor who seem least likely to pursue a tort remedy and who therefore generally derive the least benefit from the tort system. In the words of H. Laurence Ross, a sociologist who studied the tort liability system:

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51. Data supplied by State Farm Insurance Companies (on file with author).
52. *Id.*

> [T]ort law in action may . . . be termed inequitable. It is responsive to a wide variety of influences that are not defined as legitimate by common standards of equity. The interviews and observations I conducted convinced me that the negotiated settlement rewards the sophisticated claimant and penalizes the inexperienced, the naive, the simple, and the indifferent. Translating these terms into social statutes, I believe that the settlement produces relatively more for the affluent, the educated, the white, and the city-dweller. It penalizes the poor, the uneducated, the [African-American and the rural dweller] . . . .[53]

Deterrence

Will substitution of PIP coverage for traditional tort liability lessen the deterrent effect that traditional tort liability has on unsafe conduct, thereby increasing costs? RAND's calculations assume no such effect. In support of that conclusion, substituting PIP for tort liability will create offsetting incentives.[54] For example, negligent motorists will absorb or "internalize" less of their loss than under traditional tort law because they recover even if they cause accidents and

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53. H. Laurence Ross, Settled Out of Court: The Social Process of Insurance Claims Adjustments 241-42 (1970). Consider the following table from the most comprehensive study of payment to auto accident victims, done in the 1960s:

Table 3.25. Relationship of Family Income to Serious Injury and Fatality [Automobile] Cases, to Retention of Counsel, and to [Compensation] . . . Received.

(1) Family Income	(2) Percent Retaining Counsel	(3) Ratio of Net Reparations to Economic Loss
Under $5,000	50.0	0.38
$5,000 - 9,999	56.7	0.52
$10,000 and over	41.9	0.61
Total	55.0	0.49

U.S. Dep't of Transp., Economic Consequences of Automobile Injuries 54 (1970) (Automobile Insurance and Compensation Study). The compensation received figures included both tort and nontort sources, with "'[a]bout one-third' of recovery [for bodily injury and property damage] from tort." *Id.* at 2.

54. *See* Richard A. Epstein, *Automobile No-Fault Plans: A Second Look at First Principles*, 13 Creighton L. Rev. 769, 785 (1980) (arguing that "[a]ny shift in the various rules of liability . . . will create *offsetting* incentives"). *See also* O'Connell et al., *supra* note 1, at 1040-41 (arguing in accord with the text at *supra* note 24 that under first party insurance, such as PIP, insurers can create incentives when they offer lower premiums for safer cars because the savings accrue to their insureds and not to third parties). *See generally* O'Connell & Joost, *supra* note 7, at 87 n.72 (discussing the effect of a choice system on unsafe driving). *But see* Gary Schwartz, *Reality in the Economic Analysis of Tort Law: Does Tort Law Really Deter?*, 42 UCLA L. Rev. 377, 393-97 (1994).

they will not be liable for pain and suffering. Conversely, those same motorists will internalize *more* costs because their insurers pay for losses even though they were not at fault and because they cannot recover for their own pain and suffering.

Quite apart from the effects of insurance in muting motorists' responsibility for tortious conduct under traditional tort liability, unsafe driving is not deterred by a single influence; rather it is affected by a combination of criminal, civil, and tort sanctions, and, arguably above all, by one's interest in preservation of one's own body and property.[55] Thus, under PIP, all elements of deterrence but one remain unchanged, and even the influence of civil sanctions are transformed but not eliminated. Finally, as indicated above, by reducing the relative cost of driving safer cars the plan should, at the margin, necessarily increase the use of such safer cars. Thus, the plan should generate affirmative market incentives that should, in turn, enhance the overall safety of driving automobiles.[56]

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55. KEETON & O'CONNELL, *supra* note 16, at 373 & n.31.
56. *See supra* note 24 and accompanying text.

CONCLUSION

We conclude with the remarks of Professor Edward L. Lascher Jr., a professor of public policy at Harvard's Kennedy School of Government.

> In early 1993, I began studying the battle over automobile insurance reform in the Rhode Island General Assembly. My original interest was mainly in the legislature itself, and how decisions might be changing as a result of the more open process adopted by the leadership of both houses. I focused on automobile insurance reform, primarily because it seemed to be a hot issue in the Ocean State.
>
> Yet, as someone with no background in the area, I found the issue of automobile insurance reform surprisingly fascinating. It combined many elements of good drama, including the spectacle of well-funded interest groups (trial lawyers and insurance companies) duking it out in public, and fierce debate about the merits of alternative proposals. More importantly, the results of these battles really mattered to ordinary citizens, concerned about high and rising premiums. This was a true "lunch box" issue.
>
> As I became more convinced of the significance of insurance reform, I tried to examine as much information as I could on the subject. I also ventured outside of Rhode Island to review reform efforts in other states, and even in the Canadian provinces.
>
> What I found has convinced me of the wisdom of . . . "choice["] . . . legislation . . . .[84] I have come to believe that this is a reasonable, balanced approach to the chronic problem of rising premiums—one that can offer drivers meaningful savings.

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83. *See id.* at 293 (commenting on the unfairness of settlement outcomes for the poor).

84. Professor Lascher refers to a bill introduced in the Rhode Island legislature (S.B. 797, 1995 Sess., passed by the Senate and forwarded to the House Committee on Corporations, where it is pending at the time of this writing; a similar bill, H.B. 6014, Jan. Sess. (1995), was defeated in that Committee) advocating a system allowing choice of a strong verbal threshold below which claims for noneconomic damages would be barred—similar to the existing New York threshold discussed *supra* note 8 and accompanying text. As demonstrated above, we think that such a verbal threshold will be far less effective than the choice system proposed herein. *See supra* text accompanying notes 43-46. Nevertheless, Professor Lascher's comments on the deficiencies of the current system and the benefits of a plan allowing choice apply equally well to the plan proposed herein.

In my judgment, any discussion of reform legislation needs to take account of two key facts. The first is that the auto insurance industry is very competitive, and not unduly profitable. Numerous firms compete for business. Indeed, the last figures I saw from A.M. Best Co. showed that the top three carriers in Rhode Island controlled less than a third of the market. Also, data from the National Association of Insurance Commissioners indicate that auto insurance profits were below the average of other industries from the mid-1980s through the early 1990s.

This was the very time that many states, including Rhode Island, were seeing major rate increases, suggesting that something other than excessive profits was driving the premium hikes.

A second, and related, critical fact is that major, sustainable reductions in insurance premiums require reductions in claims costs. More bluntly, the total amount of money paid on behalf of people in automobile accidents needs to be reduced. Some premium savings can be achieved through efforts to improve safety (e.g., enforcing seat belt laws) and combat fraud. . . .

. . . .

Interestingly, the conclusion about the centrality of reducing claims costs is independent of one's sympathy for insurance companies. Many people have reasons to be irritated with insurance companies, but that doesn't invalidate the evidence that increases in claims costs precipitate premium hikes. . . .

. . . .

It may seem perverse to indicate that premiums can only be reduced by reducing compensation for accidents. This argument appears to suggest that rate savings can only be achieved by a dollar-for-dollar loss of insurance protection.

Yet the seeming perversity of the argument disappears if we examine where claims costs now go. . . . Numerous studies indicate that [the tort] system tends to provide disproportionate benefits in the form of compensation for "pain and suffering" to people with minor injuries, often provides inadequate compensation for accident victims with serious injuries, and requires large expenditures for legal costs. This conclusion suggests a tradeoff . . . .

. . . .

. . . [G]iven the opportunity, might . . . some drivers wish to opt for full compensation (including reimbursement for "pain and suffering") . . . , even if that meant higher premi-

> ums? Might . . . some people value their "right to sue" very highly? Undoubtedly the answer to both questions is yes. That's the beauty of the "choice system" . . . . Motorists themselves decide whether they will take a "full tort" option with higher premiums or "[PIP benefits along with elimination of claims for pain and suffering]" with lower premiums.
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> . . . .
>
> Most important, the choice system avoids the danger of "free lunch" approaches, such as California's "Proposition 103," which sought to cut rates without cutting claims costs, and that in large part has never been implemented. Tempted as we may be by such approaches, most of us realize that a free lunch is an illusion. The best we can hope for is something that is a relative bargain. A choice . . . system may offer that option for . . . motorists.[85]

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85. Edward L. Lascher Jr., *"Choice No-Fault" Insurance May Well Work in Rhode Island*, PROVIDENCE J. BULL., July 9, 1995, at D7.

As a follow-up on Professor Lascher's point that some people perhaps "value their 'right to sue' [for pain and suffering] very highly," *id.*, Professors Steven Croley of Michigan and Jon Hanson of Harvard recently challenged any movement to abolish rights to noneconomic damages. Steven P. Croley & Jon D. Hanson, *The Nonpecuniary Costs of Accidents: Pain-and-Suffering Damages in Tort Cases*, 108 HARV. L. REV. 1785 (1995). Croley and Hanson particularly emphasized the persistent interest of motorists in purchasing uninsured motorist coverage (with its payment based on fault for pain and suffering) as indicating strong consumer desire for such coverage. *Id.* at 1862-67. They emphasize that indeed UM coverage is unique in offering a voluntary choice of tort-based noneconomic damages. *Id.* Croley and Hanson thus can be seen as supporting the thesis of this Article, namely to allow consumers a broader choice between a coverage closely modeled on uninsured motorist coverage (that is, tort maintenance coverage) or to opt out of such coverage for payment of only economic loss without reference to fault.

APPENDIX A

TABLE 2: TREE CHART INPUT DATA

State	1* Total Premium ($ millions)	2* Collision and Comprehensive Premium Total ($ millions)	3* Liability Premium Total ($ millions)	4 Percent of column (3) that is Personal Injury (PI) Premium	5 PI premium savings for switchers if 50% switch	6 PI premium savings for stayers if 50% switch	7 PI premium savings if 100% switch
AL	$1,090	$530	$559	69.0%	54.4%	-9.6%	45.7%
AK	198	74	125	71.0	59.4	-11.9	27.2
AZ	1,535	455	1,080	82.0	64.5	-0.9	60.2
AR	713	286	426	67.0	70.5	4.7	68.4
CA	11,001	3,830	7,171	81.0	65.4	1.1	62.4
CO	1,535	526	1,009	81.0	57.5	0.1	56.5
CT	1,729	488	1,241	76.0	75.2	2.0	71.8
DE	325	92	233	79.0	59.4	-8.4	50.3
FL	5,182	1,469	3,713	81.0	54.6	-9.2	45.4
GA	2,325	1,003	1,325	71.0	58.9	-4.8	51.6
HI	567	124	442	83.0	66.7	-4.3	62.3
ID	275	108	167	71.0	64.1	6.4	63.1
IL	3,318	1,472	1,846	71.0	63.6	2.1	58.9
IN	1,769	695	1,074	66.0	66.2	4.5	63.5
IA	776	335	441	71.0	67.0	-7.7	59.6
KS	768	347	421	63.0	36.0	-17.0	19.9
KY	1,146	397	749	70.0	30.6	-27.0	7.6
LA	1,372	413	959	82.0	77.8	8.0	75.3
ME	375	146	229	70.0	72.4	4.4	71.2
MD	1,946	614	1,331	78.0	71.8	-4.2	68.7
MA	3,052	845	2,207	77.0	73.7	-0.2	67.9
MI	4,207	1,871	2,336	92.0	90.1	1.2	90.1
MN	1,585	536	1,050	78.0	62.7	1.9	59.0
MS	641	275	366	73.0	59.6	-6.8	51.1
MO	1,610	654	956	65.0	67.3	4.6	65.3
MT	299	100	198	72.0	79.7	7.5	79.7
NE	472	209	263	70.0	64.5	5.4	61.6
NV	560	178	383	83.0	66.1	1.7	61.6
NH	430	166	264	72.0	58.7	-5.1	48.4
NJ	4,170	1,345	2,825	81.0	65.4	3.5	65.4
NM	527	190	337	78.0	66.8	5.1	65.6
NY	6,807	2,353	4,454	75.0	71.1	1.0	69.9
NC	2,132	655	1,477	71.0	65.5	6.0	62.8
ND	137	63	74	64.0	4.4	-25.0	-17.5
OH	3,241	1,256	1,986	72.0	65.3	-2.5	58.8
OK	1,020	411	609	71.0	69.1	-1.2	64.4
OR	1,096	350	746	77.0	55.8	-7.1	47.4
PA	4,478	1,466	3,012	75.0	62.4	0.7	57.6
RI	454	138	316	78.0	52.3	-7.3	41.7
SC	1,286	402	883	72.0	73.4	-8.2	62.5
SD	182	79	103	74.0	80.0	9.1	80.0
TN	1,381	606	775	68.0	56.8	-1.4	49.35
TX	5,326	1,740	3,586	75.0	71.4	-3.6	62.8
UT	519	191	328	73.0	62.7	2.2	60.8
VT	184	83	102	71.0	53.5	-8.4	42.4
VA	2,111	683	1,428	75.0	66.2	-4.6	57.2
WA	1,778	541	1,237	79.0	67.0	0.9	63.5
WV	631	235	397	78.0	74.9	7.3	71.8
WI	1,465	590	875	74.0	71.0	5.1	68.5
WY	190	63	67	72.0	63.5	9.9	63.3
All States	$89,796	$31,678	$58,117	76.6%	63.4%	-0.5%	58.6%

* National Association of Insurance Commissioners, December 1993.

TABLE 3: TREE CHART OUTPUT DATA

	1	2	3	4	5	6
	50% SWITCH				100% SWITCH	
	% Total Premium Savings for Switchers		% Total Premium Savings for Stayers		% Total Premium Savings for Switchers	
State	Low Income and Coverages*	Higher Income and Coverages**	Low Income and Coverages*	Higher Income and Coverages**	Low Income and Coverages*	Higher Income and Coverages**
AL	37.5%	16.6%	-2.5%	-1.1%	51.5%	13.9%
AK	27.9	15.5	-8.5	-4.7	19.3	10.7
AZ	52.7	33.8	-0.7	-0.5	49.4	31.6
AR	47.2	24.9	3.1	1.7	45.9	24.2
CA	53.0	30.9	0.9	0.5	50.5	29.5
CO	46.6	27.5	-0.1	-0.1	45.8	27.0
CT	57.1	37.5	1.5	1.0	54.6	35.8
DE	46.9	30.8	-6.6	-4.4	39.7	26.1
FL	44.3	29.0	-2.6	-1.7	37.6	24.6
GA	41.8	20.8	-3.4	-1.7	36.6	18.2
HI	55.4	40.3	-3.6	-2.6	51.7	37.6
ID	45.5	24.4	4.5	2.4	44.8	24.1
IL	45.2	21.9	1.5	0.7	41.8	20.3
IN	43.7	23.5	3.0	1.6	41.9	22.5
IA	47.6	23.6	-5.4	-2.7	42.5	21.0
KS	22.7	10.8	-10.7	-5.1	12.5	6.0
KY	21.4	12.5	-18.9	-11.1	5.3	3.1
LA	63.8	40.5	6.6	4.2	61.8	39.2
ME	50.7	27.4	3.1	1.7	49.8	27.0
MD	56.0	34.7	-3.5	-2.0	49.7	30.7
MA	56.7	37.6	-0.2	-0.1	52.3	34.6
MI	27.7	13.4	1.1	0.6	27.7	13.4
MN	48.9	29.1	1.5	0.9	46.0	27.4
MS	43.5	21.8	-5.0	-2.5	37.3	18.7
MO	43.8	22.9	3.0	1.6	42.4	22.2
MT	57.4	29.2	5.4	2.8	57.4	29.2
NE	45.1	21.9	3.8	1.8	43.1	20.9
NV	54.8	33.9	1.4	0.9	51.1	31.6
NH	42.2	23.0	-4.7	-2.0	34.8	19.0
NJ	53.0	32.4	2.8	1.7	53.0	32.4
NM	52.1	29.7	3.9	2.3	51.2	29.2
NY	53.3	31.3	0.7	0.4	52.4	30.8
NC	46.5	29.2	4.3	2.7	44.6	28.0
ND	2.8	1.3	-16.0	-7.5	-11.2	-5.2
OH	47.0	25.5	-1.8	-1.0	42.3	23.0
OK	49.1	25.8	-0.8	-0.4	45.7	24.1
OR	43.0	26.4	-5.5	-3.4	36.5	22.4
PA	46.8	28.4	0.5	0.3	43.2	26.2
RI	40.8	25.8	-5.7	-3.6	32.6	20.6
SC	52.8	32.9	-5.9	-3.7	45.0	28.0
SD	59.2	29.3	6.7	3.3	59.2	29.3
TN	58.6	18.9	-1.0	-0.5	33.6	16.5
TX	53.6	32.5	-2.7	-1.7	47.1	28.6
UT	45.8	25.8	1.6	0.9	44.4	25.0
VT	38.0	18.2	-6.0	-2.9	30.1	14.4
VA	49.7	30.3	-3.5	-2.1	42.9	26.2
WA	52.9	33.4	0.7	0.5	50.2	31.7
WV	58.4	32.7	5.7	3.2	56.0	31.3
WI	52.9	27.6	2.3	1.2	50.7	26.7
WY	45.6	20.3	7.1	3.2	45.6	20.3
All States	48.6%	28.1%	-0.6%	-0.2%	44.9%	26.0%

* Low-income motorists will likely buy low (only mandatory) coverages. *See supra* text accompanying notes 16, 74-75.

** Higher income motorists will likely buy higher (more than mandatory) coverages. *See supra* text accompanying note 49 and *supra* note 75.

APPENDIX C: SUMMARY OF REQUIREMENTS, BENEFITS, AND THRESHOLDS IN FIFTY STATES[1]

1 STATE	2 SYSTEM[2]	3 C/FR[3]	4 MINIMUM LIMITS[4]	5 PIP BENEFITS FOR ADD-ON (AO)/NO-FAULT (NF) STATES	6 TORT THRESHOLD IN NF STATES	7 CAR DAMAGE	8 EFFECTIVE DATE OF AO/NF LAW
AL	T	FR	20/40/10	N/A	N/A	N/A	N/A
AK	T	C	50/100/25	N/A	N/A	N/A	N/A
AZ	T	FR	15/30/10	N/A	N/A	N/A	N/A
AR[a]	AO	C	25/50/15	Purchase is optional. $5,000/person for medical and hospital expenses. Wage loss: 70% of lost wages up to $140/week, beginning 8 days after accident, up to 52 weeks. Essential services: up to $70/week, subject to an 8-day waiting period. Death benefit: $8,000.	N/A	Continues under tort system.	July 1, 1974.
CA	T	FR	15/30/5	N/A	N/A	N/A	N/A
CO[b]	NF	C	25/50/15	$50,000 for medical expenses. $50,000 for rehabilitation. Lost income: benefits for 100% of the first $125/week, 70% of the next $125, and 60% of the remainder up to $400/week, limited to 52 weeks. Essential services: up to $25/day for up to 52 weeks. Death benefit: $1,000.	Cannot recover for noneconomic loss unless medical and rehabilitation services have reasonable value of more than $2,500, or injury causes permanent disfigurement, permanent disability, dismemberment, loss of earnings for more than 52 weeks, or death.	Continues under tort system.	April 1, 1974. These provisions effective Jan. 1, 1985.
CT[c]	NF	C	20/40/10	$5,000 benefits for medical, hospital, funeral (limit $2,000), lost wages, survivor's loss, and substitute service expenses. Wage loss, substitute service, and survivor's benefits limited to 85% of actual loss.	Could not recover for noneconomic loss unless economic loss exceeded $400, or permanent injury, bone fracture, disfigurement, dismemberment, or death resulted.	Continued under NF law and continues under tort system.	Jan. 1, 1973. Repealed July 1, 1993 (effective Jan. 1, 1994).

a Arkansas's death benefit was increased from $5,000 in 1988.

b Colorado's law was amended in 1991 to permit insurers to offer insureds the option of receiving medical and rehabilitation care through managed care organizations such as health maintenance organizations and preferred provider organizations.

c *See supra* note c to tbl. 1.

1 STATE	2 SYSTEM[2]	3 C/FR[3]	4 MINIMUM LIMITS[4]	5 PIP BENEFITS FOR ADD-ON (AO)/NO-FAULT (NF) STATES	6 TORT THRESHOLD IN NF STATES	7 CAR DAMAGE	8 EFFECTIVE DATE OF AO/NF LAW
DE	AO	C	15/50/10	$15,000/person and $30,000/accident. Covers medical costs, loss of income, loss of services, and funeral expenses (limited to $5,000.)	N/A, except that amount of no-fault benefits received cannot be used as evidence in suits for general damages.	Continues under tort system.	Jan. 1, 1972.
FL[d]	NF	FR	10/20/10 or at least $30,000 for combined PD and BI liability	$10,000/person. Pays 80% of medical costs, 60% of lost income, replacement services, and funeral costs (limited to $5,000). Deductibles of $250, $500, $1,000, and $2,000 are available.	Cannot recover for noneconomic loss unless injury results in significant, permanent loss of important body function; permanent injury; significant and permanent scarring or disfigurement; or death.	Continues under tort system.	Jan. 1, 1972, for original law. These provisions effective Oct. 1, 1982.
GA[e]	NF	C	15/30/10	Aggregate limit of $5,000. Up to $2,500 for medical costs. 85% of lost income with maximum $200/week. $20/day for necessary services. Survivor's benefits same as lost income benefits had victim lived. $1,500 funeral benefit.	Could not recover for noneconomic loss unless medical costs exceeded $500; disability lasted 10 days; or injury resulted in death, fractured bone, permanent disfigurement, dismemberment, permanent loss of body function, permanent, partial or total loss of sight or hearing.	Continued under NF law and continues under tort system.	Mar. 1, 1975. Repealed Apr. 17, 1991 (effective Oct. 1, 1991).
HI[f]	NF	C	25/ unlimited/10	Aggregate limit of $15,000. Pays for medical and hospital services; rehabilitation; occupational, psychiatric, and physical therapy; up to $8,000 monthly for income loss; $800/month or substitute services; and up to $1,500 for funeral expenses.	Cannot recover for noneconomic loss unless medical and rehabilitation expenses exceed a floating threshold established annually by the insurance commissioner. Can also recover if injury results in death; significant, permanent loss of use of body part or function; or permanent and serious disfigurement that subjects injured person to mental or emotional suffering.	Continues under tort system.	Sept. 1, 1974.
ID	T	C	25/50/15	N/A	N/A	N/A	N/A
IL[g]	T	C	20/40/15	N/A	N/A	N/A	N/A

d Florida required $5,000 of PD liability insurance in 1988. More important, Florida does not include under its financial responsibility law any obligation to buy BI liability insurance; only no-fault benefits are included.

e *See supra* note d to tbl. 1.

f Hawaii required $35,000 in per person BI liability coverage in 1988. The 1973 law has been amended several times over the years. The current lawsuit threshold was adopted in 1992 and includes a fee schedule for medical care tied to provisions for fees and allowable doctor visits in the state's workers' compensation system.

g Illinois's minimum limits were 15/50/10 in 1988.

1 STATE	2 SYSTEM[2]	3 C/FR[3]	4 MINIMUM LIMITS[4]	5 PIP BENEFITS FOR ADD-ON (AO)/NO-FAULT (NF) STATES	6 TORT THRESHOLD IN NF STATES	7 CAR DAMAGE	8 EFFECTIVE DATE OF AO/NF LAW
IN	T	C	25/50/10	N/A	N/A	N/A	N/A
IA	T	FR	20/40/15	N/A	N/A	N/A	N/A
KS	NF	C	25/50/10	$4,500/person for medical expenses. Wage loss: up to $900/month for one year. $4,500 for rehabilitation costs. Substitute service benefits of $25/day for 365 days. Survivor's benefits: up to $900/month for lost income, $25/day for substitution benefits, for not over one year after death, minus any disability benefits victim received before death. Funeral benefit: $2,000.	Cannot recover for noneconomic loss unless medical costs exceed $2,000, or injury results in permanent disfigurement; fracture to a weight-bearing bone; a compound, comminuted (i.e., pulverized), displaced; or compressed fracture; loss of a body member; permanent injury; permanent loss of a body function; or death.	Continues under tort system.	Original law adopted Jan. 1, 1974. These provisions effective 1987.
KY[b]	NF	C	25/50/10 or single limits liability coverage of $60,000 for all damages	Aggregate limit of $10,000. Covers medical expenses; funeral expenses up to $1,000; income loss up to $200 weekly, with as much as 15% deducted for income tax savings; up to $200/week each for replacement services loss, survivor's economic loss, and survivor's replacement services loss. Motorist has right to reject no-fault.	Cannot recover for noneconomic loss unless medical expenses exceed $1,000, or injury results in permanent disfigurement; fracture of a bone; a compound, comminuted (i.e., pulverized), displaced, or compressed fracture; loss of a body member; permanent injury; permanent loss of a body function; or death. But limitation does not apply to those who reject no-fault system or to those injured by driver who has rejected it.	Continues under tort system.	July 1, 1975.
LA	T	C	10/20/10	N/A	N/A	N/A	N/A
ME	T	C	20/40/10	N/A	N/A	N/A	N/A
MD	AO	C	20/40/10	$2,500 in benefits for medical, hospital, funeral, wage loss, and substitute service expenses.	N/A	Continues under tort system.	Jan. 1, 1973.

[b] Kentucky's minimum limits were 10/20/5 in 1988.

1 STATE	2 SYSTEM[2]	3 C/FR[3]	4 MINIMUM LIMITS[4]	5 PIP BENEFITS FOR ADD-ON (AO)/NO-FAULT (NF) STATES	6 TORT THRESHOLD IN NF STATES	7 CAR DAMAGE	8 EFFECTIVE DATE OF AO/NF LAW
MA[i]	NF	C	20/40/5	$8,000 in benefits for medical, funeral, wage loss, and substitute service expenses. Wage loss and substitute service benefits are limited to 75% of actual loss.	Cannot recover for noneconomic loss unless medical costs exceed $2,000, or in case of death, loss of all or part of body member, permanent and serious disfigurement, loss of sight or hearing, or a fracture.	Continues under tort system after Jan. 1, 1977. Prior to that date, no tort liability for vehicle damage.	Jan. 1, 1971 for original law. These provisions effective Jan. 1, 1989.
MI	NF	C	20/40/10	Medical and hospital expense benefits with no dollar limits; $1,475/month, adjusted annually by insurance commissioner for up to 3 years. Replacement services up to $20/day for up to three years; funeral expense benefits of not less than $1,750 or more than $5,000.	Cannot recover for noneconomic loss unless injury results in death; serious impairment of a body function; or permanent, serious disfigurement.	Cannot recover unless damage is less than $400.	Oct. 1, 1973.
MN	NF	C	30/60/10	$20,000 for medical expenses. $20,000 for other benefits, including 85% of lost income up to $250 weekly; $200/week for replacement services; with 8-day waiting period; up to $200 weekly for survivor's replacement service loss; and $2,000 for funeral benefits.	Cannot recover for noneconomic loss unless medical expenses (not including x-rays and rehabilitation) exceed $4,000; or disability exceeds 60 days; or the injury results in permanent disfigurement, permanent injury, or death.	Continues under tort system.	Jan. 1, 1975.
MS	T	FR	10/20/5	N/A	N/A	N/A	N/A
MO	T	C	25/50/10	N/A	N/A	N/A	N/A
MT[j]	T	C	25/50/10	N/A	N/A	N/A	N/A
NE	T	C	25/50/25	N/A	N/A	N/A	N/A
NV	NF	C	15/30/10	Aggregate limit was $10,000. Paid for medical and rehabilitation expenses, up to $175/week for loss of income, up to $18/day for 104 weeks for replacement services, survivor's benefits of not less than $5,000 and not more than victim would have received in disability benefits for 1 year, and $1,000 for death.	Cannot recover for noneconomic loss unless medical benefits exceeded $750 or injury caused chronic or permanent injury, permanent partial or permanent total disability, disfigurement, more than 180 days of inability to work at occupation, fracture of a major bone, dismemberment, permanent loss of a body function, or death.	Continues under tort system.	Feb. 1, 1974. Repealed June 5, 1979 (effective Jan 1, 1980).
NH	T	FR	25/50/25	N/A	N/A	N/A	N/A

i *See supra* note e to tbl. 1 for recent changes. Massachusetts's minimum limits were 10/20/5 in 1988.

j Montana's PD liability insurance minimum limit was $5,000 in 1988.

1 STATE	2 SYSTEM[2]	3 C/FR[3]	4 MINIMUM LIMITS[4]	5 PIP BENEFITS FOR ADD-ON (AO)/NO-FAULT (NF) STATES	6 TORT THRESHOLD IN NF STATES	7 CAR DAMAGE	8 EFFECTIVE DATE OF AO/NF LAW
NJ[k]	NF	C	15/30/5	Up to $250,000 for medical and hospital costs, subject to a $250 deductible and 20% co-insurance between $250 and $5,000. Wage loss up to $100/week for one year. Substitute services up to $12/day for maximum of $4,380/person. Funeral expenses of $1,000. Survivor's benefits equal to amount victim would have received if he had not died. Motorist may exclude all benefits except medical and hospital. Medical coverage may be bought with deductibles of $500, $1,000, or $2,500.	Motorist selects one of these two options: (1) Will be able to claim for any noneconomic loss as result of motor vehicle accident. (2) Will not be able to claim for noneconomic loss unless one suffers death, dismemberment, permanent loss or use of body organ, member, function or system, permanent consequential limitation of use of a body organ or member, significant limitation of use of body function or system, non-permanent impairment that disables victim for at least 90 of the 180 days following injury. Motorists choosing second option pay a lower insurance premium.	Continues under tort system.	Jan. 1, 1973 for original law. These provisions effective Jan. 1, 1991.
NM	T	C	25/50/10	N/A	N/A	N/A	N/A
NY[l]	NF	C	25/50/10	Aggregate limit of $50,000 for medical, wage loss, and substitute service benefits. Wage loss: 80% of actual loss with benefit limited to $2,000/month. Substitute services benefits: $25/day for one year. In fatal cases, estate gets $2,000 in addition to above benefits.	Cannot recover for noneconomic loss unless disabled for 90 of the 180 days after accident or injury causes dismemberment; significant disfigurement; fracture; loss of a fetus; permanent loss of use of body organ, member, function, or system; permanent consequential limitation of use of body organ or member; significant limitation of use of body function or system; or death.	Continues under tort system.	Feb. 1, 1974.
NC[m]	T	C	25/50/15	N/A	N/A	N/A	N/A
ND[n]	NF	C	25/50/25	Overall limit of $30,000/person. Covers medical and rehabilitation costs, up to $150/week for income loss, up to $15/day for replacement services, up to $150/week for survivor's income loss, up to $15/day for survivor's replacement services loss, and up to $3,500 for funeral expenses.	Cannot recover for noneconomic loss unless injury results in more than $2,500 in medical expenses, more than 60 days of disability, serious and permanent disfigurement, dismemberment, or death.	Continues under tort system.	Jan. 1, 1976. This version effective 1991.

k *See supra* note g to tbl. 1.

l *See supra* note h to tbl. 1 (discussing recent changes in New York).

m North Carolina's minimum PD liability insurance limit was $10,000 in 1988.

n North Dakota's limit on funeral expenses was $1,000 in 1988.

1 STATE	2 SYSTEM[2]	3 C/FR[3]	4 MINIMUM LIMITS[1]	5 PIP BENEFITS FOR ADD-ON (AO)/NO-FAULT (NF) STATES	6 TORT THRESHOLD IN NF STATES	7 CAR DAMAGE	8 EFFECTIVE DATE OF AO/NF LAW
OH	T	C	12.5/25/7.5	N/A	N/A	N/A	N/A
OK	T	C	10/20/10	N/A	N/A	N/A	N/A
OR	AO	C	25/50/10	$10,000 medical benefits; 70% of lost wages up to $1,250/month; $30/day for substitute services; $15/day for child care, to maximum of $450; wage loss and substitute services paid from first day if disability lasts 14 days, limited to 52 weeks.	N/A	Continues under tort system.	Jan. 1, 1972 for original law. These provisions effective Jan. 1, 1990.
PA[o]	AO	C	15/30/5	$5,000 for medical expenses. Optional coverages are available up to $177,500, including income loss benefits, accidental death benefits, and funeral benefits, in addition to medical benefits. An extraordinary medical benefit coverage up to $1.1 million is available.	Motorist chooses between a full tort option, with no limit on noneconomic loss, and a limited tort option. Those choosing the limited tort option cannot recover for noneconomic loss unless injury results in serous impairment of body function; permanent, serious disfigurement; or death. Motorists choosing limited tort option pay a lower insurance premium.	Continues under tort system.	July 1, 1990.
RI[p]	T	C	25/50/25 or $75,000 combined single unit	N/A	N/A	N/A	N/A
SC	AO	C	15/30/5	N/A	N/A	N/A	July 1, 1987.
SD	AO	C	25/50/25	Purchase is optional. $2,000 in medical expenses. $60/week for wage loss, starting 14 days after injury, for up to 52 weeks. $10,000 death benefit.	N/A	Continues under tort system.	Jan. 1, 1972.

o *See supra* note i to tbl. 1.

p Rhode Island's minimum PD liability insurance limit was $10,000 in 1988.

1 STATE	2 SYSTEM[2]	3 C/FR[3]	4 MINIMUM LIMITS[4]	5 PIP BENEFITS FOR ADD-ON (AO)/NO-FAULT (NF) STATES	6 TORT THRESHOLD IN NF STATES	7 CAR DAMAGE	8 EFFECTIVE DATE OF AO/NF LAW
TN[q]	T	FR	25/50/10	N/A	N/A	N/A	N/A
TX	AO	C	20/40/15	$2,500/person overall limit. Covers medical and funeral expenses, lost income, and loss of services. Purchase optional.	N/A	Continues under tort system.	90 days after adjournment of 1973 regular session.
UT[r]	NF	FR	25/50/15 or single limit of $65,000	$3,000/person for medical and hospital expenses. 85% of gross income loss, up to $250/a week, for up to 52 weeks. $20/ day for loss of services for up to 365 days. Both wage loss and service loss coverages subject to 3-day waiting periods that disappear if disability lasts longer than two weeks. $1,500 funeral benefit. $3,000 survivor's benefit.	Cannot recover for noneconomic loss unless medical expenses exceed $3,000, or injury results in dismemberment or fracture, permanent disfigurement, permanent disability, permanent impairment, or death.	Continues under tort system.	Jan. 1, 1974. These provisions effective July 1, 1986.
VT	T	C	20/40/10	N/A	N/A	N/A	N/A
VA[s]	AO	C	25/50/20	Purchase is optional. $2,000 for medical and funeral costs. $100/week for wage loss with limit of 52 weeks.	N/A	Continues under tort system.	July 1, 1972.
WA	AO	C	25/50/10	Purchase is optional. Up to $35,000 in medical benefits, up to $35,000 in benefits for lost income, up to $5,000 in loss of service benefits, and $2,000 for funeral expenses.	N/A	Continues under tort system.	July 1, 1994 for original law. These provisions effective July 1, 1994.
WV	T	C	20/40/10	N/A	N/A	N/A	N/A
WI	T	FR	25/50/10	N/A	N/A	N/A	N/A
WY	T	C	25/50/20	N/A	N/A	N/A	N/A

q Tennessee's minimum per accident BI liability insurance limit was $40,000 in 1988.

r Utah's minimum limits were 20/40/10 in 1988.

s Virginia's minimum PD liability insurance limit was $10,000 in 1988.

NOTES TO APPENDIX C

1. This Appendix was developed by Jeffrey O'Connell and Paul Jamieson. It was compiled with the permission of and is based on data and descriptions in STATE FARM INS. COS., NO-FAULT REFERENCE MANUAL E-101 to E-106 (Robert Sasser ed., 1995) [hereinafter STATE FARM MANUAL], AMERICAN INS. ASS'N, SUMMARY OF SELECTED STATE LAWS AND REGULATIONS RELATING TO AUTOMOBILE INSURANCE 16, 20-34 (1988) [hereinafter AIA-1988], and AMERICAN INS. ASS'N, SUMMARY OF SELECTED STATE LAWS AND REGULATIONS RELATING TO AUTOMOBILE INSURANCE 22-32 (1995) [hereinafter AIA-1995]. Specifically, information in columns 5-8 is taken from STATE FARM MANUAL, *supra*, while the figures in column 4 are taken from AIA-1988 and AIA-1995, *supra*. This Appendix is based on current law, while the data in Tables 1-3, *supra* main text, are based on laws in effect January 1, 1988. For information on how and when RAND calculated its data, see *supra* main text at notes 58-63 and accompanying text. For substantive changes to no-fault laws since 1988 in Connecticut, Georgia, Massachusetts, Nevada, New Jersey, New York, and Pennsylvania, see notes accompanying tbl. 1, *supra*. These changes, as well as less significant changes between 1988 and 1995, have been noted in notes a-t to this Appendix. For more detailed descriptions of all changes, including some not noted here, see STATE FARM MANUAL, *supra*. *See also* ROBERT H. JOOST, AUTOMOBILE INSURANCE AND NO-FAULT LAW (Supp. 1994 & forthcoming 1995).
2. "T" designates states with tort laws currently in effect; "NF" designates no-fault states; "AO" designates add-on states. For definitions of these terms, see *supra* main text at note 4.
3. "C" and "FR" designate whether the state has compulsory or financial responsibility minimum requirements. Compulsory insurance means "[i]nsurance required by law. Under compulsory tort liability insurance legislation, for instance, such insurance is a prerequisite to registration of the automobile, which in turn is a prerequisite to its legal operation." ROBERT E. KEETON & JEFFREY O'CONNELL, BASIC PROTECTION FOR THE TRAFFIC VICTIM 573 (1965). Financial responsibility laws mean

> [l]egislation requiring a driver convicted of a serious driving violation or involved in an accident causing specified results (for example, personal injury or property damage above a statutory minimum) to post "security" (usually in the form of a certificate of insurance) in a designated amount against any liability arising from a past accident

> invoking the law, and "proof" (also usually in the form of a certificate of insurance) of financial ability to meet obligations arising from future accidents. More inclusive definitions sometimes cover on the one hand compulsory insurance legislation and on the other hand legislation requiring less demonstration of financial responsibility than that incident to furnishing both "proof" (as to future accidents) and "security" (as to a past accident).

Id. at 577; *see also, e.g.*, U.S. CHAMBER OF COMMERCE, DICTIONARY OF INSURANCE TERMS 26 (1949).

4. The first number denotes the minimum dollar amount of per person Bodily Injury (BI) liability insurance required; the second number denotes the minimum dollar amount of per accident BI liability insurance required (*but see supra* note d); the third number denotes the minimum dollar amount of Property Damage (PD) liability insurance required (all numbers denote dollars in thousands). These limits reflect the status of the laws as of November 11, 1994.

* * *

STATEMENT OF MICHAEL HOROWITZ
SENIOR FELLOW, HUDSON INSTITUTE
HEARING BEFORE THE JOINT ECONOMIC COMMITTEE
MARCH 19, 1997

Mr. Chairman and Members of the Committee:

Thank you for today's opportunity to discuss the auto choice reform introduced in the 104th Congress by Senators Dole, McConnell, Lieberman and Moynihan, and soon to be introduced in revised form in the 105th Congress.

I believe that auto choice can serve as a key signature issue of the 105th Congress, and for two reasons:

- its extraordinary fiscal and policy significance; and
- its extraordinary capacity to generate bipartisan cooperation.

The JEC report issued by you last year, Mr. Chairman, is the best description of the auto choice reform and need not be repeated here. I hope it will be of value to the Committee, however, to summarize some of the reform's key features:

- **Auto choice should be seen as the largest *tax cut* remotely capable of enactment by the 105th Congress.**

As your revised report points out, projected savings from the reform, based on staff and Rand Corporation numbers, comes to nearly $42 billion for 1997 alone. Over a five year period, your revised report projects five-year savings to consumers and the business community in excess of $235 billion. These are stunningly large numbers, and there is no imaginable prospect that the 105th Congress will enact remotely comparable tax cuts. In short, auto choice represents the principal vehicle by which the 105th Congress can put significant sums of money into the pockets of American voters before the 1998 elections.

It is entirely proper to think of auto choice as a tax cut -- and not even because it will put a massive amount of disposable income in consumers' pockets. Auto choice should be seen as a tax cut because its main operating feature is to eliminate the "tort tax" now paid by businesses and consumers required to purchase costly "pain and suffering" coverage, like it or not. Few consumers would elect to purchase such coverage if given the choice not to do so, but the function of such coverage as a not-very-subtle "tort tax" can best be understood by the description of pain and suffering damages in Professor Charles Wolfram's leading ethics casebook. Wolfram accurately describes those damages as an "inflated element of damages tolerated by the courts as a rough measure of the plaintiffs' attorney fees." Consumer activists Andrew Tobias and Robert Hunter write in a similar vein: "Today, most serious auto accident victims are terribly under compensated for their actual medical expenses and lost wages. The dream of a huge award for 'pain and suffering' meanwhile is, for almost all, only a dream. And whatever large sums are awarded are heavily taxed by the lawyers." In other words, 1997 consumers are scheduled to be taxed, against their wills, to purchase a $42 billion product whose prime purpose is to provide cash for attorneys. The auto choice reform permits consumers and the American business community to decide whether or not they wish to spend massive sums for a "dream" which, even under the best of circumstances, is "heavily taxed by the lawyers."

That auto choice can provide multi-billion dollar savings to hard-pressed consumers without any deficit impact makes it all the more remarkable. It also makes clear why auto choice can and should be enacted by a 105th Congress that will otherwise be unable to offer major disposable income relief to voters.

- **Auto choice savings are fabulously progressive.**

As the JEC report indicates, auto choice is a highly progressive reform that offers its highest proportionate savings to low income drivers. This should not be surprising as the auto tort system is among the most highly regressive social mechanisms in place today -- obliging low income drivers to pay high and increasingly unaffordable premiums in order to provide higher damage awards to the high income drivers they injure than

they are awarded when they are injured. As the JEC report notes, the high cost and unaffordability of auto insurance under the present system forces mounting numbers of low income drivers to become uninsured and lawless. As the JEC report also notes, low income drivers who actually purchase auto insurance are compelled to pay obscenely regressive proportions of their income for it.

In addition, the rapid payment that the reform provides to injured drivers is in and of itself highly progressive. Under today's system, low income drivers are often forced to settle for far less than the value of their claims because the system provides means and incentives to defendants to delay payment of claims. (Injured low income parties are generally desperate for immediate cash to pay for basic necessities, thus making low income people particular victims of a litigation-oriented system.) In short, as the JEC report makes clear, auto choice is the most progressive legislation that the 105th Congress is likely to have any reasonable prospect of enacting.

- **Auto choice is a uniquely pro-urban reform.**

As Wolfram and others point out, pain and suffering damages are calculated as multiples of incurred medical expenses. Thus, as the Rand Corporation and others have made clear, a pain and suffering damages regime is one that generates large-scale medical overutilization and fraud. The easy translation of large numbers of chiropractor visits into cash bonus payouts sadly takes place in greatest excess in America's major urban centers. The following "whiplash to fender bender" ratios make the point dramatically:

- While ***California*** drivers made ***45.2*** bodily injury claims per 100 property damage claims, the PD-BI (property damage-bodily injury) ratio for ***Metropolitan Los Angeles*** was ***98.8 per 100***;

- While ***Connecticut*** drivers made ***25.1*** bodily injury claims per 100 property

damage claims, the PD-BI ratio for ***New Haven*** was ***50.4 per 100***;

- While ***Florida*** drivers made ***18.7*** bodily injury claims per 100 property damage claims, the PD-BI ratio for ***Miami*** was ***29.4 per 100***;

- While ***Illinois*** drivers made ***36.6*** bodily injury claims per 100 property damage claims, the PD-BI ratio for ***Chicago*** was ***45.7 per 100***;

- While ***New York*** drivers made ***15.4*** bodily injury claims per 100 property damage claims, the PD-BI injury ratio for ***New York City*** was ***27.6 per 100***;

- While ***Ohio*** drivers made ***28.6*** bodily injury claims per 100 property damage claims, the PD-BI for ***Cleveland*** was ***40.8 per 100***;

- While ***Pennsylvania*** drivers made ***23.3*** bodily injury claims per 100 property damage claims, the PD-BI ratio for ***Philadelphia*** was ***78.5 per 100***.

The above numbers indicate why there are few major American cities whose residents cannot put from $300 to more than $1,000 in their pockets for every car they own by moving to an adjacent suburb. Auto choice will have a profound, rate-flattening effect on city and suburban rates. <u>While auto choice will serve as a tax cut for all drivers, hard-pressed urban drivers will, as Mayor Guiliani has testified, be among its biggest winners</u>. (I understand that Committee staff is preparing a supplemental report that will actually calculate dollar and proportionate savings the reform will provide to urban residents.)

* * *

Much more can be said of auto choice reform, including:

- its affirmative impact on auto safety;
- its affirmative impact on the American public's view of the rule of law itself – this in light of the cynicism and corruption triggered by the present system's hit-me-I-need-the-money character;
- its refusal to disturb state substantive negligence law, and its singular focus on unbundling pain and suffering coverage from economic damage coverage;
- its protection of the right of willing consumers to maintain the coverages and protections now in effect under state law, at present cost;
- its ultimate rejection of "no fault" policy by always allowing injured parties to sue negligent drivers under undisturbed state law doctrines and procedures whenever the policy coverages of injured parties run out;
- its targeted focus on drunk and drugged drivers by always allowing suits for pain and suffering against the personal assets of such drivers, and such drivers alone under undisturbed doctrines and procedures;
- its remarkable pro-federalism feature that makes federal law the first rather than the last word on the subject – this by permitting states to repeal or modify any or all elements of the federal bill and to do so at any time;
- its further, remarkable pro-federalism feature that allows state administrative law proceedings to bar the

federal bill from even becoming effective if its choice feature is either substantially misleading to state drivers or does not provide them with substantial savings.

These and other features are well described in the JEC report, which I hope will receive the broadest possible reading.

* * *

Mr. Chairman, tort reform need not be broccoli. It need not simply take away rights from consumers -- as the conventional tort reform agenda has largely sought to do over the past years. The auto choice reform does not diminish, but rather enhances the rights of consumers. It offers American drivers the choice of whether to spend $335 billion during the next five years for pain and suffering insurance, or for food, education, life insurance, retirement savings, or any other expenditures they deem to be of greater value to themselves and their families. It does this while still maintaining the primacy of state law, and while subordinating federal policy to the ultimate determinations of the states. It gives the 105th Congress the opportunity to offer voters dramatic increases in their disposable income, and does so without enhancing the deficit by a penny. It offers the 105th Congress an opportunity to enact historic, bipartisan legislation.

I am grateful to the Committee for today's hearing, and for any opportunity I may have to be of assistance to it.

Consumer Federation of America

STATEMENT

OF

J. ROBERT HUNTER,

DIRECTOR OF INSURANCE

CHOICE NO-FAULT

BEFORE THE

JOINT ECONOMIC COMMITTEE

OF THE

CONGRESS OF THE UNITED STATES

MARCH 19, 1997

1424 16th Street, N.W., Suite 604 • Washington, D.C. 20036 • (202) 387-6121

STATEMENT OF

J. ROBERT HUNTER, DIRECTOR OF INSURANCE
CONSUMER FEDERATION OF AMERICA

BEFORE THE

JOINT ECONOMIC COMMITTEE
OF THE
CONGRESS OF THE UNITED STATES

MARCH 19, 1997

Good morning, Mr. Chairman and members of the Joint Committee. It is a pleasure to testify before you on this important topic.

My name is Bob Hunter. I am Director of Insurance for Consumer Federation of America, a federation of over 240 pro-consumer groups with a combined membership of more than 50 million Americans. The groups that make up CFA range from tiny, single county consumer groups up to very large groups such as the AARP and Consumers Union.

I am a property/casualty insurance actuary. I am a Fellow of the Casualty Actuarial Society and a Member of the American Academy of Actuaries. My experience is almost 40 years in the insurance business. I was a supervisor in automobile insurance ratemaking for a forerunner organization of what is now the Insurance Services Office. I served over ten years in the private sector, from 1959 to 1971.

I came to Washington in 1971 as Chief Actuary of the Federal Insurance Administration. I became Administrator of FIA in 1974. During my time at FIA, I worked with the Department of Transportation on the no-fault auto issue and assisted in the effort to create a national no-fault auto insurance system in the nation. I was part of the team that convinced both Presidents Ford and Carter to support such a plan. I continue to be a supporter of good no-fault systems, as I define "good" below.

I left the federal government in May of 1980 to create the National Insurance Consumer Organization, which I served as President on a pro-bono basis for 13 years (I consulted as an actuary for governments and consumers of insurance, not insurance companies, to feed my family).

In 1993 and 1994, I served as Insurance Commissioner for the state of Texas.

Since 1994, I have returned to Washington to resume my private actuarial practice and to serve CFA on a pro-bono basis.

Consumer groups usually oppose what is known as "tort reform" because the usual form of tort reform restricts the rights of victims and offers nothing in return to consumers. No-fault is significantly different, in my view, and many consumer groups support "good" no-fault reform.

Why is no-fault different? There are several reasons:

1. There has been careful study of how the current tort system works for auto insurance and consumers see that, while a person with small economic losses may get more than those losses in recompense for his or her injuries, seriously injured victims of car crashes get only a small percentage of the economic damages out of the system. No such careful research exists for product liability and other proposals to alter the legal rights of Americans.

2. In most proposals to alter the legal rights of Americans, there are only limits on rights and nothing in return for victims of injury. In no-fault auto, good no-fault offers a quid-pro-quo -- excellent benefits. In my view, good no-fault offers unlimited medical and rehabilitation benefits such as found in Michigan in exchange for the giving up of the right to sue for injuries below a strict verbal threshold.

3. There is no apparent need to use contingency fees and the courts to balance power between parties. Unlike, say, product liability where a large manufacturer has a stable of legal help at the ready when injuries occur and the typical consumer of the product does not, the typical parties in an auto accident are roughly in the same boat. They have no lawyers at the ready, they do not deal with accident situations all the time, they are roughly equal in power after a fender bender.

Choice no-fault has not gained consumer support in the many years it has been pushed and defeated at the state level, however. The reasons are rather straightforward and are addressed here.

Because we have the research, we know we are adequately compensated only below about $25,000 of economic damages. Up to that amount, consumer/victims of auto accidents receive at least $1.00 for each $1.00 of economic loss. Above that amount victims receive, on average, under $1.00 for $1.00 of economic loss. Most choice plans offer no change in the legal system where consumers receive too few dollars to compensate but take away benefits where consumers are adequately compensated.

In other words, Choice is designed to minimize consumer benefits. It is not a fair trade off for giving up your right to sue.[1]

Worse, Choice is really not a choice at all. What is offered is not a choice between "traditional tort" and no-fault, the bill's language to the contrary notwithstanding. What is offered is two forms of no-fault with one disguised as tort.

Here's why: If I choose tort because I am an excellent, careful driver so that I want to be responsible for my actions and have others responsible for theirs, and I get hit by a reckless driver who chose no-fault, I cannot sue that driver. I must seek recovery from my own insurer under the so called tort maintenance (TM) coverage. Thus, the costs of the misdeeds of the no-fault driver in this example will be externalized into the tort purchasers insurance pool.

The reason the driver in this example chose tort, internalization of costs he incurs, has been defeated. Choice is, I emphasize, essentially two forms of no-fault.[2]

Another reason consumers oppose Choice is that is is confusing. Why have this bifurcated system when you really are adopting no-fault? Why not just bite the bullet and adopt good no-fault instead of this confusing form of it. Why not adopt a Michigan sort of plan for the nation? It works well for Michigan. It takes care of the truly hurt and eliminates the vast majority of lawsuits. It holds costs down.

The proof of the confusion that Choice brings to the market is clear from the bill itself. Why else would you immunize agents , insurer employees and others from legal action if the consumer, after an accident, realizes he or she was misled in making the purchase?[3]

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[1] Just a word about our legal system. It has been beaten up very badly by stand-up comics and the like over recent times. But America's legal rights are the finest in the world. Just like civil rights and our other great traditions that are the envy of the world, our legal rights are precious. Any alteration of these rights, rights that guarantee that poor people can get an attorney and that imbalances in power do not decide outcomes, must be done with extreme care. Pain is a real injury, so is suffering. Most of us have had a small burn. Imagine it over 2/3 of your body, as an example of the reality of this. Or, imagine losing one deeply loved in your home. These are real injuries that, if removed, must have substantial benefits to replace their value.

[2] In the bill, the TM coverage is described as definition number 18. The immunization for the reckless driving no-fault insured is found in Section 5 (b) (2) (B) (ii). To be sure, if a tort selector hits a tort selector, tort as we know it exists. But the approach is hardly what it claims to be when it is called "traditional no-fault."

[3] Section 5 (d).

Buying auto insurance is confusing enough without having to choose between competing no-fault regimes. Consumers have to determine price, service and solvency rankings to find the best insurer. Most do not shop from more than one provider. Consumers are faced with a strange combination of boredom and intimidation today. Choice will weaken consumer knowledge and, thus, weaken competition.

Another problem with choice is that it gives the insurer undue power in the settlement of claims. For example, the bill allows the insurer to require arbitration of disputes over claims[4] but offers no bad-faith option if an insurer treats claimants abusively in denying or delaying claims payments. If you create any no-fault system, I believe that the key to consumer protection is the bad-faith option when the promise of prompt payment of legitimate claims is abused.

A final question: Why adopt a "national" approach that your own data indicates will apply to only 22 states? Section 6 (b) (1) (A) states that the Act does not apply in any state where the changes do not lower "...statewide average motor vehicle premiums ... by an average of at least 30 percent for persons choosing personal protection coverage...".

According to Table 2 in the Joint Economic Committees' "Improving the American Legal System: The Economic Benefits of Tort reform," the states of Arizona, California, Colorado, Connecticut, Hawaii, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Montana, Nevada, New Jersey, New Mexico, New York, North Carolina, South Carolina, South Dakota, Texas, Washington, West Virginia and Wisconsin would be the states that would qualify under the minimum 30% savings rule. Since this Table 2 is predicated upon a 100% switch, this is the average savings for those "persons choosing personal protection coverage" so that means that more than half of the states would not be impacted by this bill.

If no-fault delivers benefits faster and cheaper, why limit these benefits to under half of the states. although I oppose Choice, if you adopt it you should not have such a limitation.

For your information, I undertook to do a bit of research over the weekend (I was told I'd be a witness last Friday). The information is contained in the attached two exhibits.

Exhibit 1 shows the 1995 data on the costs and profits of the private passenger car insurance market in the most recent year compiled, 1995. This is interesting for a couple of reasons:

[4] Section 5 (e) (6).

1. Savings outside of benefits (called "losses incurred" on the exhibit) are little under Choice. If the new no-fault claims settlement costs (called "loss adjustment expense" on the exhibit) could be as low as the cost to settle physical damage claims (doubtful given the more complex nature of people damage as compared to vehicle damage) costs would fall by 2.9% (12.0% - 9.1%). The way ratemaking works, that would drop overall personal auto insurance prices by 1.5% (liability only -1.7%). This proves that the Choice savings are almost entirely benefit reductions, not efficiencies. This is consistent with Rand who found that the "costs of compensating victims who elect (no-fault) under the Choice plan would be at least 60% less" than tort.[5]

2. In order to achieve an overall 30% reduction in personal auto costs, the liability part of the premium would have to be reduced by 54.2% ($102,482 * .3 / $66,651). Given that the savings for efficiency are less than 2%, benefits paid to victims must be reduced by over 50% to achieve the bill's price goals.

Exhibit 2 shows four things: the current legal regime for auto insurance, the liability price change ranking for the most recent 5 years, the most recent year rank for liability price level and the most recent year rank for no-fault physical damage price levels.

Overall there are 27 tort states (53%), 14 no-fault states (27%) and 10 add-on states (20%).[6] Over the five year period studied in the National Association of Insurance Commissioners' (NAIC) report, there is no clear pattern as to how liability (including no-fault in those states with no-fault) rates have risen by type of law. Of the ten highest price increase states 4 (40%) were tort, 3 (30%) were add-on and 3 (30%) were no-fault. Of the ten lowest price increase states 6 (60%) were tort, 1 (10%) were add-on and 3 (30%) were no-fault. If anything, tort states had a slightly lower rate of change than no-fault and add-on states, but this is not significant enough to conclude anything, in my view.

More important information exists in the two columns that show the 1994 price rankings. If we look at collision price levels as indicative of the underlying price for a no-fault, no lawsuit system for each state, we would expect that, if the legal system selected for liability or no-fault had no impact, then each state would be ranked in the same order as collision.

What we find, however, is that there are significant differences in the rankings of the liability (including no-fault where applicable) prices than the collision prices. As anticipated, add-on states tend to have higher rankings for "liability" than for collision. Indeed, 9 of the 10 add-on states had a higher liability ranking than the collision ranking. Thus, add-on no-fault is costly.

---

[5] "The Effects of a Choice Auto Insurance Plan on Insurance Costs" Rand, 1995.

[6] An "add- on" state is one which allows both normal tort and no-fault benefits. In that both systems run at the same time, one would expect the costs of an add-on system to exceed the costs of tort alone or no-fault alone.

What is unexpected is that, of the 14 no-fault states, 8 have higher liability rankings, 5 lower and 1 identical. No-fault seems, by this test, to be more costly than a neutral system.

Tort states show that 6 of the 27 tort states have higher relative costs for liability than for collision, 18 have lower and 3 are identical. By this test, tort has lower costs.

I believe that this is due to low thresholds and otherwise "faulty" no-fault. Choice, I fear, would produce similar results, given the low benefits and the incentives in choice to reach the low tort thresholds in the bill.

Michigan succeeds under this test. Ranked 4th in the nation in collision prices, Michigan's "liability: (no-fault) cost is 26th. And Michigan gives victims the remarkable unlimited no-fault medical and rehabilitation benefits. Good no fault works! Bad no-fault, such as Choice, does not.

I would be pleased to respond to any questions you might have.

EXHIBIT 1

A	B	C	D	E	F	G	H	I	J	K
SUBLINE	DIRECT PREMIUMS EARNED (MILLIONS)	INCURRED LOSSES (% OF DPE)	LOSS ADJ EXPENSE (% OF DPE)	GENERAL EXPENSE (% OF DPE)	SELLING EXPENSE (% OF DPE)	TAXES, LIC. AND FEES (% OF DPE)	DIVIDENDS TO POLICYHOLDERS (% OF DPE)	UNDERWRITING PROFIT (% OF DPE)	OPERATING PROFIT (INCL. INV INCOME)	RETURN ON NET WORTH
PP AUTO LIAB	66651	68	12	4	15.2	2.3	1.1	-2.6	5.4	11.6
PP AUTO PHYS	36830	65.8	9.1	4.1	15.5	2.2	1.1	2.3	2.8	11.7
PP AUTO TOTAL	102482	67.2	11	4	15.3	2.2	1.1	-0.9	4.5	11.6

SOURCE: REPORT ON PROFITABILITY BY LINE BY STATE IN 1995
NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

EXHIBIT 2
SHEET 1

	A	B	C	D	E
1	STATE	CURRENT	RANK IN %	RANK IN LIAB	RANK IN COLL
2		LEGAL	CHANGE IN	PREMIUM LEVEL	PREMIUM LEVEL
3		REGIME	"LIAB" RATES	IN 1994	IN 1994
4			90-94		
5	Alabama	TORT	31	43	16
6	Alaska	TORT	32	17	3
7	Arizona	TORT	20	11	33
8	Arkansas	ADD-ON	9	37	21
9	California	TORT	48	12	8
10	Colorado	NO-FAULT	5	15	31
11	Connecticut	TORT	43	5	11
12	Delaware	ADD-ON	33	7	22
13	Dist. of Col.	NO-FAULT	37	8	2
14	Florida	NO-FAULT	49	19	40
15	Georgia	TORT	44	31	6
16	Hawaii	NO-FAULT	13	1	9
17	Idaho	TORT	25	45	41
18	Illinois	TORT	35	30	19
19	Indiana	TORT	34	32	30
20	Iowa	TORT	18	48	48
21	Kansas	NO-FAULT	6	46	43
22	Kentucky	NO-FAULT	15	29	20
23	Louisiana	TORT	16	9	18
24	Maine	TORT	50	40	32
25	Maryland	ADD-ON	45	14	25
26	Massachusetts	NO-FAULT	28	2	24
27	Michigan	NO-FAULT	26	26	4
28	Minnesota	NO-FAULT	12	20	49
29	Mississippi	TORT	27	34	14
30	Missouri	TORT	24	31	28
31	Montana	TORT	7	44	42
32	Nebraska	TORT	1	47	47
33	Nevada	TORT	17	10	10
34	New Hampshire	TORT	47	25	12
35	New Jersey	NO-FAULT	51	3	1
36	New Mexico	TORT	4	21	15
37	New York	NO-FAULT	22	6	7
38	North Carolina	TORT	36	35	44
39	North Dakota	NO-FAULT	19	51	51
40	Ohio	TORT	41	33	38
41	Oklahoma	TORT	29	38	37
42	Oregon	ADD-ON	38	24	39
43	Pennsylvania	NO-FAULT	46	18	26
44	Rhode Island	TORT	21	4	5
45	South Carolina	ADD-ON	30	22	27
46	South Dakota	ADD-ON	2	49	50
47	Tennessee	TORT	42	41	23
48	Texas	ADD-ON	3	13	34
49	Utah	NO-FAULT	10	27	29
50	Vermont	TORT	40	42	17

	A	B	C	D	E
51	Virginia	ADD-ON	39	28	46
52	Washington	ADD-ON	14	16	36
53	West Virginia	TORT	8	23	13
54	Wisconsin	ADD-ON	23	39	45
55	Wyoming	TORT	11	50	35
56					
57	SOURCE:	STATE AVERAGE EXPENDATURES FOR PERSONAL			
58		AUTOMOBILE INSURANCE IN 1994			
59		NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS			

EXHIBIT 2
SHEET 2

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